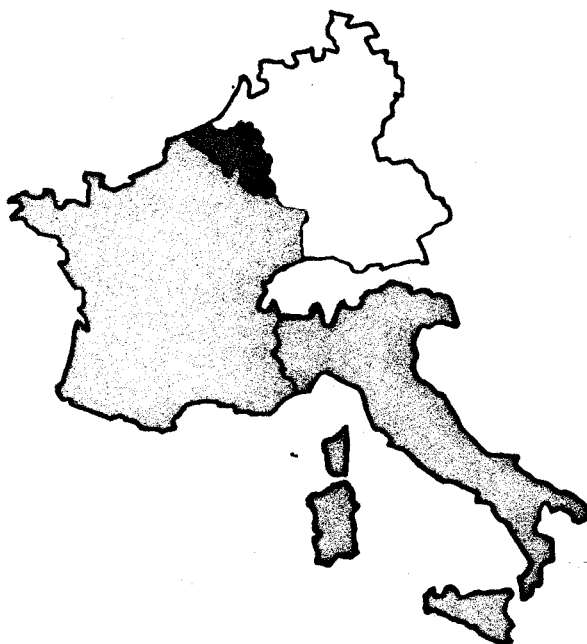


**E U R O P E A N  
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**T H E E C O N O M I C S I T U A T I O N  
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**EUROPEAN ECONOMIC COMMUNITY**

**COMMISSION**

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**The Economic Situation in the Community**

**SEPTEMBER 1961**

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## I. THE ECONOMIC SITUATION IN THE COMMUNITY

*The economy of the Community continued its advance throughout the second quarter of 1961 and—as far as can already be seen—into the summer months. Some slackening in the pace of expansion cannot however be overlooked, even when allowance is made for the fact that the damping effect of mid-year seasonal factors is growing from summer to summer. In any case, this slackening was felt even in the months before the summer period.*

*The reduction in the real tempo of expansion is doubtless attributable only to a very small extent to a slower growth of demand. None the less tendencies in this direction made themselves felt in particular branches—of more or less importance according to country. Physical limitations were by far the most important factor in this hesitant advance: the more acute shortages of manpower and the full use already being made of available capacity in certain member countries.*

*The recovery in Community exports in the last few months is a particularly noteworthy aspect of the way in which demand has developed. In fact, demand from abroad has now risen again after the stagnation observed in the first quarter, a major reason being that the vigorous economic upsurge in the United States has already had a stimulating effect on the economic situation throughout the world. In the second quarter the value of exports to non-member countries was 6 % higher than in the same period of 1960.*

Home demand has further increased. Expenditure on investment by enterprises continued to show the highest growth rates. There may however have been a slight weakening in the expansion of investment, although the trend has varied from one member country to another. In France, for example the increase of investments may even have gathered some further speed. The growth of private consumers' expenditure has also continued. In some member countries—France, the Federal Republic of Germany and perhaps also Italy—this increase, influenced by large increases in pay, was even somewhat more rapid than at the beginning of the year. In the Benelux countries on the other hand, particularly Belgium, the expansion was probably on a smaller scale; in the Netherlands a certain slowing down of the growth of private consumption was noticeable at times.

Domestic supply rose only slowly during the period under review. In the June quarter the adjusted figure for industrial production was about 1 % higher than in the March quarter, when the corresponding increase was still 2 %. However, the level of production was up 6.5 % on April-June 1960—after a year-to-year rate of increase of 8 % in the two previous quarters.

This slowdown is all the more remarkable as the number of persons in employment seems again to have increased appreciably—particularly in the Federal German Republic, where larger numbers of foreign workers were recruited and the influx of refugees from the Soviet occupation zone increased; it is evident from the continuing tightness on the labour market that all these have immediately found work. And yet the adjusted figures show no increase in production in Western Germany and it is evident that output per worker has declined, particularly because of a reduction in the number of hours actually worked. The same is true of the Netherlands, where the tendency of production may at times even have been slightly downwards.

Agricultural production in the Community was marked by the continuing expansion of livestock products, whilst in some countries crops were sometimes smaller than in 1960.

Imports, which had remained stable in the first quarter, rose a little in the second. They were up 8 % in value and 9 % by volume on the second quarter of 1960. They were no longer growing faster than exports, so that the balance of trade, apart from seasonal variations, probably remained unchanged. In any case the deterioration hitherto observed has not continued. The balance of payments showed surpluses which were due, among other reasons, to a strong influx of short-term capital. Between the end of March and the end of July, total gold and foreign currency reserves of the monetary authorities in the member countries went up \$ 445 million.

For the remaining part of the year 1961 no important changes are expected in these trends. The estimates made at the beginning of the year for the whole of 1961—a rise in the gross national product of about 5 %, with industrial production increasing by 6 to 7 %—will probably prove correct.

*The favourable economic conditions and full employment are expected to continue in early 1962, when the expansion of total demand may well be further boosted by orders from abroad. At the same time home demand in the investment sector might be less vigorous in some countries, but in the private consumer goods sector it should on the whole continue its rapid expansion. In several countries the shortage of manpower seems likely to remain an obstacle to the expansion of production, even if new capacity coming into service is sure to make a somewhat more rapid pace possible.*

*From the point of view of economic policy, this means that no expansive measures of a general nature seem to be called for. In some countries attention will on the contrary still have to be concentrated on curbing the expansion of home demand, or some slow-down may even be regarded in these countries as definitely beneficial for the trend and prices at home. On the other hand, policy must not permit the growth of domestic investment to weaken so much that the surplus on the Community's current account again becomes too high.*

*In any case the policy of directly increasing supply by encouraging the Community's imports and trade among member countries should be continued and intensified. Not the least important reason for this is the need to counter the tendency—moderate but fairly wide-spread—for prices to rise. This tendency has of late been observable in almost all member countries.*



## 1. Demand

In recent months overall demand has further increased. While its growth in the first quarter was due almost exclusively to the expansion of home demand, demand from abroad has now also expanded again.

The seasonally adjusted figures for the Community's exports to non-member countries—which in the first quarter of 1961 had been stable if they did not even tend slightly downward—went up again in the second quarter. In value these exports were 3 % higher than in the first quarter; when allowance has been made for the normal seasonal variations, this represents a definite increase. The export figure was up 6 % on the corresponding period of the previous year, whereas in the first quarter the level of January-March 1960 had only just been reached.

However, it is not yet clear whether this spurt in exports was maintained in the summer. The results available for July again point to a fairly considerable shrinking of the rate of growth, and it is possible that seasonal factors, with their growing influence, have played a part in this state of affairs. In any case, the world economic situation does not suggest that, apart from seasonal variations, any considerable slackening has again occurred in the pace at which Community exports are expanding.

The economic recovery in the United States has in fact continued and become considerably more vigorous. It is now beginning once more to have a genuinely stimulating effect on the world situation. The gross national product of the United States, when seasonally adjusted, was 3 % higher in the second than in the first quarter of 1961. The corrected index of industrial production reached a new record level in July, when it stood at 112 (1957 = 100) compared with 102 at the worst stage of the recession early this year. With the exception of exports, all the components of overall demand contributed to this expansion. The strongest stimulus came from re-stocking; fixed capital formation, public expenditure and private consumption went up by about 2 % between the first and second quarter (as always, after adjustment for seasonal variations). The recovery has already stimulated Community exports to the United States; the fall gave way to an up-turn, however modest so far. In the second quarter sales to the USA were at the same level as a year earlier, whereas in the first quarter exports had been 26 % below those of January-March 1960.

Community exports to the EFTA countries continued the fairly regular advance hitherto observed. In the second quarter, as in the first, they were up 11 % on the previous year. This is all the more remarkable since the exports of the Community to Great Britain were 1 % below the level of April-June 1960. In contrast it proved possible to expand exports very considerably towards Switzerland and Austria (the year-to-year increases were 25 % and 16 %).

The weakness of sales to Great Britain is not to be attributed to any deterioration of the export position of the Community's industries on this market. Rather is the contrary the case. It would seem that the very modest economic expansion which had



just got under way in Great Britain after a very long period of stagnation is already tending to slow down again. In June the adjusted figure in the index of industrial production was only two to three points higher than in January. In the second quarter, both industrial production and the total real gross national product were up only 1 % on the level of the corresponding period of 1960. In addition, since relatively high stocks were available from the former import boom, the trend of imports, apart from seasonal variations, was noticeably downward. This was the main reason why the deficit on the trade balance fell somewhat; exports went up only slightly.

Community exports to the developing countries have again shown a more favourable trend. Whereas in the first quarter they only just managed to reach the level of a year earlier, they were 5 % higher in the second quarter than in April-June 1960. This is all the more remarkable as sales to the French overseas Départements were, on account of the political situation, 15 % less than in the same period of the previous year. On the other hand exports to the overseas countries and territories associated with the Community were 8 % higher than in the second quarter of 1960. Finally, there was a slight rise in purchases from the Community by the Latin American countries and various countries of the sterling area.

The expansion of home demand continued, growth still being highest in fixed investments by enterprises. It is true that new orders received in the capital goods industry in the Federal Republic slowed down towards the middle of the year. The backlog of orders is, however, no smaller and the growth of actual investments has probably fallen only slightly. In the Netherlands, too, investments by industry in the second quarter were well above the level of the corresponding period of 1960. In both countries manpower shortages continued to be a strong incentive for enterprises to invest. In Italy the upward trend of investment demand by enterprises has probably continued, although at a slightly slower pace. In France too the pace of investment has speeded up a little. In Belgium the increase in investments is at present the principal factor in economic expansion.

In most member countries demand continued lively in building and constructing. The number of housing permits granted in the first quarter of 1961 was up appreciably on the level of January-March 1960, and industrial and commercial building projects also increased further. Because of the shortage of manpower this growing demand could often not be fully met, and completion dates have generally lengthened. These strains continued to be most acutely felt in the Federal Republic of Germany and the Netherlands, and building costs rose again. The Netherlands authorities reacted by tightening up measures of supervision and by once again cutting back on the number of building permits granted.

Stock-building seems to have made only a slight contribution to the expansion of total demand in the second quarter. In general, industrialists have followed quite a cautious stock policy on raw materials. For certain semi-finished products (such as rolled steel) some inclination to reduce stocks seems to have made itself felt in a few sectors.

Expenditure on consumption and investment by the public authorities continued to rise. Everywhere in the Community direct public investment is again tending to rise; in addition, the pay of public servants has been increased in several member countries.

Private consumers' expenditure, too, has shown a general increase, the rise being particularly rapid in the Federal Republic of Germany and in Italy; in the Netherlands there was a reduction in the pace of growth; in Belgium the increase was very modest.

The decisive factor in the rise of consumption was the further growth in the total volume of wages and salaries. Numbers in employment rose appreciably, particularly in the Federal Republic of Germany and in Italy. Furthermore, the upward movement of hourly wages in these two countries was slightly more rapid than in the first quarter. In the Federal Republic of Germany the influence of the real reduction in time worked was thus more than offset. In the Netherlands on the other hand, the income of workers in some cases probably rose at a relatively slower pace because increases in pay were smaller and the tendency to work shorter hours was, if anything, stronger than in the Federal Republic. In France the rise in wage rates continued in the main without change, while in Belgium they maintained by and large their earlier level.

With a relatively small increase in agricultural production in most member countries and, in some of them, higher returns from sales, agricultural incomes in the Community—taken as a whole—probably went up slightly. As business continued to develop favourably despite the pressure on profit margins noted in some member countries, the incomes of self-employed persons will have continued to run at a high level.

The development of private consumption varied from one category of goods and services to another. Changing the trend it had shown in the first quarter, expenditure on consumer durables again increased at a somewhat more rapid pace, while retail sales of various traditional consumer goods, in particular textiles and furniture, were much more hesitant in several countries. Expenditure on services—in particular holiday travel—again went up very appreciably.

## 2. Supply

Despite the perceptible expansion of overall demand, the increase in production has slowed down in recent months. The elasticity of domestic supply has clearly fallen off in several Member States.

The preliminary estimates of agricultural production at present available indicate that even in the aggregate crop production may not have attained the level of 1960. Crops in most member countries except in Italy, where they had been only modest in 1960—were probably not up to the previous year's standard. The grain harvest will hardly be more than 50 million tons, against a full 53 million tons in the two preceding years. In particular it seems that the wheat harvest may be about 7 % below the 1960 level, and yields per hectare were everywhere smaller. In addition, areas under potatoes and sugar beet have been reduced. The wine harvest will probably be average in volume, but of good quality. Unlike crops, livestock production as a whole has increased further of recent months.

Industrial production has maintained its growth, but the pace has been visibly slower. According to the index established by the Statistical Office of the European Communities, the level of production in the second quarter was 6.5 % above that of April-June 1960. This compares with a year-to-year growth rate of 8 % in the first quarter. The seasonally adjusted figures show that the increase in production between the first and second quarter of 1961 was only 1 %; it had been over 2 % between the last quarter of 1960 and the first three months of 1961.

The slowdown is to be attributed particularly to the facts that, if seasonal factors are allowed for, the growth of production came almost to a halt in the Federal Republic of Germany and that stagnation persisted in the Netherlands. In these two countries it was especially the long familiar physical handicaps of manpower shortages plus reduction in working hours which decisively influenced the trend. In this connection it is worthy of note that the number of persons employed in the Federal Republic of Germany has increased perceptibly as a result of the recruitment of greater numbers of foreign workers and the much higher influx of refugees from the Soviet occupied zone. In France on the other hand the pace at which production was expanding increased slightly. In both Italy and Belgium production continued to grow, but in Belgium the increase was only modest.

Differences in the pace at which production was growing in various branches seem to have narrowed. True, the investment goods industries were again in the lead, but the pace of their advance had evidently slowed down—on the whole more than that of the consumer goods industries. Expansion in the iron and steel and the chemical industries, which had attained very high growth rates in 1960, was somewhat modest. The boom in steel has evidently slackened, not only as a result of the general slowdown in the growth of industrial production and building, but also because of a more cautious

stock-building policy on the part of steel users. On the other hand the situation in ship-building, which hitherto had been steadily deteriorating, seems to be stabilized.

These tendencies were not without effect on the way in which average productivity developed. The slackening of the growth of production in capital-intensive industries—where output per worker is particularly high and is rising relatively fast—has had an adverse influence on the average increase of productivity in industry as a whole. To this must be added other factors : overemployment, the recruitment of less skilled or less capable manpower, etc. All in all it can be said that the per caput productivity of workers in Community industry has practically ceased to rise in recent months.

Expansion in the field of services, which always depends in part on structural factors, seems to have continued unabated. This applies particularly to travel and the various trades ancillary to motoring. As a result of the growth of consumption, retail turnover figures also improved, and sales in certain member countries were 6 to 9 % higher than in the corresponding period of the previous year. The transport industry was adversely affected by the slower pace at which production expanded, but against this the various branches of transport benefited from the rise in exports and trade among member countries. On the whole, it appears likely to have expanded somewhat.

The expansion of employment, expressed in hours worked, was probably slower in recent months. It is true that the number of persons in employment in the Community again increased, but this was largely offset by the reduction in the actual working week in the German Federal Republic and the Netherlands, as a result of which the unsatisfied demand for manpower remained very high. Ever since the spring the unemployed have ceased, in both countries, to provide a significant growth reserve on which employers could draw. In France, also, the strains on the labour market have increased in certain areas and callings; here, too, unemployment was very low. Even in Italy the increase of employment in some branches and areas came up against shortages not only of specialists but even, in a few cases, of less skilled manpower. Nevertheless, the general situation on the labour market in Italy is still far from being difficult. In Belgium, on the other hand, employment expanded more or less without difficulty, since the unemployed offered a sufficient growth reserve; in the last few months there has been another unmistakable fall in their number.

### 3. The balance of the markets

The expansion of the Community's imports from non-member countries again speeded up somewhat in the second quarter, after the slowdown noted in the first three months. The value of imports was 8 % higher than in the same period of the previous year, after having been only 4 % higher in the first quarter. By volume, the increase was probably even greater, for, with the exception of the Belgo-Luxembourg Economic Union, import prices weakened everywhere; in the Federal Republic of Germany and the Netherlands this was partly a consequence of the revaluation of the mark and the guilder,

The increase in imports was mainly in manufactured and semi-manufactured goods, particularly investment goods. It probably resulted chiefly from the strains prevailing in important investment goods markets in the Community. In addition, the revaluation of the mark and the guilder may already have had certain stimulating effects on imports. Imports of raw materials on the other hand increased at a definitely slower pace, and even continued to stagnate in some member countries, largely because of the slower expansion of production and of more cautious stock-building policies.

This development was also reflected in the movement of import figures by areas of origin. Imports from the other industrialized countries developed favourably : in the second quarter the Community imported 14 % more from the United States and 12 % more from EFTA countries (14 % more from Great Britain) than in the same period last year. Against this, imports from the developing countries were—like those of the first quarter—only slightly above the level of the previous year.

The Member States have increased their purchases within the Community itself much more than those from outside. During the second quarter trade between the member countries maintained the fast rate of growth which had been observed in the three preceding months : the increase over the corresponding period of 1960 was about 16 %. The causes for this relatively rapid expansion are to be found not only in the efficacy of the measures taken to establish the Common Market but also, *inter alia*, in the imbalances which are features of various national markets within the Community. These resulted in corresponding compensatory trends which are reflected in the flow of goods within the Community.

The Federal Republic of Germany, in particular, increased its purchases from the other Member States of the Community. French imports from the Community, especially of investment goods, were also high. Total Netherlands purchases, however, rose relatively little, although the rate of growth for imports from the Belgo-Luxembourg Economic Union was higher.

On the other hand those Member countries where home production is still relatively elastic in many sectors—Italy, the Belgo-Luxembourg Economic Union and France—were able to step up their exports to their Community partners. Against this, exports

from the Netherlands in the second quarter only just exceeded the level of the same period in 1960.

The trade balances of the individual Member States with all other Community countries combined changed but little in the second quarter of 1961. Although still high, the surplus of the Federal Republic of Germany declined slightly, while the balance of the Belgo-Luxembourg Economic Union—whose exports had fallen in the first quarter as a result of the strikes in Belgium—showed a perceptible improvement.

While price levels in the first quarter had generally remained stable—thanks in the main to falling prices for agricultural products, while those for industrial products and services went up a little—the second quarter saw a slight tendency for the level of consumer prices in almost all member countries to rise. This is chiefly attributable to the fact that the prices of agricultural products again began to rise. In this way the increases in other prices, which continued in most of the member countries, became more apparent in the overall indices.

The rise in the cost of living between March and July was highest in the Federal Republic of Germany, where it was 1.5 %, although the revaluation of the mark damped down the pressure on prices in a number of sectors. A similar movement was observed in Italy and the Netherlands, although on a more modest scale. In Belgium, on the other hand, there was practically no important rise apart from some increase in the prices of foodstuffs. In France the cost of living remained stable until the end of the second quarter, for here the decline in the prices of food at first continued. However, in this country, too, the tendency has once again been for prices to move clearly upward in recent weeks.

The causes of this upward movement are not in every case quite the same. In certain countries, particularly the Federal Republic of Germany and the Netherlands, the principal role is played by the long familiar excess demand, which is now leading more and more frequently to higher prices. In other countries the process results less obviously from the present or earlier expansion of demand and is mainly due to structural factors and administrative “adjustments” of the prices paid for certain services. Just as costs rise autonomously when there have been relatively large increases of pay, the boom demand and the high degree of liquidity also play their part in the consequent price rises, inasmuch as they permit costs and prices to increase without any fall in employment. Agricultural policy measures are also exerting some influence on the trend of food prices.

The Community's trade balance has not deteriorated further in the last few months. It is true that in the second quarter of 1961 there was a deficit of about 160 million dollars instead of 130 million dollars in the first three months of the year. When seasonal variations are allowed for, however, it can be said that no change has occurred in the balance of trade. The figures based on value also reflect a certain improvement in the terms of trade, and this again was partially a result of the revaluation of the German Mark and the guilder.

The deterioration in the trade balance which is shown when no correction is made for seasonal variations has not seriously affected the development of the overall balance of payments. Net income on services is sure once again to have reached a high level, and the influx of private capital into the Community continued. In this way the gold and foreign currency reserves of the monetary authorities of the Community rose in the second quarter of 1961 by 139 million dollars and in July 1961 by a further 306 million dollars. This was despite the advance repayment made in April by the Federal Republic of Germany of almost 800 million dollars of debts to non-member countries (in particular the United States) and despite higher transfers abroad made by the banks of several Member States. In this quarter, however, it was mainly France and Italy which contributed to the increase, while the official gold and foreign currency reserves of the Federal Republic declined.

Internal liquidity in most of the member countries was therefore again influenced by the considerable influx of funds arising from the balance of payments surplus. In some of them, however, the increased cash holdings of the public authorities, due to a considerable temporary increase in receipts not offset by a corresponding growth of expenditure, has tended to reduce liquidities. In the Federal Republic of Germany this has been coupled with the effects of a sometimes very steep rise in the exports of short-term funds. The tendency for German interest rates to fall was therefore halted, although in an endeavour to avoid strains on the market various measures were taken in the monetary and credit policy fields, in particular successive reductions of minimum reserves. In France, where there was a certain tendency for interest rates to rise—only temporarily, it is true—the minimum compulsory holding of government bills was slightly lowered, an action which enlarged the margin of liquidity of the banks. An increase in interest rates was also observed in Italy. One reason may have been the coincidence of a strong demand for credit with the notable deterioration in the balance of payments during the first quarter, and the increase may in part be connected with the cash surpluses that developed in the public accounts. In the Netherlands, liquidity remained so high, despite increased exports of capital, that the trend of interest rates hardly changed. However, this stability was probably in part due to the repatriation by the banks of large assets held abroad. In Belgium, the level of liquidity was fairly high, as there was only a limited expansion of credit. In the other member countries the volume of credits granted by the banks continued to grow, sometimes even at a more rapid rate. In the Netherlands, the Central Bank was obliged to invite the banks, under an agreement concluded with them last year, not to increase their supply of credit in 1961 by more than 15 % over a reference period based on 1960.

As already mentioned, the operations of the public authorities have again been influenced in recent months by a very large rise in revenue from taxation. In the Federal Republic of Germany total cash holdings of the public authorities have once more increased. Despite an expected growth in expenditure in the coming months, it would seem that the Federal Government may cancel its plans to float a loan. In Italy the considerably higher fiscal revenue resulted in a large surplus for the financial year which ended in June, and the State has temporarily further reduced the funds available to the

economy by floating a loan to finance future expenditure under the Green Plan. In France the deficit during the first six months of the year was relatively small. In Belgium the cash deficit in the first seven months of 1961 was a little smaller than in the corresponding period of 1960, and it was fairly easily financed thanks to the increased liquidity of the economy. In the Netherlands the State has floated a fairly large scale loan, mainly in order to mop up a part of the surplus liquidity.



## 4. Outlook

The economic situation of the Community, as it appears from the above analysis, does not seem likely to undergo any important change during the remaining months of the year.

The expansion of overall demand will continue, but the main stimulus may once again be found in demand from abroad. In fact, it seems likely that, in view of the lively upswing which has got under way in the United States, the slight recovery noted in the world economic situation during the second quarter will gather momentum.

On the other hand the possibility is not to be excluded that in certain countries, in particular the Federal Republic of Germany, and perhaps also in the Netherlands, the propensity of enterprises to invest may weaken somewhat under the influence of the revaluation which has taken place in these two countries and because of the pressure on profit margins exerted by increases in pay, and the rise in taxation. In the Netherlands the effect of the measures adopted to slow down the investment boom may well be increasingly felt. Nevertheless, the actual volume of investment will most probably continue to expand in these countries in the coming months, only the pace being a little slower than at the beginning of the year. In the remaining member countries, on the other hand, the most recent indications are that the propensity to invest will remain high for the rest of the year, and the increase in fixed investments fairly vigorous.

Finally, a continuation if not an acceleration of the growth of private consumption is generally expected. In the Federal Republic of Germany the wage bill might increase a little more slowly because of the fact that the tendency for wages to rise is slightly weaker and that an appreciably more rapid increase in the total number of hours worked is not to be expected. On the other hand, higher increases in pay are to be expected in the Netherlands, where the renewal of several important collective bargaining agreements will lead to a considerable rise in hourly wage rates.

In the Federal Republic of Germany and the Netherlands the expansion of industrial production will continue to be handicapped by serious manpower shortages and by the fact that production capacity is being used to the full. In the other member countries, where the cramping effect of these factors is much less noticeable, the expansion of demand will be accompanied by a corresponding growth of production. On the whole, production in the Community will continue to advance at a relatively slow pace. This pace may, however, be once again a little higher in the autumn than it was in the summer, especially as the high level of investment activity should then be making further capacity available in the Federal Republic of Germany and the Netherlands.

In view of previous developments, and taking into account the tendencies which can be predicted for the coming months, it seems likely that the forecasts established at the beginning of the year concerning economic developments in the Community for the full year 1961 will prove to have been accurate. According to the most recent estimates,

industrial production in the Community may be up 6 to 7 % on the 1960 level. The forecast that the gross product of the Community would increase by 5 % will no doubt prove correct.

Everything indicates that the growth of economic activity in the Community will also continue until the summer of 1962. There is no reason to be less optimistic for the second half of 1962. However, it is premature to establish forecasts for the whole of the coming year.

During the early months of 1962—and for as far ahead as can be seen—demand from abroad might again constitute an important factor in the expansion of overall demand in the Community. The improvement in the economic situation in the United States will doubtless continue and will be accompanied by a more and more appreciable increase in imports—inter alia of raw materials and semi-finished products from the developing countries. As these countries are also drawing considerable financial help from the United States and Europe, their economic and foreign exchange situation might improve. There are therefore fair prospects for an increase in their imports, and these, as we know from experience, will be in relatively large measure drawn from the Community. On the other hand the tendency for purchases by other countries and territories associated with the Community to fall off might continue for some time yet. Finally, the improvement in the USA's domestic situation will probably also have a directly favourable effect on deliveries from the Community to that country, although we can hardly expect another expansion on the scale of the period before the beginning of the last American recession.

The tendency for world trade to expand, which stems from the economic recovery being experienced in the United States and, to no small extent, from the uninterrupted economic growth of the Community, is hardly likely to be seriously upset by the depressive influences which might now emanate from Great Britain. The constant deterioration in the United Kingdom balance of payments on current account and in the "basic balance" as a whole during 1960 and early in 1961 led to a world-wide speculation against the pound (in which the British public itself participated to some extent) as soon as the short-term foreign money (especially American) which had entered the country as a result of the previous year's recession in America and of the British policy of high interest rates began to flow out again. This outflow revealed the weak position of the balance of payments, which had been concealed in the previous months by the influx of short-term foreign capital. The gold and foreign currency reserves, which in any case were small in comparison with the level of indebtedness in the form of freely convertible liabilities, moved very rapidly downwards. Although the adjusted figures for the balance of trade were already improving, the crisis assumed such proportions that European issue banks, in particular found it advisable to give support to the pound. Finally, in July, the British Government itself imposed a number of more drastic measures to improve the balance of payments (these included raising the Bank Rate to 7 %, increasing the special deposits of the London banks with the Bank of England, a 10 % rise in indirect taxes, and a pay freeze in the public services and State enterprises). The effect of these measures is being reinforced by the tendencies now visible in the world economic situation and will have some short-run impact on the balance-of-payments position. But it is questionable

whether the chronic weakness of the British balance of payments can be cured, and whether in the longer run it will prove possible to carry out successfully the projected policy which would assist economic growth and make industry more competitive. In the short run, however, domestic expansion will probably be curbed by the measures taken. This means that the immediate prospects for the expansion of Community exports to Great Britain are anything but auspicious.

Meanwhile, if account is taken of the importance of the present currents of trade and the factors which favour exports to many other countries, total demand from abroad in the first half of 1962 should—as already mentioned—have a definitely beneficial effect on the situation in the Community.

The indications are that domestic demand, too, will continue to expand during this period. True, investment by enterprises may increase less vigorously than hitherto in the member countries, where the large pay increases, the repercussions of heavier taxes due to the growth of profits in recent years and, in some branches, the fall in export prices have tended to squeeze profit margins. In addition, measures to curb investment, such as have been taken in the Netherlands, may have a greater effect in 1962. On the other hand, manpower shortages and more insistent demand from abroad will again give a perceptible stimulus to investments.

To judge by the number of residential and industrial building permits recently granted and the present trends in public works, demand for building in general will in the first half of the coming year exceed the level of the corresponding period of this year. Building and construction might well expand very appreciably but for the fact that the extreme manpower shortages, especially in the Federal Republic of Germany and in the Netherlands, will probably prevent any increase in supply.

The partial information concerning the development of budgets so far available suggests that current expenditure and fixed investments by the public authorities in the member countries will again increase considerably in the coming year.

An appreciable rise in consumers' demand also seems to be certain. Business activity is likely to increase once more in most countries, and in all of them the level of wages will continue to rise.

The shift in the relative influence on demand exerted by exports, investment and consumers' expenditure creates an uncertainty which makes it difficult to forecast how supply will develop. It seems probable that in some Member States scarcity of manpower will be the factor which, more than any other, hampers the expansion of output in most branches. However, there may also be branches which, in view of some slowdown in the investment boom, are again paying more attention to export business. It is therefore impossible to assert in a general way that in every case the physical limitations are bound to have an adverse effect on the trend of exports. In those Member States where domestic supply is still more or less elastic, production will probably not have any special difficulties in keeping up with the growth of demand. Here too, therefore, it would seem that an increase in demand from abroad would lead directly to a corresponding growth in exports.

On the whole these prospects seem to foreshadow a further growth of industrial production. A further pointer in this direction is the fact that the investment boom which has been going on for the past 2 or 3 years is now producing a considerable expansion of capacity. In a few branches the trend towards a higher production potential is such that it may not be very long before the capacity available will be plentiful, if not in some cases overplentiful, in relation to demand.

Community imports will without doubt also increase further. Whether their growth will keep pace with the expected growth in exports is not certain. The outlook for the economy of the world, and consequently for demand from abroad, coupled with the probable evolution of domestic demand suggest rather that there will be some tendency for the Community's balance of trade—and probably its whole balance of current payments—to improve again. The extent of this improvement would depend in part on the extent to which the growth of investment expenditure within the Community in fact slowed down. In this case even an increase in the rate at which consumers' expenditure has been expanding would for various structural reasons hardly suffice to enable imports from non-member countries to increase as much as would otherwise be the case and as much as the increase in exports would make desirable from the angle of balance-of-payments and currency policy.

This being so, it would indeed seem that a policy of general economic expansion is not called for in any member country. In some member countries, even, care will still have to be taken that home demand does not grow unduly. In any case tendencies for growth to slow down should be considered to be actively beneficial in view of the domestic business and price situation. On the other hand the growth of investment must not be allowed to fall away too sharply should it be found that in this or that country such a tendency threatens to last. In some Member countries it will be necessary to watch that neither the expansion of cash surpluses in the public budgets, nor developments affecting rates of interest, liquidity and the capital market shall act as a serious additional brake on investment; there is a risk that the growth of surpluses in the hands of the public authorities may have just this effect.

Given the present business and balance-of-payments outlook, any increase in interest rates should as far as possible be avoided. In this respect particular attention should be paid to the more recent trend of interest rates in the Federal Republic of Germany. Here rates on the capital market have recently crept up perceptibly, mainly in connection with the outflow of foreign capital prompted by the psychological effects of the Berlin crisis. Although this outflow will probably be only temporary, the trend of interest rates which they have set in motion may provide a problem for some time to come as it has been complicated by factors arising from currency speculation. Experience has shown that interest rates are not quick to fall again. Both high rates of interest and the subsequent recovery in share prices might result in further inflows of capital in excess of the present outflows and thus make balance-of-payments policy more difficult to operate. In addition, the sometimes high rates of interest might further strengthen the tendency for investment to fall off. Consequently the Federal Bank is

endeavouring to parry these trends, its main weapon being reduction of the level of minimum reserves. Further steps will perhaps be possible in this field. Should this action not be sufficiently successful, it will need to be backed up by fiscal policy.

Pay rises which exceed the rise in productivity are more and more becoming a source of economic problems in certain member countries. Where they do not represent a further factor—additional to the sharp rise in taxation—making for a reduction of profit margins and thus, in certain circumstances, weakening the propensity to invest, such rises mean further and thoroughly undesirable price increases.

It is true that in some member countries the considerable rises in pay are mainly a result of the excess of demand which has hitherto prevailed, particularly on the labour market. In others they have in any case been favoured by boom conditions. Since attempts to curb the expansion of wages by restrictions on demand would probably be inappropriate in certain countries, principally for reasons connected with the balance of payments, and in others because of the structure of the economy and the requirements of growth policy, the need for developments in wage rates to be related to the needs of economic policy.

With the exception of the Netherlands, however, no member country possesses the institutional, political and psychological prerequisites for a strict wages policy consonant with the needs of an economic policy related to growth. But even in the other member countries efforts could perhaps be made to organize close collaboration between the Government, managements and labour in order to lay down certain binding basic lines of wages policy and in this way to avoid any excessive rise in wages which might eventually weaken the balance-of-payments position unduly. In certain countries, however, this could only be done once arrangements had been made to produce overall national economic forecasts, as these would show the repercussions of the various proposals and thus provide a basis for wage talks.

Moreover, it is still necessary to do everything possible to increase the supply of manpower and thus to reduce the strains on the labour market which lead to wages increases. Here it is becoming more and more evident that the State must give greater encouragement to vocational training and that occupational mobility must be increased. Movement between areas with a demand for labour and the pockets where surpluses exist should also be further improved by giving greater encouragement to migration both of labour and of capital. In this respect it is important that the directive concerning the free movement of labour, which came into effect on 1 September 1961, should be applied in a very liberal spirit.

It is already an accepted fact that the gradual establishment of the Common Market has contributed to a better balance in the economic situation generally and has led to an increase in supply. At this point it should in addition be stressed that it contributes essentially to the reduction of imbalances on the labour market. For all these reasons the Economic Policy Committee stated in its opinion of 26 May 1961 that the additional 10 % reduction in the Community's internal customs duties, which was envi-

saged for the end of 1961 as part of the speedier establishment of the Common Market, appeared to be desirable. Under Article 15 (2) of the Treaty the various member countries can take even more rapid action, and this could only further enhance the part played by trade between member countries in improving the balance of the economic situation within the Community and in stabilizing prices. France has already taken the first steps in this direction. The price trends and economic developments in other countries, in particular the Federal Republic of Germany and perhaps also Italy, suggest the need for really far-reaching "advance action" in this field.

Finally, the liberal line of policy in trade with non-member countries should be maintained and developed. This is even more urgent when looked at from the angle of economic development and the balance of payments, because of the changes in the world economic outlook on the one hand and of the trend of business and prices in the Community on the other. It is obvious that in this field there still remain many direct and indirect possibilities of increasing imports further without always causing a corresponding rise in exports.



## **II. OUTLOOK**





## 1. Federal Republic of Germany

*Economic expansion has continued during recent months. In the second quarter exports were up fully 11 % on the level reached in the corresponding period of the previous year ; actual expenditure on investment continued to increase steeply and private consumption also expanded very appreciably as a result of the rapid upward trend of wages.*

*On the other hand production has clearly become less elastic. If seasonal variations are left out of account, industrial production has practically ceased to grow. Nevertheless, in the second quarter it was still 6.4 % above the level recorded for the second quarter of 1960. Although imports rose again slightly, foreign trade has not yet, in the aggregate, made a sufficient contribution to easing the pressure which demand is exerting on supplies, and the general price level has therefore again risen slightly.*

*The signs that the boom is settling down have, however, become more marked. The rate at which orders from abroad came in was appreciably slower. On the whole, too, the gap between new orders and deliveries by industry, narrowed greatly but the backlog of orders is very large. In some limited sectors, in particular for certain finished industrial products, prices have been stabilized, largely as a result of increased imports.*

*The basic trends are likely to continue throughout the remaining months of 1961. In addition, the pace at which production is increasing might pick up slightly in the autumn. In the early months of 1962, too, the seasonally adjusted figures should show an expansion of business activity, though the pace of expansion may be decidedly slow.*

*The improvement of world economic conditions could, if it continues, further strengthen demand from abroad. The large wage increases registered in 1961, which because of the tight situation on the labour market will continue next year, although perhaps on a reduced scale, should ensure a further rise in private consumption. Public works projects of all sorts and the demand for housing will probably continue to expand perceptibly ; but the readiness of enterprises to invest, in so far as it depends on the level of profits, might well slacken in the course of 1962. However, should investment demand lay too far behind the potential supply of capital goods, economic policy makers have at their disposal adequate means, particularly in the realm of fiscal policy, by which to step up existing incentives to investment and thus prevent any further undesirable increase in balance-of-payments surpluses.*

### A. Recent developments

In recent months economic expansion has continued to benefit from the increase in exports. The value of these (expressed in DM) went up 5 % between the first and

second quarter of 1961, and was consequently a full 11 % above the level of the corresponding period of the previous year, compared with a year-to-year growth of 7.3 % in the first quarter. However, a fairly sharp dip occurred in July when exports were only 3.4 % above the figure for July 1960, owing no doubt primarily to the seasonal decline in industrial production which occurs at that period and was on this occasion very appreciable. Except perhaps in a few sectors, the trend of demand was hardly such as to cause the growth of exports to slow down at all.

The expansion of actual internal expenditure has also continued in recent months, the vigorous increase in fixed investments continuing to be the main factor of expansion. In both the construction and capital goods sectors increasing expenditure for investment was in evidence. The chief incentive for investment by enterprises seems once again to have been the shortage of manpower.

The wide gap which exists in the construction sector between demand and the physical possibilities of meeting it—the production index for the building industry in the second quarter was only 2 % higher than that of the same period in 1960—is most evident in housing. Whereas, in the course of the first half-year, the number of building permits granted in this sector was 7.2 % up on the corresponding period of the previous year, the total of dwellings completed during the same period rose only 2.5 %. This meant that the housing backlog, which already stood at about 670 000 at the beginning of the year, reached approximately 817 000 by the end of June. By increasing their orders and through the encouragement given to house-building, the public authorities have until recently contributed not a little to the persistence of strains on the building market.

In the first six months of the year stocks of raw materials and semi-manufactures—in particular steel—held by manufacturing industries and the distributive trades again increased—more rapidly than consumption or sales in some sectors. This situation, a result of the large orders placed last year, suggests that the enterprises are again trying to keep stocks at a lower level.

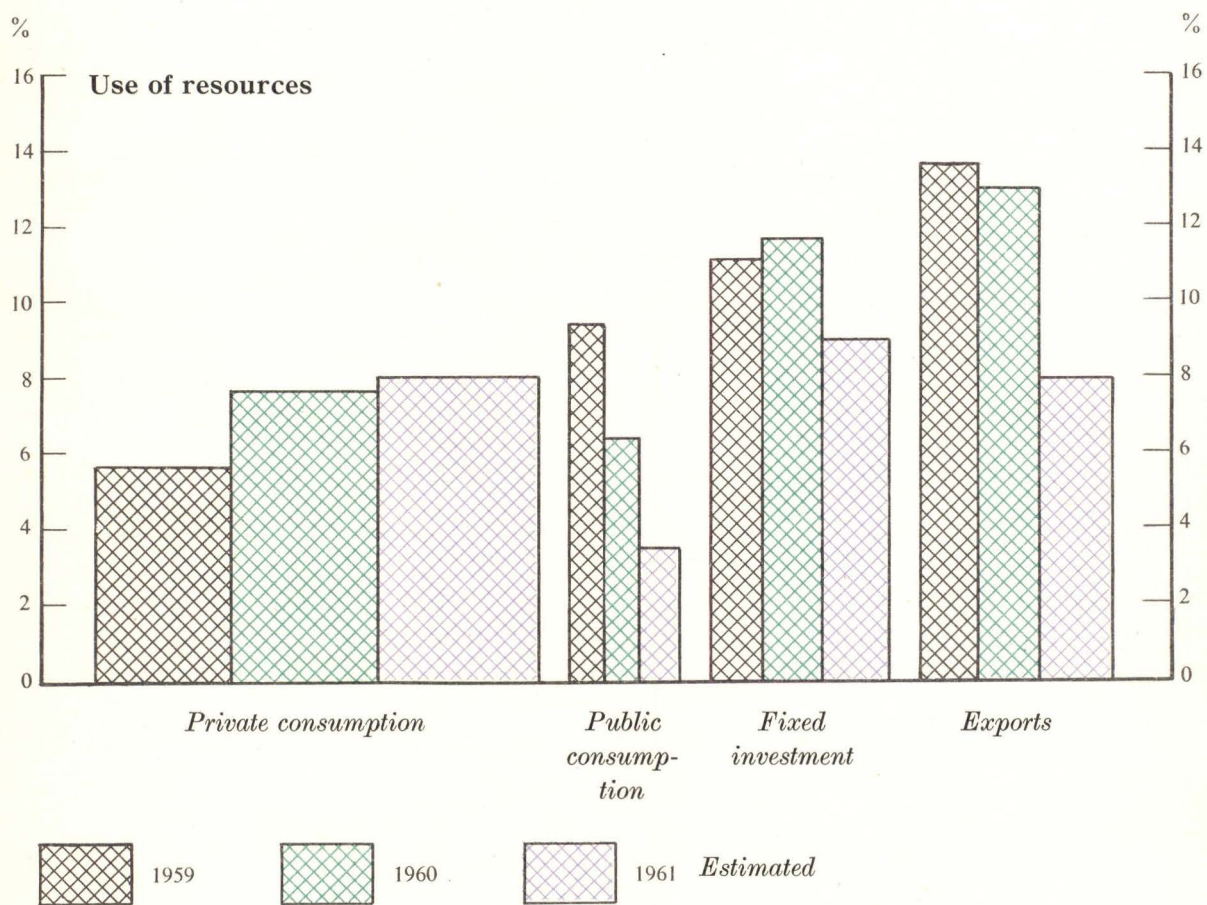
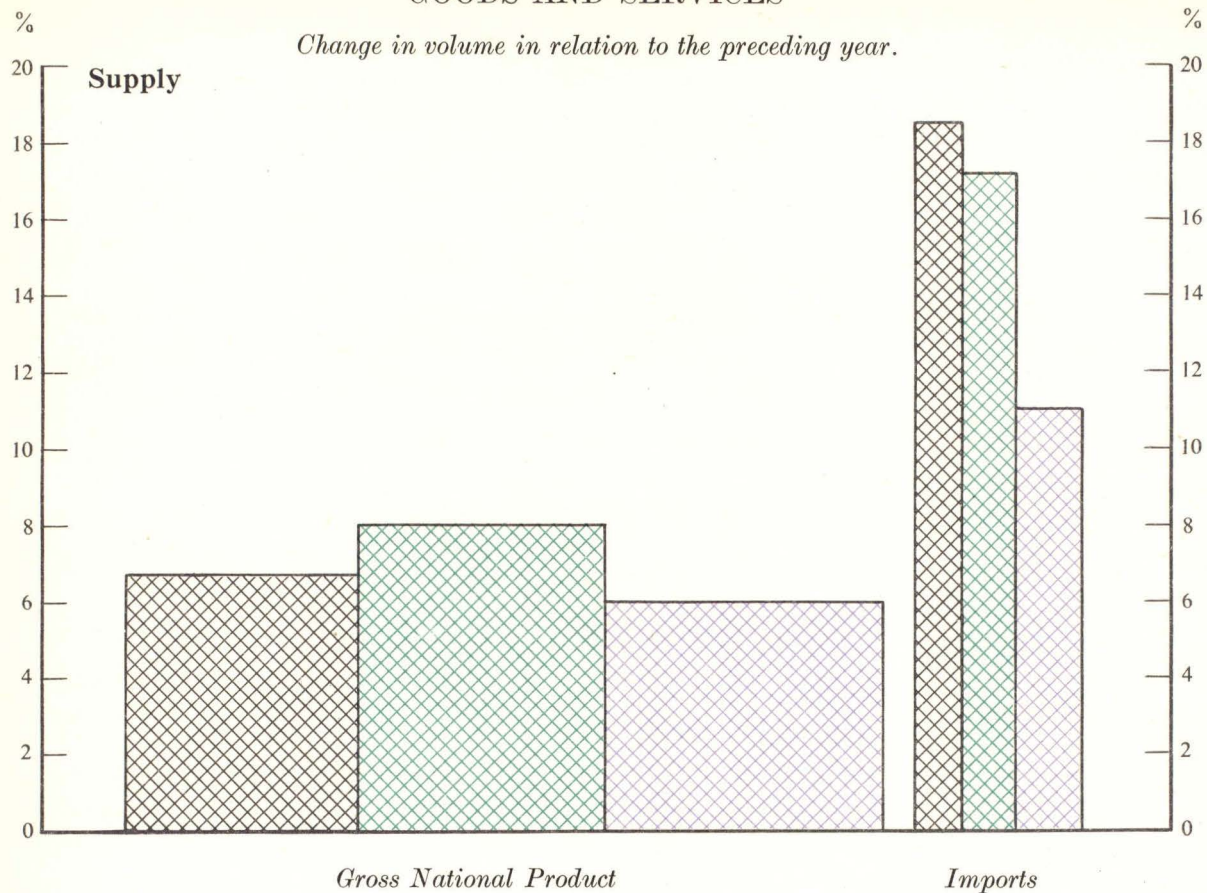
The strong bargaining position of the workers on the labour market has triggered off a further vigorous rise of salaries and wages. Increases of pay obtained by the trade unions, which amount on the average to 9.5 %, have been higher than in the first quarter (when they were only 5.2 %), and were also above the average for the year 1960 (8.6 %).

The wages shown in collective agreements in the second quarter of 1961 were nearly 9 % above the level for the corresponding period of the previous year. The rate at which actual earnings rose was appreciably higher still. Furthermore the total volume of wages paid out increased as a result of a considerable growth in the numbers employed. Finally transfer incomes which, in the first quarter, were nearly 6 % above those of the same period last year, showed an even stronger increase in the second quarter.

Although the rate of saving has risen, this increase in the total volume of wages has again caused a vigorous expansion of consumer expenditure. Private consumption,

## SUPPLY AND USE OF RESOURCES GOODS AND SERVICES

*Change in volume in relation to the preceding year.*



1959    
  1960    
  1961 *Estimated*

*The width of each column corresponds to the aggregate value for the preceding year. Percentages include neither Berlin nor the Saar.*



which in the first quarter was about 10 % higher in money terms than a year previously, seems to have maintained this rate of growth in the second quarter. From May to July retail sales, representing a little less than half the total of consumer expenditure, were on the average up 9 % by value and 7.5 % in volume over the same period last year. (In August the increase in value was even 14 %). While there has been little general and decisive slackening in the expansion of demand the elasticity of domestic supply has diminished considerably, at least in the most important sector, that of industrial production. A major factor in this development has been the shortage of manpower.

It is true that the number of wage-earners increased between the end of March and the end of July by about 340 000 and of these the majority were taken on by industry. This increase is mainly due to a growth in the number of migrant workers, which, at the end of July stood at 520 000, or almost 244 000 more than at the end of July 1960, and to the considerable influx of further refugees from the Soviet occupation zone. In addition, there was a further fall in the already small number of unemployed. At the end of August, this was only 98 000, or 0.4 % of the total labour force. Despite the unexpectedly large increase in employment the situation of the labour market has not been eased. At the end of August the number of unfilled vacancies was as high as 588 000—a new record. There were six vacancies to each person unemployed.

Despite the poorer yield of various crops, in particular bread grains, it seems that agricultural production will have risen again this year, largely owing to the increase in livestock and livestock products.

If seasonal variations are left out of account, industrial production has hardly advanced in recent months despite the increase in employment. The rise between the first and second quarters was only 4.7 % compared with an average of 8.2 % in the last 4 years. (1) During the second quarter, production was hardly more than 6.4 % above the level for the corresponding period in 1960, whereas in the first quarter the year-to-year growth rate had still been 10.2 %. The seasonal fall in production between June and July even brought the rate of growth down to 4.8 %, but it is possible that the incidence of summer holidays, a factor whose effect is increasing from year to year, may have contributed to this development.

However this may be, output per head employed in industry seems to have made little further progress in recent months. This appears to be due, not only to the high rate at which capacity is being used but even more to a reduction in the working week of persons in employment, resulting from the rules contained in collective agreements and from the fact that workers are less and less inclined to do overtime.

Imports in the second quarter again made a rather higher contribution to total supply. They were 7.5 % by value and 9.4 % in volume above the January-March imports and 4.4 % by value and 9 % in volume above their level at the corresponding period of the previous year. In the first quarter the rate of growth in relation to the first

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(1) According to the index of the "Statistisches Bundesamt".

three months of 1960 had been only 2.8 % by value and 4.3 % in volume. The month of July brought a slackening which seems partially attributable to the accentuation of seasonal factors, and import figures exceeded the corresponding figures for July 1960 by only 2 % in value and about 7 % in volume.

The difference between the figures for imports by value and by volume reflects the greater fall in import prices due to the revaluation of the German Mark. The average value of imports in June was 4.7 % below that of June 1960.

Although the share of imports in total supply has increased slightly, it is clear that external trade has not made any essential contribution to the easing of longer-term economic strains. At 1 700 million DM in the second quarter, the surplus on the balance of trade was, it is true, slightly below the figure of 1 900 DM registered in the first quarter; but it was also 800 million DM above the surplus for the corresponding period of 1960. Even in July 1961 the trade balance showed a surplus of 500 million DM.

Although the surplus on services continued to fall, and even gave place to a deficit for a short time, in particular by reason of the heavier deficit on tourist account, the overall surplus on current account in the second quarter—at 1 200 million DM—was also considerably above that of the corresponding period of 1960, when it totalled 700 million DM. The July surplus was, however, smaller than in the previous year.

The difficulty experienced by domestic production and imports in meeting overall demand led to a continued rise in the level of prices, although the trend differed from sector to sector. Not only was there an appreciable rise in agricultural and building prices, but producer prices for equivalent goods also went up by nearly 1 %, thus exceeding their level for the corresponding period of the previous year by fully 3 %. According to the cost-of-living index, consumer prices rose by 1.5 % in the same period and in August they were 3.2 % higher than they had been in August 1960. Even if the prices of food products are left out of account, the same index shows in July an increase of 0.6 % in relation to March and of 4 % in relation to July 1960.

However, the pressure on prices seems to have eased in some branches, in particular for certain manufactures. This appears to be largely due to the high rates at which imports of finished products have been expanding.

Despite the high surpluses on the balance of current payments, the gold and foreign currency reserves of the Federal Bank declined in the second quarter from 31 400 million DM to 29 500 million DM. At the end of August they had dropped further to 27 000 million DM. Most of this decline of 4 400 million DM in all was due to exceptional factors. In April and May there were advance repayments, amounting to 3 120 million DM, of the debts incurred for post-war economic aid, and in August further special payments, particularly in connection with British drawings on the International Monetary Fund. In the second quarter net exports of capital by banks other than the Central Bank were 600 million DM, of which July alone accounted for 400 million. The surplus on the balance of current payments was thus more than offset by net exports of long-term and short-term

capital. From July onwards political factors leading to an outflow of foreign capital also played a role in this process.

Up to July the money market was influenced mainly by the high surpluses on the current balance of payments, by the Federal Bank's policy of increasing liquidity and lowering interest rates, and by the large cash surpluses held by the public administrations, with their effect on the internal situation. These cash surpluses may partly explain the slowness with which interest rates moved downwards; for although internal expenditure by the Federal Government and the Länder continued to grow, this increase was more than offset by the very large rise in fiscal receipts. Ever since interest rates on long-term borrowing began to increase—and increase appreciably—particularly as a result of the outflow of capital provoked by the political events already referred to, the Federal Bank has again reduced the incentives to export short-term capital and has been freeing further banking reserves which has previously been frozen.

## B. Outlook

The expansion of overall demand will probably continue during the coming months of 1961, but the tempo will doubtless decrease further. In particular the rate at which orders are being placed might slacken even more, with the result that the figures for new orders and for deliveries, which have already come appreciably closer to each other in recent months, might meet. This is not, however, tantamount to the end of the excess of demand, as the backlog of orders is very high and order books have till very recently been growing slightly longer.

In particular, the backlog of orders from abroad has continued to grow. Although new orders in the second quarter were 2.6 % below their level for the corresponding period of the previous year, they were nevertheless still about 5 % above the figure for deliveries. The present state of order books and the new orders being received should in any case pave the way for a further increase in exports in the coming months.

There seems also to be no likelihood yet that the investments sector will settle down in the near future, although the flow of orders placed with the capital goods industries by domestic buyers has eased off considerably. However, new orders were still a little above the figure of sales and order books are very long. In addition, the second quarter still showed a year-to-year increase of 18 % over 1960 in permits issued for industrial and commercial construction (calculated on the basis of space enclosed).

With regard to other investments in the construction sector, too, the present situation is such that the rise in demand is still in excess of the possibilities of supply. The cubic capacity represented by the housing permits granted in the second quarter was 12 % above that of the corresponding period of the previous year. For public building the equivalent rate of growth was as high as 36 %. However, there have recently been signs that the administrations concerned have for policy reasons been exercising a certain caution and the expansion of demand in general seems to have become



slower. Finally, in view of current wage increases and those expected in the near future, and also of the increase in transfer incomes, particularly the extension of family allowances with retroactive effect from 1 April, there is reason to anticipate that the very rapid increase of private consumer expenditure will continue.

It is still improbable that supply will adapt itself sufficiently to demand. Industrial production at home seems to be still thoroughly inelastic although the possibility that from the autumn onwards the investments made will again be reflected in certain increases in output and productivity is in no way to be excluded. In any case expansion will doubtless be very slow. In view of the situation which continues to prevail even after the 5 % revaluation of the DM, it is unlikely that the present gap between the growth of overall demand and that of internal supply will be filled by increased imports. In any case there is little cause to anticipate a drastic fall in the surplus on the balance of current payments. This does not mean that there is no chance of price stability being attained or maintained in certain branches, but on the whole we must expect that the price level will again tend to rise.

Taking into account the probable trend in the final months of the year, we may expect, that for 1961 as a whole the results of economic activity will be very satisfactory. The growth of the gross national product in real terms may be estimated at about 6 % (against 8 % in 1960) and that of industrial production at about 7 % (11.5 % in 1960). The expansion of investment will be specially large, attaining some 9 to 10 %. Whereas the progress of consumption in the public sector will be relatively small, the rate of increase of private consumption should be about 8 %, or on much the same scale as in the preceding year. The increase in the volume of exports will be around 8 %, roughly corresponding to the forecasts made in the spring. On the other hand the volume of imports will not increase as much as had in fact been expected after the revaluation of the Mark. It would seem, however, that the surplus, on the balance of payments would have been considerably larger still but for the revaluation.

As regards the foreseeable trend for next year, it is legitimate to think that the moderate increase in economic activity will continue at least during the first half of 1962. However, a number of factors making for uncertainty should not be overlooked. Thus it is difficult to foresee whether the present weakening of external demand, reflected in a fall in the flow of new orders from abroad, will continue or will be replaced by further expansion. There is more than one reason to think that the business recovery in the United States, the payments to be made on account of aid to developing countries and the reduction of customs duties which the Community countries are to make on 1 January, will tend to strengthen demand from abroad.

While it would seem that demand is likely to increase again in public works and in housing, it is more difficult to forecast the probable trend of the readiness of enterprises to invest. True, certain powerful incentives to invest have become stronger rather than weaker : the extreme shortage of manpower, the increase in foreign competition, the more ample liquidities of the banking system today and also the lower rates of interest. But

on the other hand wage increases, which are much greater than the corresponding improvements in productivity, and the steepness of the rises in taxation, are affecting the profits of enterprises and consequently the rates of self-financing. It remains to be seen whether heads of enterprises will next year be prepared to run into debt on an appreciably larger scale than hitherto in order to finance new investments.

The draft budgets established for 1962 suggest that there will be a further appreciable increase of expenditure in the public sector. The growth of private consumption, too, seems likely to lose little of its impetus : with no noteworthy easing to be expected on the labour market, at least in the first half of the year, the volume of wages has every opportunity of expanding. In fact, no further significant increase will be possible in the available manpower, apart from a rise of about 40 000 in the number of young people leaving school, and the recruitment of foreign workers—which is, however, becoming increasingly difficult, at any rate in the neighbouring countries.

A fillip to production is therefore hardly to be expected from this factor, especially as the trend towards reduction in the number of hours actually worked may well continue. We must, of course, not underestimate the opportunities to improve productivity which stem from the execution of investment programmes. But on the other hand it is not altogether impossible that in 1962 the boom in fixed investment by industry may slow down. The expansion of output in the corresponding equipment goods industries concerned might then also suffer from the slackening in demand.

In these circumstances a restrictive monetary and financial policy would not be the right one. On the contrary, it will be necessary to prevent any very great slowing down of the expansion of internal demand in comparison with possibilities of supply. Particularly if such a slowing down were to affect the capital goods sector, an unpleasantly large further increase might possibly occur later in the surpluses on the balance of current payments.

It is true that for some time now monetary and credit policy has no longer been in any way restrictive. On the contrary, by increasing bank liquidities and lowering interest rates it is intended to slow down the net influx of foreign capital and even, if possible, to attain a net outflow; at the same time it makes it easier to finance the expansion of demand at home. On the other hand, there can be no doubt that the present financial policy of the public authorities runs counter to the efforts being made by the Federal Bank. Consequently, it would be opportune to contemplate leaving a greater portion of the liquid cash surpluses of the Federal Government and of the Länder provisionally at the disposal of the banking system rather than sterilizing them in the Federal Bank. It might even be necessary in certain circumstances to make greater use of reductions in minimum reserve requirements. If it should prove, however, that readiness to invest is flagging unduly, these measures would doubtless not suffice. It would then be necessary to examine in good time whether appropriate financial measures should not be taken to correct the drag on demand exerted by the public budgets. One possible line of action would be to step up public investment.

It would be, however, in the interest of price stability and in line with the Treaty to take forthwith all possible measures calculated to stimulate imports still further, in particular significant advance reductions in customs duties and widening of quotas—including those which would place limits on price rises in the agricultural sector.

## 2. France

*The expansion of economic activity, which had been somewhat hesitant at the beginning of the year, speeded up slightly in the second quarter, mainly thanks to increased demand from abroad. After marking time for nearly a year, the growth of exports to countries outside the franc area became so vigorous that it more than made up for the simultaneous decline observed in sales to Algeria. Total exports in the second quarter were up fully 8 % by value on the previous year. But the propensity of industrialists to invest has also become definitely more pronounced, and programmes for expenditure on building and equipment have been revised upward since the spring. Lastly, with incomes continuing to increase, private consumption was still a factor which made for the expansion of demand.*

*It was again possible to step up production appreciably. Agricultural production was satisfactory; industrial production, after seasonal adjustment, showed an increase of 1.5 % between the first and the second quarter, and of 6.5 % over the corresponding period of 1960.*

*The adjusted figures for imports also increased—roughly to the same extent as exports. Until the middle of the year the general price level remained stable, the slight rise in industrial prices being offset by the fall in the prices of some food products.*

*In recent months the balance of payments has registered growing surpluses. The influx of gold and foreign currency, which amounted to nearly \$ 900 million between the beginning of the year and the end of July, is only in part due to capital movements. In any case the balance on current account again showed a large surplus.*

*There is no reason to anticipate any appreciable change in the situation for the rest of this year and the early months of next year. Overall demand should continue to expand and there will be a certain margin of unused capacity and—in view of the somewhat higher numbers expected to leave the schools—of manpower available for a further increase in production. Since there is reason to expect that imports will rise further, supply should on the whole be able to keep up sufficiently with demand.*

*We must nevertheless anticipate that there will still be certain pressures on prices and that there may be more serious threats to the stability of the general price level, particularly if agricultural prices were also to move up again.*

*In these circumstances the problem before dealing with short-term economic policy is to ensure that expansion can continue without strains. This would be all the more the case if a further boost were to be given to domestic demand by the coming increase in State expenditure, which will benefit agriculture in particular. Arrangements to finance the additional outlay in a manner consonant with the needs of the economic situation, coupled with fuller use of the opportunities to expand supply which are offered by the high surpluses on current account, could contribute to the attainment of immediate economic aims.*

## A. Recent developments

The upturn in demand from abroad which became perceptible at the beginning of the year after several months of stability is now confirmed. The seasonally adjusted figures for exports appear to have increased, in terms of value, by about 3.5 % between the first and the second quarter. They were more than 8 % above April-June 1960.

This development is the more remarkable as the weakening of sales to Algeria, which has hitherto taken about 15 % of French exports, has tended to grow worse in recent months. Total deliveries to the franc area in the second quarter of 1961 were 3 % below the level of a year ago, despite increased purchases by franc area countries other than Algeria.

The increase of exports over the previous year is therefore exclusively due to rising sales outside the franc area, in particular to France's partners in the Community. In relation to the corresponding period of the previous year, the rate of increase in exports to the EEC was no less than 27 % in the second quarter, while those to EFTA went up by only 6 %. In the same quarter sales to the United States, which have shown a sharp recovery since February, were again above those of the corresponding period of the previous year.

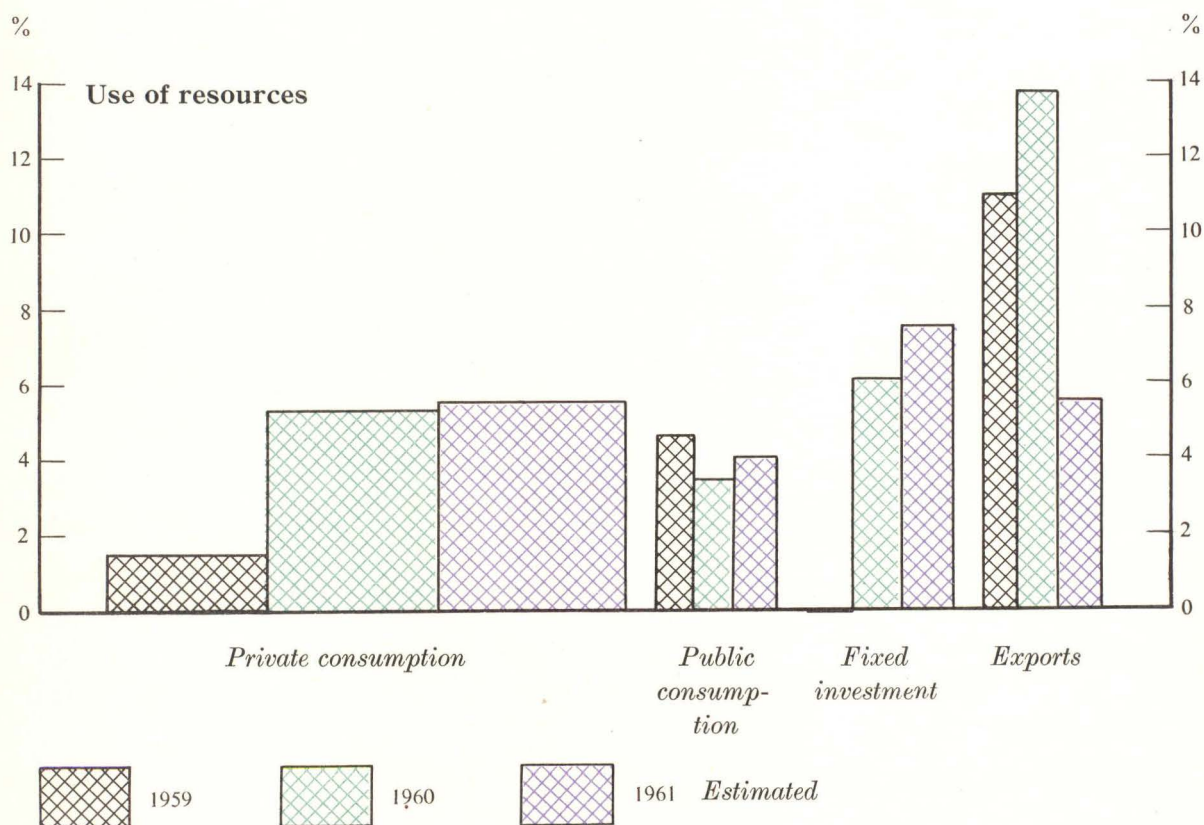
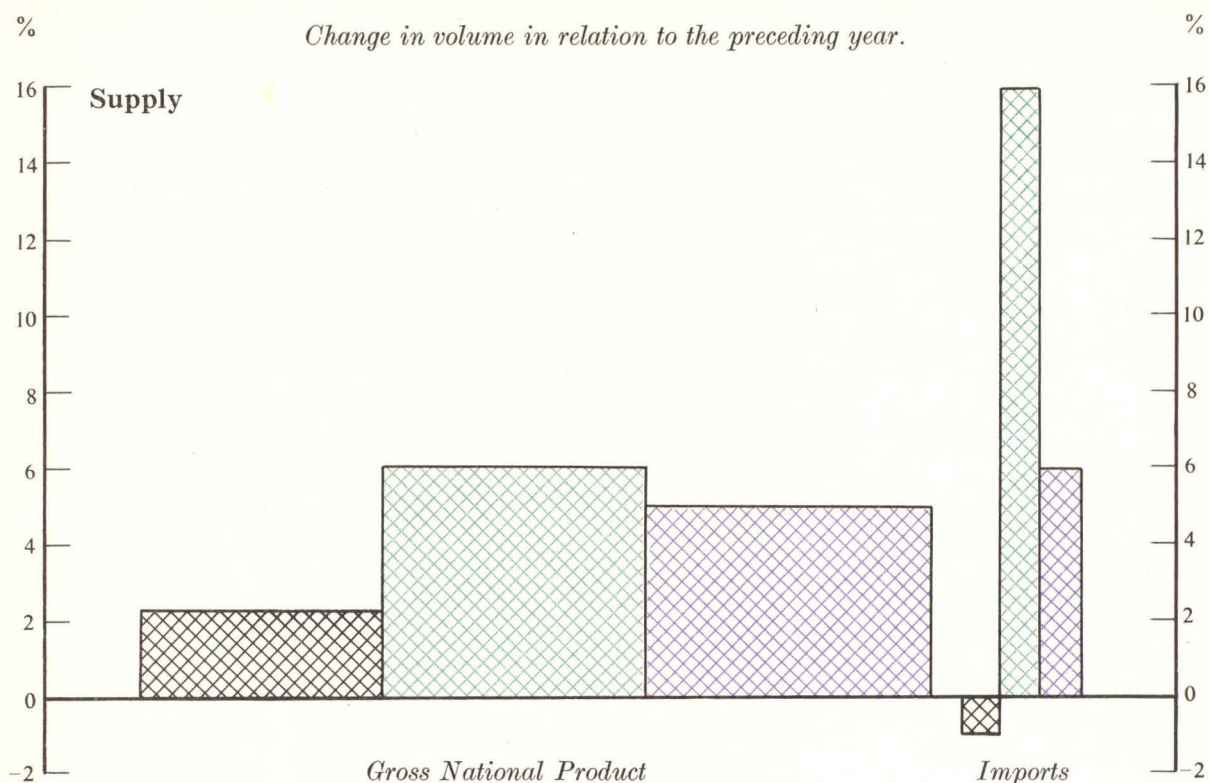
The expansion of demand at home was also vigorous. The rate of increase of *fixed investments by enterprises* may have risen slightly. At any rate, the enquiry carried out by INSEE in June reveals that private industry has revised its investment programmes upward. Whereas in March the intention was still to invest in building and equipment 8 or 9 % more than in the previous year, the additional projects to be executed should now raise the rate of growth to about 12 or 13 %. However, it seems that on the whole investments by public enterprises have again hardly increased : the recent rise in investment credits for certain of these enterprises (Charbonnages de France, Gaz de France, Air France) was almost entirely offset by the cuts made in other sectors.

While direct public investment also increased at a slightly faster pace than was originally planned, housing in the second quarter reflected the fact that the building season had started early because of a relatively mild winter. Growth rates were not as high as in the first quarter, either in the number of starts or of completions. However, the trend in this sector was still clearly upward.

Incomes also continued to increase in the second quarter. In particular the real income of wage and salary earners went up by about 2 to 2.5 %, for there was a vigorous increase in rates of pay, while the adjusted figures for employment and hours worked also went up slightly. This meant that *private consumption* again increased even though the propensity to save may have become a little more marked. The temporary slowdown in the expansion of retail sales seems to be mainly attributable to the shift in seasonal buying caused by the early date of the Easter holiday, and to weather which was unfavourable to sales of certain consumer goods (clothing, refrigerators). It is also possible that demand was directed more towards services and certain goods, such as motor cars,

# SUPPLY AND USE OF RESOURCES GOODS AND SERVICES

*Change in volume in relation to the preceding year.*



*The width of each column corresponds to the aggregate value for the preceding year.*



which do not figure in retail trade statistics. Nevertheless, the turnover of the big multiple stores in Paris was still 11 % higher in the second quarter than in April-June 1960; the rate of increase in the first quarter had been 16 %.

Supply had no particular difficulty in adapting itself to this trend of demand. *Agricultural production*, both crops and livestock products, was so abundant that the support measures for agricultural markets had to be considerably strengthened.

The pace at which *industrial production* was expanding again increased a little : after rising only very slightly between the fourth quarter of 1960 and the first quarter of 1961, the seasonally adjusted index of industrial production (1) went up 1.5 % in the second quarter, thus reaching a level 6.5 % over that of a year earlier. In general, deliveries in the second quarter probably kept pace with new orders, for in June businessmen reported no further increase in the backlog on their order books. In a few branches delivery dates may even have been reduced somewhat, with stocks of finished products increasing a little. In the consumer goods sector dealers seem to have been a little more reluctant in the second quarter to place orders. Thus the rise in production, especially among the traditional consumer goods, was less marked. The seasonally adjusted figures for the production of motor cars, on the other hand, rose sharply between the first and second quarters. In the capital goods sector, too, the general buoyancy of demand at home and abroad led to a noteworthy increase in production.

With the slightly speedier expansion of production, signs of an increasing run-down of the reserves of capacity and of manpower have become more apparent. In reply to an enquiry among businessmen organized in June by INSEE, 66 % still declared that they could produce more if they received more orders. However, this percentage has fallen steadily. It is particularly the difficulties in recruiting qualified manpower which have grown. Although there has been a notable expansion in immigration, offers of employment have been constantly increasing. The already very small proportion of unemployed has shrunk further. At the beginning of July those seeking employment probably represented no more than 0.6 to 0.7 % of the paid labour force.

To meet demand greater calls have been made on supplies from abroad. The seasonally adjusted figure for *imports* rose between the first and second quarter of 1961 by about 3 %. Imports were 11 % by value and 13 % in volume above those of April-June 1960. It is chiefly purchases in the EFTA and EEC countries which increased, but imports from the United States have recently begun to pick up again. On the other hand it does not seem that purchases in the franc area increased in the second quarter, the extra demand for imports being almost exclusively for industrial finished products, by far the larger part of which are procured outside the franc area. On the whole, imports of raw materials have hardly increased since the beginning of the year despite the increased industrial activity. Imports of food products have been declining.

As imports since the first quarter have increased at practically the same pace as exports, the overall *balance of trade* has continued to show a large surplus. However,

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(1) INSEE index.



in trade with countries outside the franc area the surplus may, when corrected for seasonal variations, have been lower in the second quarter than in the first three months of 1961.

Even the rapid expansion of imports of finished products could not hold down the *prices* of industrial products, which have increased at a rate equivalent to about 2 to 3 % per annum. The fall in the prices of certain foodstuffs nevertheless exercised a compensatory effect in the first six months, so that—with the prices of services remaining stable—the index of consumer prices in June was roughly at the same level as in December 1960. But from the middle of the year, with higher prices for some foods (bread, meat) and services (rents, radio licences) it was possible to recognize an underlying tendency for the cost of living to rise. In July the cost of living was fully 2 % above the July 1960 level.

The *balance of payments* continued to be extremely favourable and very high surpluses were again achieved. They were due not only to the surplus on visible trade but also to higher net receipts under the heading of services—particularly from foreign travel—and, in no small measure, to a greater influx of capital. Here speculative movements may very likely have played a part at times. Total gold and foreign currency reserves of the official monetary institutions increased by nearly \$ 900 million in the first seven months of the year. At the end of July they stood at \$ 2 965 million. The Government decided to repay in advance, in August, the remainder of France's debts to EPU, amounting to \$ 303 million, so that long-term debts to abroad now total no more than \$ 1 800 million.

As a result of the continuous inflow of foreign currency the *money market and capital market* continued to be relatively liquid. The rates for call money, which had been very steady for some time, again showed a clear downward trend from June onwards; rates of interest on the capital market also declined again somewhat in the second quarter, although the business demands for funds for financing purposes again increased. The main increase was in bank credits, but greater appeal has also been made to the capital market.

The Treasury has continued to avoid interference in the capital market. The offer of short-term funds from banks and individuals has been so plentiful that the ceiling of the banks' obligation to buy Treasury bills, already reduced from 25 to 20 % of deposits at the end of January, was further lowered to 17.5 % at the end of June. In addition, it would seem that the surplus of government expenditure between April and June was roughly equal to the surplus of receipts registered during the first quarter. On the whole then *public finances* were practically in balance during the first half of 1961.

## B. Outlook

There is nothing to indicate that the general economic situation in France will undergo any profound changes during the *last months of 1961*. It seems that a fairly vigorous and perhaps even slightly more rapid expansion of demand may again be expected.

Prospects for *exports* to countries outside the franc area are better because of the now certain recovery of the United States economy and the improvement discernible in the foreign currency situation of certain primary producing countries. This opinion is shared by entrepreneurs. It is particularly the metal-producing and metal-manufacturing industries which report increased orders and higher prospective sales abroad. Exports to the franc area, however, might continue to be handicapped by the difficulties in Algeria.

The expansion of home demand will also continue during the coming months. The recent revision of the *investment programmes* of private industry may even justify the expectation of a slight speed-up in the pace of investments during the remainder of the year. Finally, because of the continuing favourable trend of incomes—further wage increases are to be expected in the autumn—a continuation of the increase in private consumption may be expected.

It does not seem that it will be too difficult to expand *production* to keep pace with this increase—the more so as new capacity is being constantly created, and as the advent on the labour market of a slightly higher number of young school leavers will ease the situation a little in the autumn. Account must also be taken of the increased *imports* of finished products which should result from the second reduction in customs duties, made on 15 September 1961 in the light of the general economic situation.

Nevertheless, threats to the stability of the general level of consumer prices may become more serious in the coming months. The slight rise in the prices paid for industrial products will no longer be offset—as was the case in the first six months—by a fall in the prices of agricultural products. Quite apart from the seasonal increases which must be expected, these prices might well be given more active support under the new measures to assist agriculture. In the services sector, too, the structural tendency for prices to rise, interrupted for several months under the influence of certain special factors, will also make itself clearly felt once more.

On the basis of the economic developments so far and of the prospects which have just been outlined, it is very probable that the forecasts established in March for the *whole of 1961* will prove accurate: the increase in the gross national product should easily reach the 5 % foreseen. The only important modification called for would seem to be in the forecasts for foreign trade: the rates of growth for 1961, in particular for exports outside the franc area, may well be higher than was expected.

For the *year 1962*, at least in the early months, there are so far no signs that there will be any basic change in the economic situation. The new upsurge of exports has shown that the ability of French industry to compete is still great. In fact, the average prices of exports were no higher at the end of the first half of 1961 than in the previous year. If general international economic conditions continue to improve, we may again expect satisfactory progress in exports for the year 1962.

Home demand will in 1962 probably be once again the decisive element in expansion. Investment by enterprises will certainly derive some further stimulus from the Fourth

Plan, which has been worked out in terms of vigorous expansion over a longer period. Agricultural investment may also draw fresh vigour from the coming increase in French farm incomes. Further factors in demand will probably be found in increased housing construction and greater direct investment expenditure by the public authorities. Finally, the rise in incomes seems to provide the required conditions for a lasting expansion of private consumption.

The problem before those dealing with current economic developments is once again to decide how the increasingly apparent tendency for prices to rise can be combatted without adversely affecting the strong—and desirable—growth of investment and of private consumption. The measures so far adopted to increase supply by stepping up imports—trade liberalization and reduction of 5 - 10 % in customs duties on industrial products—have obviously not yet curbed to any appreciable extent the rise in the prices of manufactured goods.

The further customs reductions effective from 15 September are again only moderate. In fact, these merely extend to all industrial imports the 10 % reductions made on 1 April. Together they do no more than introduce at an earlier date reductions which would in any case have had to be made on 31 December as steps towards full implementation of the Common Market. It would perhaps be worth while to examine whether the possibilities provided in the Treaty of Rome could not be used to bring about a reduction of customs duties which would really affect the issue. Such a policy could also help maintain the balance of the economy despite the perceptible increase in public spending which is to be expected : during the coming year government expenditure, which is in any case rising, will be swelled by additional disbursements of 1 500 to 2 000 million NF for agriculture. It is not certain whether the growth in revenue to be reckoned with will be sufficient to cover this additional outlay.

Since in the coming budget year the intention is once again to hold the surplus of expenditure down to about 7 000 million NF—the level that has been considered necessary in the interest of balanced growth and consequent price stability since the measures taken in 1958 to place the finances of the country on a sound footing—certain fiscal and budgetary measures are indispensable. In this connection care must be taken that absolute or relative cutbacks in expenditure and any measures to increase revenue shall do as little as possible to reduce investment activity or to increase the tendency for prices to rise. Possibly a part of the excess spending should be financed by the capital market—i.e. by floating a long-term loan. Such a method could also have the effect of stabilizing the liquidity situation within the French economy.

### 3. Italy

*Economic expansion continued in the second quarter, though it did not gain further momentum. In comparison with the same periods of the previous year, the rate of growth of exports fell (in values) from 10.8 % in the first quarter to 7.4 % in the second. In July, however, it rose to 22 %. Domestic demand also went ahead, but it would seem that investment moved forward slightly less rapidly than before. On the other hand, the pace at which private consumption had been expanding appears to have been at least maintained, owing to the appreciable expansion of employment and of incomes.*

*By and large, output adapted itself without difficulty to the growth of overall demand. Thanks to good harvests, agricultural production was well above the rather poor results obtained in 1960. The expansion of industrial production continued in the second quarter, though not so rapidly as in the previous quarter. The seasonally adjusted index increased by nearly 1 %, compared with the 3.5 % of the previous quarter, during which industrial production had, however, been stimulated by exceptional factors; the level of production was none the less 7 % in the second quarter and even 8.5 % in July above the corresponding figures for 1960. The expansion of production seems to have been hampered in certain sectors, although this is almost certainly only a temporary difficulty, by limited production capacity and manpower shortages, including shortages of unskilled labour. In comparison with the same periods of the preceding year, imports increased (in value) by 12.4 % in the second quarter, as against 13.1 % in the first.*

*Although wholesale prices eased slightly, the cost of living rose by a full 1 % from March to June, to nearly 3 % above the level of June 1960. This rise was due to higher rents decided upon by the public authorities and to certain increases in the price of food and services. In July, however, the cost of living declined to some extent on account of the seasonal fall in food prices. As a result of a sharp reduction in the deficit on the balance of trade (on a cash basis) and of a considerable increase in earnings from services and capital operations, the balance of payments for the second quarter again showed a surplus, where the first quarter had shown a deficit: the official gold and foreign exchange reserves rose by 172 million dollars in the second quarter and by no less than 124 million dollars in July.*

*Till the end of 1961 and in the first months of 1962 the general trend of the economy will probably still be toward expansion. For 1961 as a whole the increase by volume in the gross product may be estimated at some 6 %.*

*Agricultural exports—thanks to good harvests—should show an upward trend. Exports will be stimulated not only by the generally satisfactory economic prospects in importing countries, but also by the recent improvements made in official export credit guarantees. The fact that even in Italy surplus manpower is now being appre-*

*ciably reduced and that the limits of production capacities in certain sectors have been reached may combine with the new official measures of financial aid for small and medium-sized enterprises to encourage the entrepreneurs' propensity to invest. The execution of large programmes of public works should also give economic activities a considerable boost. Finally, there can be no doubt that private consumption, too, will continue to expand.*

*The likelihood that production will maintain its rapid rate of growth will correspond with the degree of success achieved in expanding investment and making the best use of the still considerable reserves of manpower available—particularly by means of more intensive vocational training.*

## **A. Recent developments**

Economic expansion continued in the second quarter and—as far as can be judged from the incomplete figures available—in the summer months.

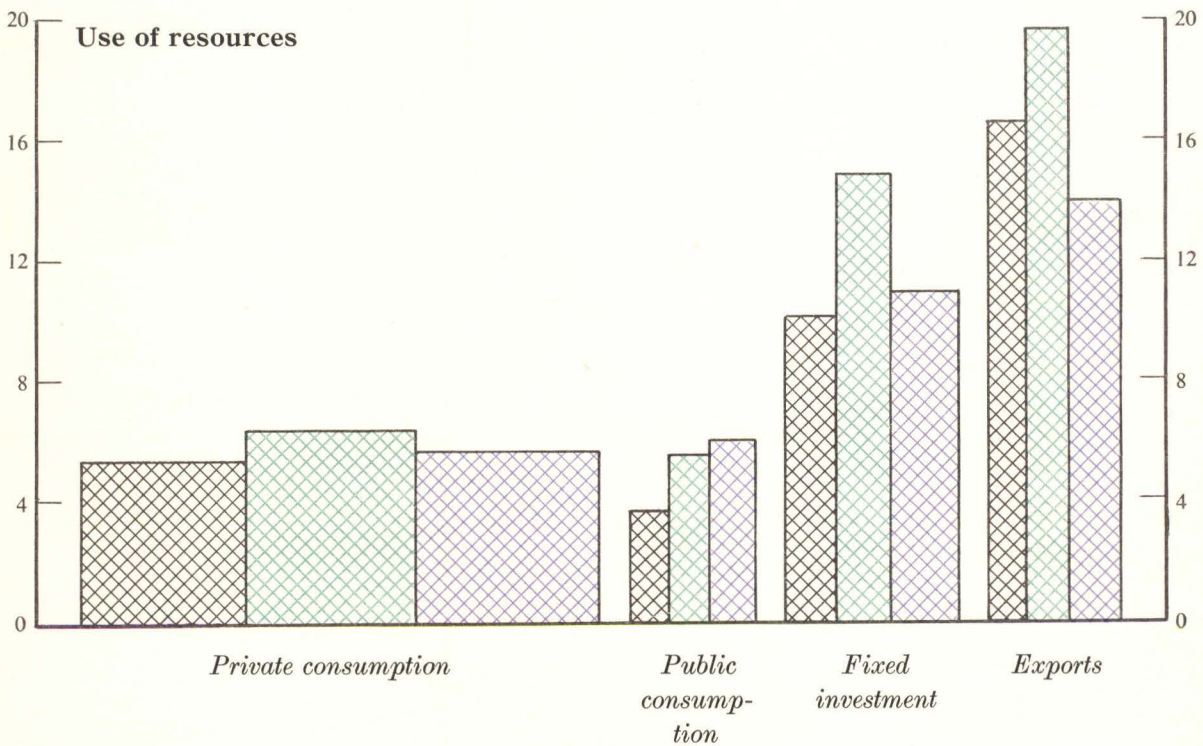
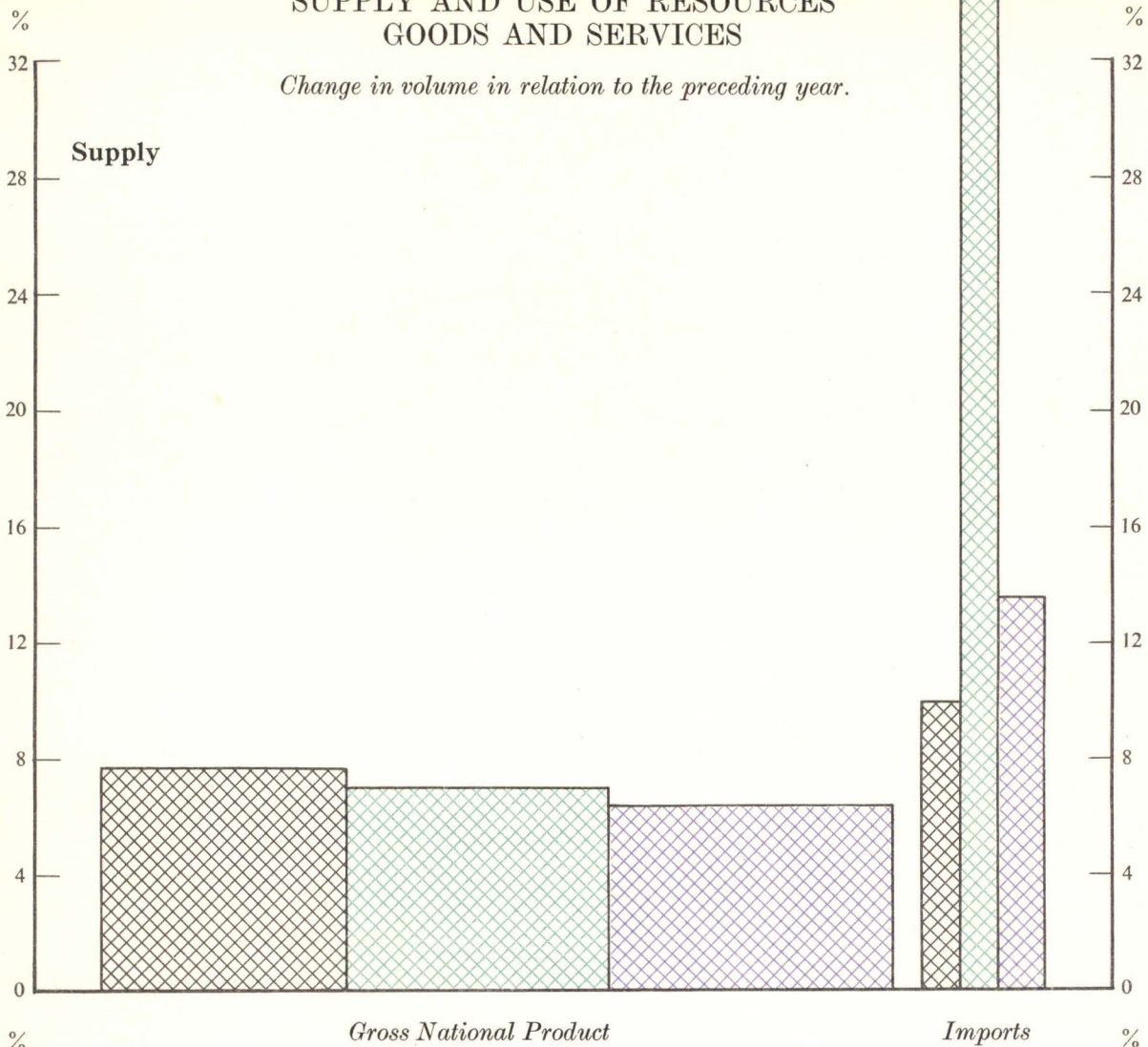
The importance of *demand from abroad* as an expansion factor in the economic activity of Italy may have declined during the second quarter; however, exports in July were very considerably up (in terms of value) on July 1960 : the increase was no less than 22 %. According to data supplied by the Banca d'Italia, the value of exports, after elimination of seasonal variations, rose at an appreciably slacker pace during the second quarter than during the three preceding months. On a year-to-year basis there was also a rather less lively rate of increase in the second quarter (7.4 %) than in the first (10.8 %).

The year-to-year rates of increase were particularly high for exports to Western Europe, especially to the other Member States. On the other hand, in spite of the signs of recovery observed recently, exports to the United States in the second quarter remained below the figures for the same period in 1960; the same holds good of late for exports to Great Britain, which are on the decline. Sales to developing countries outside Europe have progressed only slightly. The highest rates of increase over the previous year were attained in exports of machinery, chemicals, rubber and clothing. Recently, however, exports of motor cars, textile goods and agricultural products have also seemed to be recovering after their setbacks.

The expansion of domestic demand, too, has certainly continued. But it is particularly difficult in this instance to estimate the rates of growth, on account of the impact of certain exceptional factors, especially in *housing* and in *public investment*. Thus the number of dwelling rooms completed in the second quarter was up by only 6.1 % over the same quarter of 1960, whereas the figure for the first quarter had been as much as 18.7 %.

# SUPPLY AND USE OF RESOURCES GOODS AND SERVICES

*Change in volume in relation to the preceding year.*



1959    
  1960    
  1961 *Estimated*

*The width of each column corresponds to the aggregate value for the preceding year.*



Similarly, year-to-year growth in the value of public works fell from 16.3 % in the first quarter to 11.3 % for April and May. However, it must be borne in mind that mild and dry weather in the first quarter of this year made possible an early start on building, whereas in the first quarter of 1960 activity had been held up by the weather.

*Fixed investments* by enterprises, though very high, may well have moved forward rather less rapidly than early in the year. Judging from turnover tax receipt, the internal sales in the second quarter of some important equipment goods such as machinery, apparatus, and electrical appliances should in any case have exceeded by more than 20 % those of the same period of 1960, whereas progress had been at the rate of 30 % in the preceding quarter. For the months of April and May, the last for which statistics are available, the ISCO seasonally adjusted index also points to a slower increase in the output of this category of products. The pace of development in the construction of industrial and commercial buildings has in all probability been much the same as that for expenditure on equipment by enterprises. As before, the accumulation of *stocks* does not seem in the aggregate to have made any noteworthy contribution to the growth of economic activity. However, according to the inquiry carried out in July by ISCO-Mondo Economico, stocks of finished goods in industry increased in the second quarter, whereas they had fallen during the same period of 1960.

*Private consumption* also continued to grow; the rate of increase was probably at least as high as before. Its expansion rests not only on the increase in employment that goes with economic expansion, but even more on the numerous and considerable rises in pay under new collective wage agreements, as well as higher wages resulting from the operation of existing sliding scales as the cost of living moved up. The threat of a shortage of manpower in some areas may well have led employers to agree to increases in actual wages greater than the rates laid down in the agreements. Finally, agricultural incomes this year have, unlike last year, been showing an increase.

A structural trend towards improvement of quality has continued to be a leading feature of private consumption. In the second quarter, for instance, registrations of new motor cars rose by more than 18 % and home sales of high-grade consumer goods (classified as "luxury goods" in Italian statistics) were 9 % by value above those of a year earlier. From the first to the second quarter of this year a notable decline in the rate of growth of new registrations in comparison to the corresponding period of the previous year is, however, apparent. But this decline might be explained by the fact that the weather was better in the first quarter of 1961 than in the first quarter of 1960, and might also be connected with the fact that Easter fell early in 1961.

On the supply side too, a considerable improvement has been observed in the last few months. *Agricultural production* in particular has been developing favourably. The grain harvest was unexpectedly good. In spite of difficult weather conditions during sowing and a further reduction of the areas under cultivation, the wheat crop was 16 % above the (admittedly very low) level of the previous year, although the results were not quite as good as in 1959. The fruit and vegetable crop has also been abundant and livestock products have increased further.



In the services sector, too—in transport, in trade and in tourism—there has been appreciable progress; this has been helped by the continued expansion of industry, which always increases the demand for services and, in particular, of transport.

The rise in *industrial production* has continued. According to the ISCO index (corrected for seasonal variations), economic growth reached almost 1 % in the second quarter : it had still been 3.5 % in the first quarter, but this figure was explained in part by exceptional factors such as the weather and the early Easter. Similarly, the rate of growth in comparison with the same periods of the preceding year fell from more than 10 % in the first quarter to 7 % in the second. It moved up again to 8.5 % in July.

It is still in the production of basic materials and capital goods that the rates of increase were highest. It should be noted that the output of textiles, which had reached a very low level in January, showed a definite recovery afterwards.

It would seem that in certain cases more rapid expansion of production was hampered by physical difficulties : in a few sectors a certain shortage of *production capacity* and *skilled manpower* was noted.

There have even been increasingly frequent reports of shortages of less skilled manpower, though these have been limited to particular areas. At harvest time, for instance agriculture has also had to contend with labour shortages in some areas. In building and construction the local manpower shortages, both skilled and unskilled, have at times been severe enough to limit the growth of activity in this sector.

This development, which does not yet give cause for anxiety, is all the more striking in view of the fact that the number of school leavers has been particularly high this year. Moreover, unemployment has continued to wane : according to ISTAT statistics, the rate of unemployment as a proportion of the paid labour force declined until July, when it reached the figure of 3.5 %.

Under the influence of the general expansion of economic activity, *imports* continued to progress in the second quarter, although their growth does not, to say the least, seem to have gathered any further momentum. The figure for the corresponding period of the previous year was exceeded by 12.4 % (in terms of value), whereas the rate of growth had still been a full 13 % in the first quarter. Since at the same time average import values, particularly in the second quarter, declined in comparison with the previous year, the rate of growth of imports, by volume, rose from one year to the next from 13.6 % to more than 16 % for the months of April and May. On account of the poor harvests in 1960 and the high level of investment, the highest rates of increase were in imports of agricultural products and equipment goods, and therefore in purchases from North America and the other Member States.

These developments in supply and demand caused some *prices* to move up and others down. Wholesale prices again weakened slightly, mainly on account of rather lower prices; wholesale prices for consumer goods and the prices of raw and basic materials fell a little; for equipment goods they edged up again. The cost of living hardened by

1.1 % from March to June, when it reached a figure 2.8 % above the level of June 1960. This development is due mainly to a fresh rise in rents, decided on by the public authorities. It is also explained by the higher prices for certain other services resulting from wage increases granted since the beginning of the year, and by higher food prices. However the cost of living eased slightly in July on account of the seasonal fall in food prices. It was then 2.4 % above the July 1960 figures.

In contrast with the results for the two previous quarters, the balance of current payments once again showed a surplus (of 56 million dollars) in the second quarter. This improvement is connected with a sharp contraction of the deficit on trade (on a cash basis). It is also explained by the unusually heavy surplus on services resulting, in particular, from earnings on tourism, which had been favoured by good weather. Since, moreover, the net inflow of capital had been very large, *official gold and foreign exchange reserves* increased by \$ 172 million in the second quarter, whereas they had diminished by \$ 148 million in the preceding six months. However, though the bank's foreign exchange reserves have dropped by \$ 15 million, total reserves increased by \$ 157 million, half as much again as was recorded in the corresponding period of the previous year. In July, soaring official gold and foreign exchange reserves added \$ 124 million to the total.

The tendency for the bank's liquid resources to grow as a result of balance of payments developments in the second quarter was more than offset by the great extension of credit together with the public authorities' large cash surpluses, which totalled 220 000 million lire. In fact bank liquidities contracted during this period and yields on stocks and shares improved slightly. In July, however, government cash transactions once more showed a heavy deficit. In view of the inflow of foreign exchange mentioned above, this deficit should have led to an increase in bank liquidity, although a large loan was floated by the Government.

## B. Outlook

There is every reason to believe that the general trend of the economy will still be upwards during the last months of 1961. The ISCO-Mondo Economico inquiry carried out in July reveals that in any event heads of enterprises are noticeably more optimistic about exports than they were at the same time last year, that is to say before the halt in the expansion of exports which lasted for several months. A number of important growth factors justify such optimism, particularly the current economic recovery in the United States, French tariff cuts made in the light of the current economic situation (France is Italy's leading trade partner after the Federal Republic of Germany and the United States), and lastly the recent improvement in official export credit guarantees. Moreover, good crops will probably make it possible for more agricultural produce to be exported again.

These expectations should support managerial *propensity to invest*. The fairly high degree of use made of capacity and, as we have seen, the very prospect of further measures being taken to make a reality of the Common Market, are likely to have the

same effect. Again the recent extension and improvement of the law on State financial aid to smaller and medium concerns will encourage the latter to invest. Housing, at least, subsidized residential construction should also make progress. For the development of direct fixed State investment, much will depend on the speed with which long-term public investment programmes are put into effect.

*Private consumption* will almost certainly be strongly stimulated not only by the wage increases already mentioned, but also by the very appreciable increase in minimum legal wages provided for in the new collective agreement on wage areas.

Supply deriving from home *production* and *imports* will no doubt continue to adapt easily until the end of the year to the expansion of demand. It is, however, probable that the slightly rising price trend will persist, mainly affected by factors which, as indicated above, are making services dearer. However, it may be expected that bumper crops will to some extent curb this trend by reducing the prices of food. A surplus on the balance of current transactions and the probable continuation of the inflow of foreign capital are likely to increase the gold and foreign exchange reserves still further by the end of the year.

The *overall results for 1961* also seem likely to be very satisfactory. It is true that the expansion of industrial production has lost considerable momentum in comparison with 1960, and may reach only 8 to 9 %, as against 15.5 %; the effect of this slowing down on general economic expansion will nevertheless be offset by the harvests which, unlike those of 1960, are expected to be good. But since the loss of momentum in industrial growth will be accompanied by a slight weakening of expansion in the services sector, the growth of the *gross national product* might well, in real terms, be rather less than the 6.9 % reached last year. It is more likely to be about 6 %.

It is not yet possible to predict with a sufficient degree of certainty whether the rate of growth between now and the end of the year and in the *first months of 1962* will be as high as would still seem desirable both from the point of view of growth and from that of the balance of payments. In any case, there are many signs that the Italian economy will continue to expand in 1962. The prospects for exports, in particular, appear favourable for a number of reasons : the economic upswing in the United States and its probable direct and indirect repercussions on foreign demand, the quota and tariff measures to be taken to further the establishment of the Common Market, and the generally satisfactory economic outlook in Europe. It is almost certain that private consumption will also be a factor contributing to expansion.

In the field of public investment, the long-term programmes which have been voted should lead to a growth in expenditure; however, the questions of correct timing and of co-ordination cannot yet be considered as finally solved. One should therefore welcome the recent establishment of a special ministerial committee, one of whose tasks is to ensure, through action in the field of investment by the public authorities, that home demand expands at the necessary rate. In view of these different factors, there is no reason to fear any appreciable loss of momentum in the growth of private investment for 1962.

In the case of Italy, a rapid growth in demand is in no danger of causing a general inflationary imbalance between overall demand and overall supply, particularly if there is again a bigger increase in imports. This would still hold good even if production were to lose some of the elasticity it has shown so far. Moreover, the elasticity of industrial production should not be underrated : capacity is being constantly expanded by current investments, which are considerable; and there can be no question yet of any grave and general manpower shortage, all the more since there are still very many workers, particularly among the unemployed, who can be trained for skilled jobs.

It might be well in this respect to recommend the adoption of further special measures giving vigorous encouragement to the geographic mobility of the factors of production, that is to say channelling manpower towards centres where it is lacking and capital towards areas where labour is plentiful. Vocational training should be intensified as far as possible.

In view of the continued rise in the cost of living, there is reason to welcome the Government's decision to scale down electricity rates from 1 September 1961, after having put into force a few weeks earlier a further price reduction for a series of pharmaceutical products. It might well be that considerations of price policy were also partly responsible for the recent measures by which imports from the dollar area have been almost entirely liberalized. The rising price trend may, however, persist. In the interests, then, of monetary stability at home, it might be well to contemplate, in addition to the rationalization of distribution channels, anticipatory cuts in customs duties, such as are allowed for by the Treaty. Since Italian customs duties are relatively high in comparison with the future common external tariff, and since gold and foreign exchange reserves are large and constantly growing, the Italian authorities have in any case considerable room to manoeuvre in this field.

## 4. Netherlands

*Boom conditions persisted in the Netherlands, though the expansion of demand may have slowed down somewhat. Production rose very little, mainly as a result of physical limitations.*

*In the second quarter the value of exports was only slightly higher than in the corresponding period of the previous year, whereas in the first three months the increase over the first three months of 1960 had still been 8 %. Investment demand, on the other hand, seems to have risen further, the extreme shortage of manpower providing a constant stimulus for the propensity to invest. While there was hardly any slackening in the growth of actual expenditure on investment, the increase in private consumers' expenditure was, however, somewhat slower than in the first quarter.*

*As can be seen from the seasonally adjusted index of the Central Statistical Office (CBS), industrial production hardly increased. This is mainly due not to the development of demand, but to the extreme shortage of manpower, which has been further aggravated in recent months by reductions in working hours.*

*Consequently imports continued to rise, though not as rapidly as in the preceding months. The import figure was 9 % in value and 12 % by volume higher than in the corresponding period of the previous year.*

*On the whole prices remained stable, one reason being that—largely because of the revaluation of the guilder—import prices fell slightly. The trade balance showed a deficit that was 350 million guilders higher than a year earlier. However, the deterioration which occurred in the balance of current transactions during the same period was not half as large.*

*The overall deficit in the balance of payments for the second quarter amounted to nearly 420 million guilders. Whereas the foreign exchange reserves of the banks other than the Central Bank declined sharply, the gold and foreign exchange reserves of the "Nederlandsche Bank" increased by 178 million guilders. In July they rose by a further 180 million and were considerably above the level of 6 thousand million reached before revaluation.*

*The Netherlands economy can be expected to show further expansion in the closing months of 1961 and the first half of 1962. Demand from private consumers is likely to grow more rapidly again, especially as considerable wage increases are to be expected. Orders from abroad will receive an even stronger stimulus from the improvement in the economic situation throughout the world. The shortage of manpower will probably persist and provide a spur for further rationalization investments.*

*Expansion of demand can be expected to remain quite considerable, though the Government has taken damping measures in connection with direct control over*

*building demand, in the field of policy on liquidity and hire-purchase credits, and in the public investments sector. In these circumstances anything that can be done to increase supplies—especially the supply of manpower—continues to be of great importance. A speedier adjustment of the wages of women to those of men, and supplementary fiscal measures are amongst the steps which could bring success in this field.*

## A. Recent developments

*Exports*, which had already ceased to show any expansive trend at the end of the first quarter, failed to rise in the months which followed. From February onwards there must even have been a slight drop. From April to July the value of exports (according to trade statistics expressed in guilders) just managed to reach the level of the corresponding period in the previous year, whereas in the first quarter a year-to-year expansion rate of 8 % had still been recorded. The slackening in Netherlands exports can certainly be put down to physical limitations, i.e. to difficulties with deliveries. In certain sectors, however the trend of demand may also have had a braking effect. This applies to the export of such items as agricultural products, for which demand from abroad was weaker than in the corresponding period of 1960. Lastly, the revaluation of the guilder in March seems to have affected the value of exports, especially as exporters have obviously cut their quotations in order to cushion part of the price increases resulting from revaluation. In the second quarter the volume of exports was actually a little (almost 3 %) above the level of the corresponding period in the previous year.

Exports to the Community countries continued to show a considerable rate of expansion, especially those to the Belgo-Luxembourg Economic Union. Exports to non-member countries, on the other hand, made a very poor showing; deliveries to the countries of the European Free Trade Area dropped 5 % below the level of the corresponding period in the previous year and those to the United States remained markedly below the figures for the corresponding months of 1960, but they do not seem to have fallen any further recently.

Investment remained very lively though the expansion of actual expenditure may, after adjustment for seasonal and random variations, have been a little slower than in the preceding months. In particular, investment in *fixed assets* by industry showed a marked expansion; their rate of growth (in terms of volume) was 20 % in the first quarter, as compared with 10 % in the corresponding period of the previous year. There is every indication that the second quarter was again marked by a considerable rate of expansion. Evidently the propensity to invest is being steadily maintained by the extreme shortage of manpower, recently rendered even more acute by reductions in working hours. Investment in the building industry probably made a major contribution to the expansion of overall investments.

The *building* industry continued to suffer very severe stresses and strains. In the housing sector 74 % more building permits were issued in the second quarter of 1961 than in the corresponding period of the previous year. At the same time the number of starts rose much more rapidly than that of completions, with the result that the number of dwellings under construction was 17 % higher at the end of June than it had been at the end of the second quarter of 1960.

In *public investment* too development continued to be lively, despite some results obtained by Government efforts to limit expansion as far as possible in order not to aggravate the strain produced by the boom in private investment. After public investment in the first quarter had exceeded the previous year's level by 10 %, new authorizations for public works issued in the second quarter were notably fewer (figures for public investment in the second quarter are not yet available).

The pace at which *private consumption* increased in the second quarter fell off somewhat, the number of employed increasing but slightly and wage and salary incomes rising only slowly. The incomes of those in paid employment rose, it is true, as a result of non-tariff wage increases and the reductions in working hours obtained in collective agreements, these reductions having meant more paid overtime; but an increase in the rate of savings by private households probably played a role in slowing down the expansion of consumption. Nevertheless, private consumers' demand was still brisk and may have regained some momentum in July. For the first half of the year the increase was 6 %, in terms of volume, over the corresponding period of the previous year.

Internal supply has hardly expanded, largely because of the shortage of labour and certain effects of over-employment.

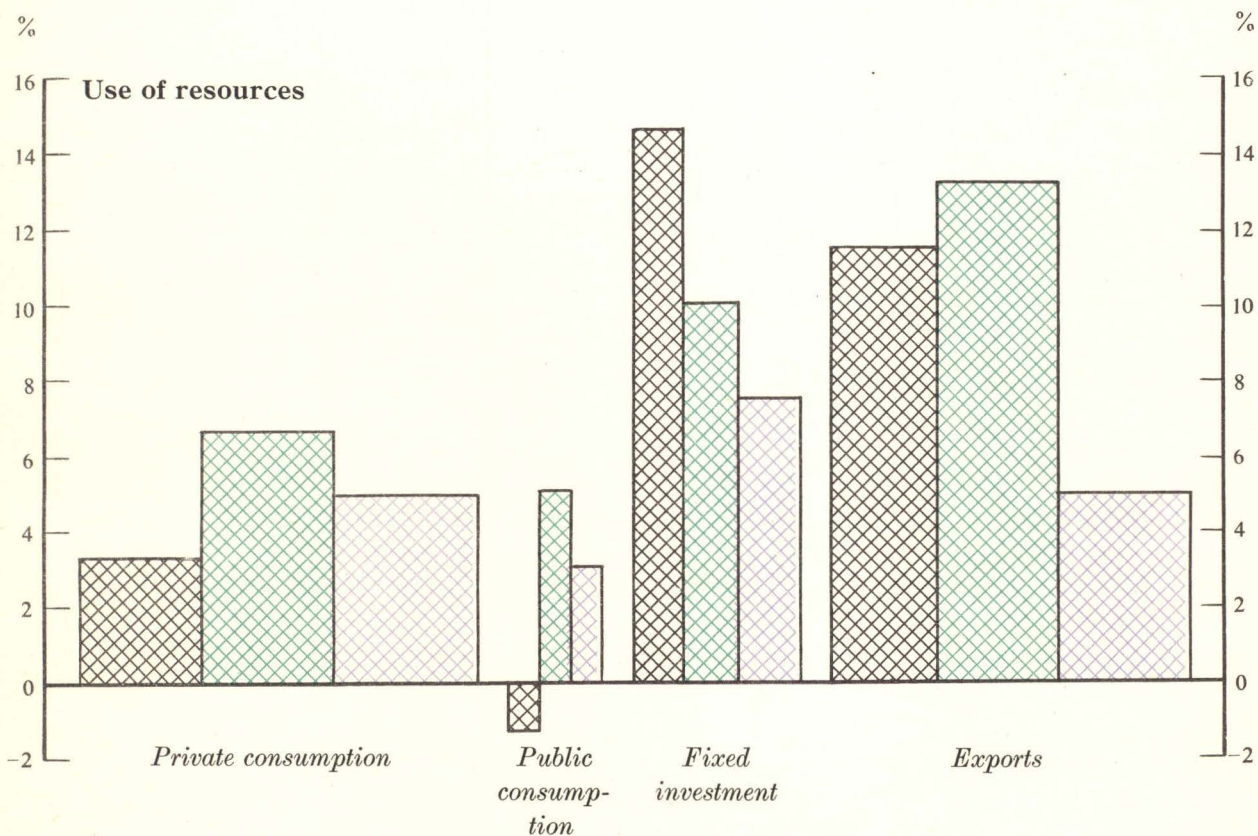
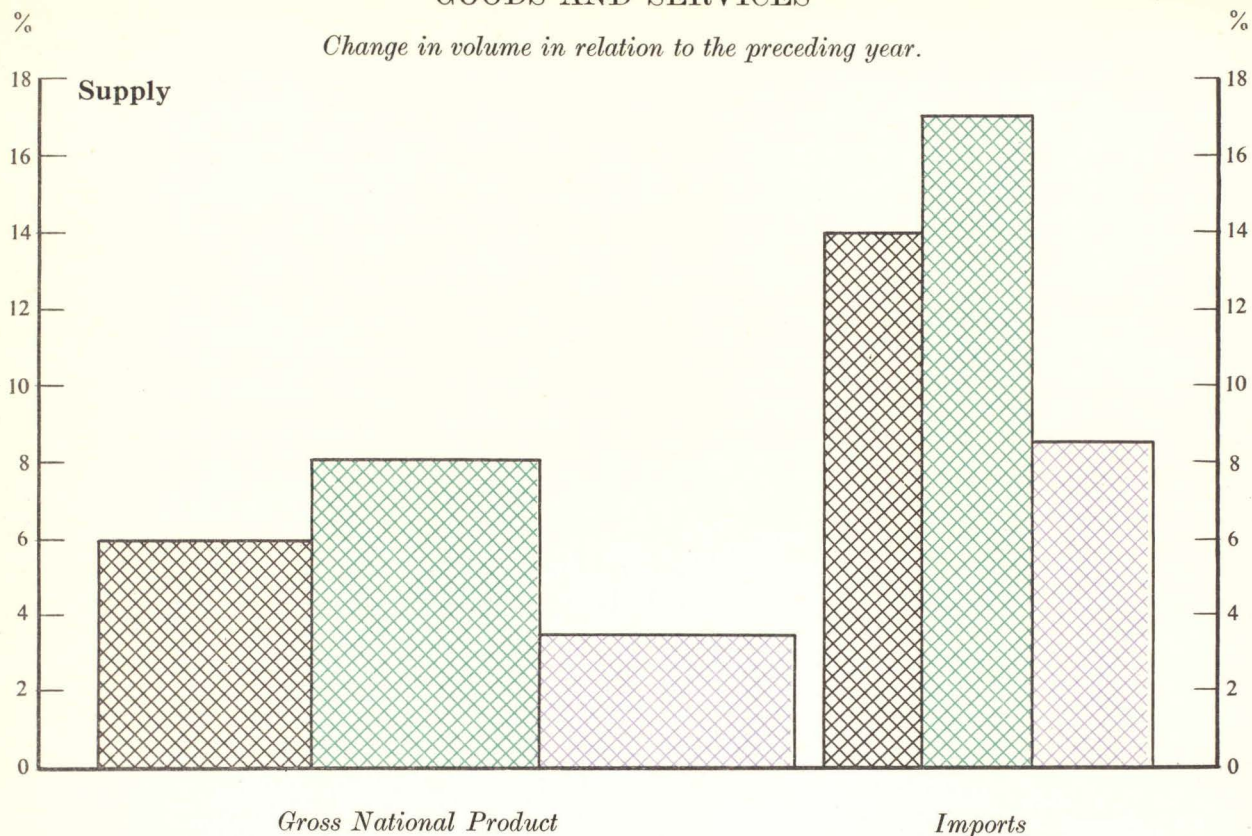
Indeed, the situation on the labour market became even more strained. In June the number of unemployed was 24 000, which is less than 0.75 % of the paid labour force. Though in July there was a very slight seasonal increase in the number of unemployed, they nevertheless remained below 1 % of the paid labour force. At the end of July there were five vacancies notified for every person unemployed—of whom moreover more than one third can hardly be absorbed in the labour process on account of age or limited working capacity.

Apart from the limit of capacity having been reached in several branches, the shortage of manpower—frequently aggravated by cuts in working hours—was probably the main reason why, in the second quarter, the adjusted figures for *industrial production* again made little further progress. For the first time in three years production was only very slightly (1.4 %) above the level of the corresponding period in the previous year. As the number of persons employed in industry has probably increased a little, productivity per employee in industry will have grown either not at all or only insignificantly this year, despite the effects of rationalization investments. The growth of production has slowed down in the textile and metal industries, whereas in most other sectors the investments already made have meant that a considerable rate of growth in production has still been possible.



# SUPPLY AND USE OF RESOURCES GOODS AND SERVICES

*Change in volume in relation to the preceding year.*



1959     
  1960     
  1961 *Estimated*

*The width of each column corresponds to the aggregate value for the preceding year.*





*Agricultural production* showed varying results. The grain and potato crops seem to have been smaller in volume than in July 1960. Vegetable and fruit growing may have reached the level of the previous year, both as to quantity and quality. The output of milk and dairy produce has risen.

Owing to the stagnation of industrial output, high rates of expansion were again registered for *imports*. According to the customs statistics their value was approximately 9 % higher in the second quarter than it had been in the second quarter of 1960. Import prices having dropped, in part as a result of the revaluation of the guilder, the annual rate of expansion in terms of volume is as high as 12 %.

Nevertheless, the expansion of imports seems also to be slowing down, especially if the figures are extended to include the month of July, during which imports showed an exceptionally sharp drop. This is probably in large measure due to seasonal influences, which were particularly strong during this period; it must also be remembered that in the first quarter imports were particularly high as a result of a number of special factors; and yet the impression persists that a certain tendency towards stabilization has set in.

Prices have on the whole remained stable—no doubt largely as a result of the Government's price policy. The fall in import prices has also helped to ensure price stability. Nevertheless, food prices have crept up a little recently and the cost-of-living index was 1.6 % higher this July than last.

The *balance of trade* continued to show a large deficit, but the tendency towards further deterioration may have weakened very considerably—especially if the July results are again taken into consideration. According to trade statistics, the deficit in the second quarter amounted to 892 million guilders, compared with 809 million in the first quarter of 1961 and 545 million in the second quarter of 1960. In July, however, the deficit in the trade balance at 218 million guilders was even lower than in the corresponding month of 1960 or 1959. For the second quarter the balance of current transactions (on a cash basis) shows a slight deficit (70 million guilders), which contrasts with a comparable surplus for the same period in 1960. There is still, however, a small surplus on the overall balance of payments figures for the first half of 1961.

For the *balance of payments* it is further of importance that in the period under review there has been a very considerable influx of short-term capital—partly as a result of the repatriation of liquid external assets by the banks and partly because of the inflow of speculative foreign capital occasioned by the weakness of sterling. As against this there was a notable outflow of both private and public long-term capital after the public authorities had opened the capital market from May to July for foreign loans up to 365 million guilders. All these loans (mainly issues by the High Authority of the ECSC, the Belgian State, the World Bank and the European Investment Bank) were subscribed without difficulty. Since the Government continued its policy of advance repayment of its foreign debts (more than 140 million guilders to the USA in the second quarter), long-term capital exports more than made up for the inflow of short-term money capital.

The total deficit in the balance of payments for the second quarter amounted to nearly 420 million guilders. Whereas the foreign exchange reserves of the banks other than the Central Bank declined sharply, the gold and foreign exchange reserves of the "Nederlandsche Bank" increased by 178 million guilders. In July they rose by a further 180 million and were considerably above the level of 6 000 million reached before revaluation.

There was no evidence of strain on the *money and capital markets*. The rates of interest for government securities and call money have remained unchanged and a very limited turnover remained the characteristic feature of the money market. Private demand for credit continued at a very high level; during recent months it may however have fallen off a little, partly for seasonal reasons.

If the issues of foreign bonds are left out of account, the capital market showed a very modest turnover in the second quarter. At the beginning of August the Government issued a 25-year loan of 300 million guilders. This operation, which was primarily intended to limit the liquidity of the banks and the private sector showed clearly the extent of monetary liquidity attained by the Dutch economy. A total of 11 000 million guilders was subscribed for this loan, so that only 2.7 % of the amounts subscribed could be allocated. Despite this the "Nederlandsche Bank" has decided to lower the minimum reserves from 10 % to 8 % from the end of August to the end of September in order to avoid any strain caused by the transfers in connection with this loan.

## B. Outlook

There is no indication of any major lessening before the end of 1961 in the pressures which are a feature of the economic situation.

Orders from abroad can be expected to maintain their high level or even to rise further—especially if the improvement in the world economic situation should have a more marked impact. In view, however, of the high level of demand at home and of the physical obstacles impeding the expansion of production in important sectors of industry, it is uncertain whether a new and rapid growth of *exports* will be possible.

The increase in domestic demand is likely to continue, though *investments in fixed assets* may slow down somewhat. This will be due in part to the damping measures taken to reduce strain in the public investments sector—and in the whole of the building industry. In July strict controls were introduced for non-subsidized housing too, and since then the number of building permits issued in this sector has fallen sharply. Nevertheless the level of overall investment is likely to remain very high, *especially* because purchases of equipment by enterprises will continue to be on a large scale.

*Private consumers' demand* will probably increase again; the volume of wages will rise, largely because a number of important collective agreements are to be renewed at the end of the year, and this will doubtless entail new and considerable wage increases.

That *industrial production* will still fail to expand is hardly likely. Some degree of progress can be expected in the autumn because the increase in productivity due to recent investments should by then become more noticeable. Nevertheless it is unlikely that there will be a marked recovery in the pace at which production is expanding.

In view of this situation, *imports* are likely to go on rising, though relatively slowly because the hesitant trend in industrial production unsettles the expansion of current requirements for imported raw materials and semi-finished goods, and also because there is some indication of firms taking a more cautious attitude in regard to their stocks.

The strains that are apparent in the labour market in particular may make it difficult to keep prices stable in the months to come.

On the basis of what has occurred so far and what is still expected to happen, there is no need to alter essentially the forecasts made for 1961 as a whole. However, the rate of expansion in industrial production will hardly exceed 4 % and the total gross national product is likely to rise by barely 3.5 %. In terms of national accounting the surplus on current account will be considerably smaller than in 1960.

The economic situation in the Netherlands *during the early months of 1962* will probably be marked by a continuing expansion of demand. This applies equally to home demand and to demand from abroad. At home, however, a certain loss of momentum in the investment boom is possible, and this will increase as the moves to restrict public investment and the measures to reduce strain in the housing sector become more effective and the expansion of equipment investment in the private sector comes under control. The Bank of Issue has an agreement with the other banks which enables it to set a quantitative limit on credit expansion; it has already on the strength of this instrument called on the banks not to extend their credit offer by more than fifteen per cent above a reference figure based on 1960. In the consumer goods sector, too, measures were taken at the beginning of August to prevent excessive hire-purchase expenditure (e.g. considerable increases of minimum deposits). All these steps will probably become fully effective next year.

None the less existing liquidity, together with the expected wage increases and the resultant increase of consumption next year, will probably bring about a further notable expansion of domestic demand. Therefore the draft 1962 Budget which has just been submitted provides that the proposed reductions in taxation on income and wages shall not take effect until July 1962, so as not to aggravate existing strains. The reductions will amount to some 525 million guilders in a full year. The marked rise in military expenditure proposed for 1962 (130 million guilders) will be in part balanced by increasing taxes on certain mineral oil products and postponing till 1963 the intended reduction in company profits tax. On the whole, the budget shows only a very small deficit, and the Government does not intend to call on the capital market.

It is not certain whether even this financial policy will enable production to catch up with the expansion of demand, especially since the shortage of manpower is likely to persist despite the expected increase in the number of school leavers. Imports therefore

will probably again rise appreciably. But prices, too, will show some increase, especially since the cost of wages per unit of production is likely to rise a little further.

The Netherlands' balance-of-payments position and reserves are still very strong; nevertheless it seems advisable—and this will be in the interest of more long-term expansion too—that all opportunities to increase domestic supply should be exploited to the full. Manpower is the most important bottleneck in this context. Perhaps arrangements to take immigrant workers could be pressed forward more vigorously. In addition, measures might be considered to increase the ratio of labour force to total indigenous population in the Netherlands. Since the proportion of gainfully employed women is definitely lower than in most neighbouring countries, there may well be a reserve of manpower here which, if tapped, could ease the strain on the labour market. This is one more reason why consideration should be given to the speedier approximation of women's wages to those of men. It would certainly stimulate the supply of female labour if at the same time the obstacles at present preventing women from working were removed; they are to be found largely in the taxation of married couples where both man and wife are in employment. The 1962 Finance Bill which has just been submitted already provides that from January 1962 taxes paid by married women will be lower by some 60 million guilders.

This policy could be supplemented by introducing into the wages system greater incentives to productivity, for instance by introducing or increasing bonuses. In the prevailing conditions of overemployment the incentives provided by the current wages system seem insufficient to counteract the adverse effect on productivity which results from slackness in labour morale and the employment of marginal manpower.

## 5. B.L.E.U.

### Belgium

*The moderate expansion which has again become apparent in the Belgian economy since the end of the winter has continued to gather momentum in recent months. The value of exports in the second quarter increased by 5 % over the corresponding figure in the previous year. Domestic demand also seems to have risen further, with private investment and housing in particular considerably above their 1960 levels. Private consumption, however, does not seem to have made any very appreciable progress.*

*Supply expanded in line with demand. A large part of the additional demand, however, was for imported goods, which continued to register comparatively high rates of growth. Moreover, as a further part of this additional demand was for building and contracting and for various services, the growth of industrial production remained only moderate. According to the trend recorded by the IRES index, the average level for the past few months was not more than 4.5 % above that of the corresponding period a year earlier.*

*Prices continued in the main to be stable, with the exception of increases for certain food products and services which caused retail prices in the second quarter to be about 1 % higher than those of April-June 1960.*

*Although the balance of trade showed an improvement on that of the first quarter, when it had suffered a severe setback as a result of the strike, the situation is still appreciably less satisfactory than in the corresponding period of last year. Thanks to the improvement in the balance of capital transactions, however, the fall in gold and foreign exchange reserves was only slight.*

*The rest of the year is unlikely to bring any major change in the trend of economic activity. However, certain tendencies towards a slackening in the growth of exports are making themselves apparent. Moreover, the figures recorded for the first half of the year, which were not, on the whole, encouraging, and especially the fact that during this period exports and industrial production showed no advance on the first half of the previous year, mean that the national product for the full year can hardly rise more than about 2 %.*

*In 1962 the pace at which expansion continues will largely depend on the development in effective demand from abroad and on whether the growth in investments is not only kept sufficiently brisk but dovetails with structural requirements in such a way that the competitive position of the Belgian economy as a whole registers a marked improvement. Taking into consideration the fresh buoyancy of the world economic situation, the rather encouraging outlook for the other members of the Community and the scale of current investments, conditions do not in fact seem unfavourable for a further expansion of the Belgian economy.*

## A. Recent developments

Exports have, in the last few months, been expanding gently. After the setback suffered as a result of the January strikes, exports picked up towards the end of the first quarter, and this upward movement continued in the following months. Although in the first quarter the value of exports was 4.7 % below their value in the corresponding period of 1960, the year-to-year rate of growth rose to 5.7 % in the second quarter. Taken as a whole, however, the first six months of 1961 showed no advance on the previous year. Even in July exports were only a little up—some 4.5 %—on the previous July.

Not all Community countries were concerned in the recent expansion of Belgian exports. The increase recorded during this period was due entirely to the considerable rise in demand from the Netherlands and—to a lesser extent—from France. On the other hand, exports to the Federal Republic of Germany have been on the decline ever since March. So far as the trend in sales to non-member countries is concerned, a slight recovery in trade with the United States and several OEEC countries did not suffice to offset a decline in exports to other non-member countries, a decline which cannot be wholly ascribed to the contraction of the Congo market.

The upward movement in *fixed investment* seems to have gathered considerable momentum over the past months, especially in investment by enterprises: not only were new undertakings set up, but in existing plant, too, rationalization programmes were carried through. The setting up of subsidiaries by foreign firms continued, bringing with it an influx of foreign capital. Symptomatic of this vigorous investment activity is the exceptionally high level of activity in commercial and industrial building—the total number of starts in the second quarter was 13.6 % higher than a year earlier; further signs are the sharp rise in imports of equipment goods since the end of last autumn and, finally, the increase of domestic sales in the investment goods sectors of the metal processing industry. The steep increase in the number of buildings started in 1960 was reflected by an annual growth rate of 50 % in buildings completed during the second quarter of 1961.

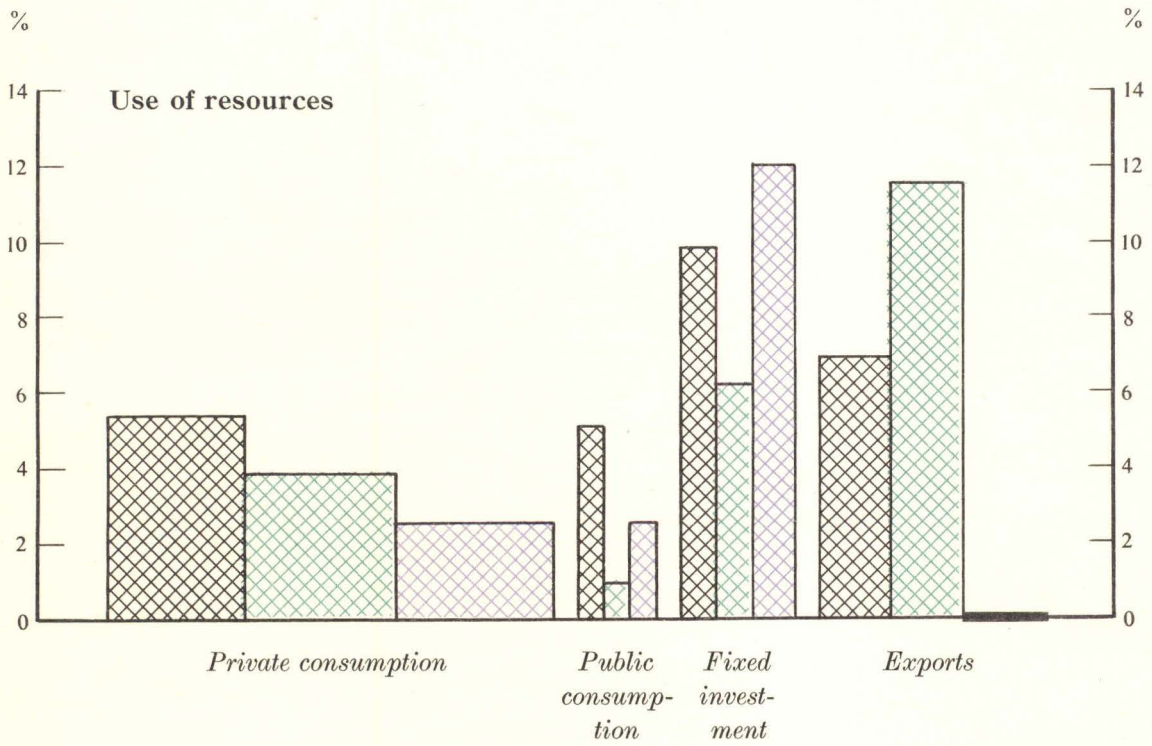
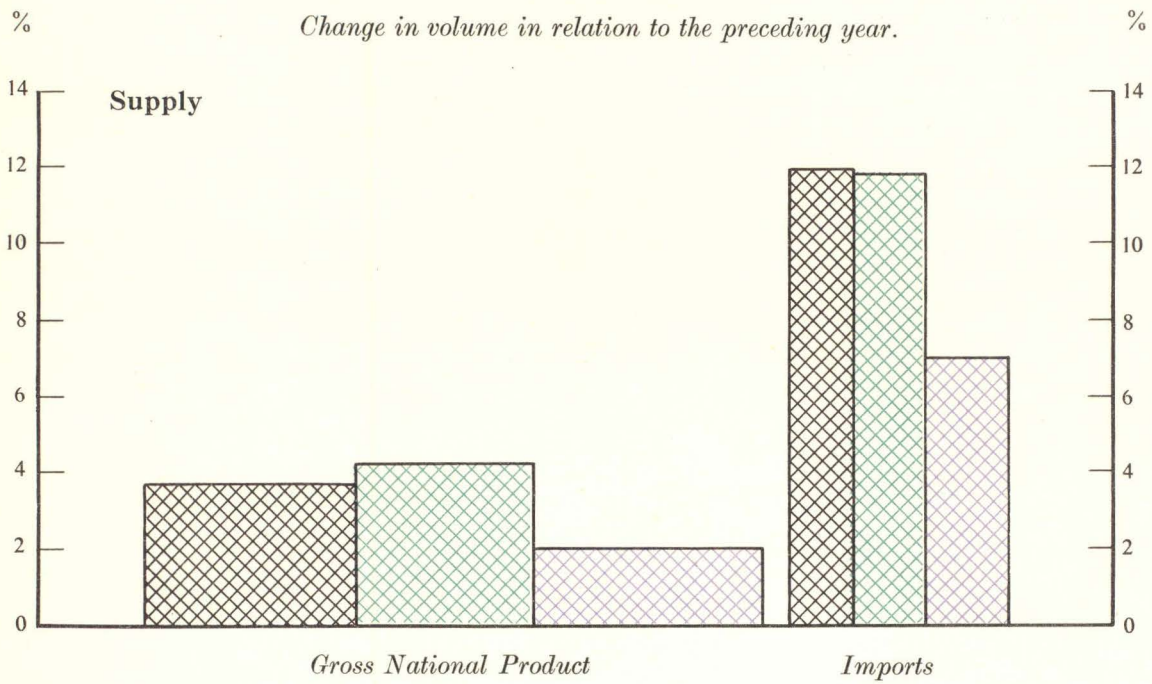
In the second quarter vigorous expansion also took place in the *housing sector*. The number of starts and completions exceeded the figures for the same period of the previous year by 7.8 % and 11 % respectively.

The development in *public investment* which had developed in the preceding months was maintained in the second quarter. The total of payment orders once more remained below the figure for the corresponding period of 1960, while new orders placed were again at a distinctly higher level.

In contrast, however, to the elements of demand examined above, it seems that *private consumption*, after being slightly more lively in February and March, advanced only very slowly in the following months. The turnover of large retail stores showed scarcely any increase (1.9 %) over the level for the corresponding period of the previous year, and this included the structural expansion always registered by large stores, even when retail sales as a whole are in the doldrums. Moreover, the level of retail prices

## SUPPLY AND USE OF RESOURCES GOODS AND SERVICES

*Change in volume in relation to the preceding year.*



*The width of each column corresponds to the aggregate value for the preceding year.*





—with the exception of foodstuffs—has remained more or less unchanged, despite a 20 % increase in turnover tax which came into force on 1 May. The fact that retailers have made hardly any increase in prices to pass on this increase in costs does not indicate a very vigorous expansion of consumer expenditure.

In certain commercial sectors the drop in sales was particularly noticeable. In the motor industry especially (with exception of goods vehicles) sales of new cars, after making a striking advance in the first quarter, actually fell in the second quarter to a figure 2 % below that for the corresponding period in 1960. The growth rate for the first six months of this year compared with the first half of 1960 was only 10 %, whereas the first six months of 1960 showed a growth rate of 29 % over the first half of 1959. It should be borne in mind, however, that the high turnover registered toward the end of the first quarter of 1961 may largely be attributed to buyers' efforts to anticipate the increase in turnover tax. It remains to be seen whether the summer sales figures have suffered as a result. Indeed, the trend in incomes gives little ground for expecting any appreciable expansion in private consumption. Wages and salaries have by and large remained stable while the improvement in employment was not very great.

However, the number of unemployed continued to decline; in the second quarter the average monthly figure of 111 000 persons out of employment was 38 000 or 25 % below that of the corresponding period of 1960. The relatively slight increase of industrial output and the likelihood that this was in part due to an increase in productivity make it rather difficult to find an explanation for the fall in unemployment. The improved situation could be partly attributed to workers, particularly foreign workers, leaving the country also to some tightening of the regulations on unemployment. Demand on the labour market may have risen as a result of the ageing of the population; the increase in the number of persons in employment will also stem from the stepping up of economic activity in some economic sectors, e.g. in construction, some service sectors and mechanical engineering.

Although there are reports of local shortages of skilled labour, the expansion of supply from domestic sources does not seem to have suffered particularly from physical difficulties; nor can it be said, generally speaking, that the limits of productive capacity have yet been reached. The expansion of *industrial production*, at any rate as shown in the IRES index, was not vigorous enough for this. In the last few months the level of this index has been about 4.5 % above that recorded in the corresponding period of 1960. In all probability this expansion of production corresponds in the main to the increase in demand, in so far as this was not met from imports.

Some sectors of production, however, were influenced by lively external demand or the upward surge of internal investment, and they consequently showed a faster rate of expansion. This applies in particular to mechanical engineering, chemicals and parts of the textile industry. On the other hand the steep rise in the output of the iron and steel industry for the period from February to April seems to have come to a halt. The high level of employment in the building materials sector again reflects the brisk state of activity in the building industry.

Preliminary estimates of *agricultural production* indicate a situation that is on the whole favourable, although rates of expansion similar to those recorded in 1960 cannot be expected.

*Imports* have continued to make progress; on the basis of value the year-to-year rate of growth, which had been 7 % in the first quarter, rose in the second quarter to 9 %.

Although imports of various consumer goods fell off or remained at their previous level, imports of machinery and other equipment goods moved forward rapidly, followed by those of basic chemicals, of textiles and non-ferrous metals.

The *price level* remained stable. In the wholesale trade there was, it is true, a slight rise in the prices paid for imported raw materials, but this was more than offset by a fall in the price of certain semi-finished and other industrial products. Retail prices showed little change, and in the second quarter were only about 1 % higher than in the corresponding period of the previous year—an increase due mainly to the rise in the price of certain agricultural products.

There has been an appreciable reduction in the deficit on the *balance of trade* since the first quarter when, largely as a result of the effects on exports produced by the January strikes, it had reached a very high figure. The deficit, nevertheless, continued to be of quite considerable proportions in the second quarter, when it totalled 1 500 million Belgian francs, in contrast to the small surplus still being recorded in the corresponding period of the previous year. The year-to-year growth rates for imports, which are higher than those for exports, clearly reflect the improvement in the domestic situation. By comparison with the same period in 1960 the balance of current transactions may have deteriorated appreciably more than the balance of trade as a whole, owing in the main to the slackening in the export of services in general and of transport in particular.

Over the last few months the *net gold and foreign exchange reserves* of the Central Bank fell only slightly (from 57 900 million Bfrs. at the end of March to 55 000 million Bfrs. at the end of July). This is mainly the result of the improvement of the balance of capital transactions which follows from the reduction of short-term State indebtedness abroad by consolidating the public debt (issue of long-term loans on foreign capital markets at a low rate of interest), and from the consequent hardening of the Belgian franc on international money markets. For a while there may also have been capital influxes as a result of speculation against sterling.

In these circumstances a very high level of liquidity prevailed on the *money and capital markets*, without however causing any reduction in the relatively high rates of interest.

The demand for credit in the economy was therefore easily met without additional calls on the Central Bank, while there was only very limited activity in rediscount credits. On the other hand, government finances remained strained, although by no means as severely as in the first quarter, thanks largely to the tax increases. Up till the end of July the total cash deficit, reckoned from the beginning of the year, was still growing,

although it was about 1 000 million Belgian francs below the figure reached at the same date in 1960. The National Debt, too, has risen once more : in June a further loan was also floated on the home market, bringing in a total of 7 000 million Bfrs.

## B. Outlook

*From now till the end of 1961* the development of the economy is expected to remain substantially unchanged. There are no signs that the expansion of *exports* will speed up significantly. In particular it is uncertain whether the unusually high growth rates of exports to France and the Netherlands, which have been the main factor in the expansion of total exports over the past few months, will rise still further. The July figures already seem to indicate a slackening of demand from the Netherlands. Ever since the end of the first quarter sales to the Federal Republic of Germany have been steadily below the 1960 level; since the German demand for steel, which is partly determined by the stock cycle, shows a tendency to slacken, it is hardly likely that Belgium's total exports to Germany, consisting as they do in relatively large measure of steel deliveries, will show any great expansion. In fact, the weakness that at present affects the iron and steel market in some parts of Europe might well disturb the development of Belgian exports although, on the other hand, it is not unreasonable to expect that they will benefit from the growth of business activity in the United States and the consequent improvement in world economic conditions.

Against this must be set the fact that home demand will rise more rapidly than could have been foreseen at the beginning of the year. True, fixed capital investment may not maintain its recent high rate of expansion—demand from abroad has not been as encouraging as was expected—and shows the influence of certain factors causing uncertainty; at the same time there are various signs suggesting that the investment activity that can be observed today may last for some time. This tendency is confirmed by the number of building permits, issued which continues to be encouraging, and by the brisk activity in imports of capital goods. The extension and strengthening of the provisions contained in the laws of 17 and 18 July 1959 may also help to carry this trend a stage further.

Demand due to *private consumption* will probably not advance much more rapidly than it has done hitherto. A substantial rise in personal incomes in particular seems unlikely. A few wage claims have, it is true, been lodged, but these are not likely to produce any appreciable effect on this year's wage level.

In these circumstances *industrial production* will maintain approximately the rate of expansion that has been observable in recent months. *Imports* will continue to grow. It seems that the price level may none the less creep up slightly.

In the light of developments to date and the prospects for the rest of the year, as they have been outlined above, it can be estimated that for *the whole of 1961* the expansion achieved in the real gross national product will be in the region of 2 %. This

estimate is somewhat more optimistic than that made at the beginning of the year, which had to be based on the assumption that the financial provisions of the "loi unique" would come into force immediately and that as a result its direct deflationary consequences would become fully effective. This law has, however, been applied only in part and with a considerable delay. The planned tax increases only took effect on 1 May and the proposed curtailment of government non-capital expenditure has made little progress. The deflationary effect has therefore been much less than might have been expected. The propensity of enterprises to invest, therefore, has suffered no abatement. This development was reinforced by the extension and strengthening of those provisions in the laws of 17 and 18 July 1959 which are intended to promote investment. The real increase achieved by fixed capital investment in the private sector can be estimated at perhaps 15 %. The total volume of exports of goods and services, on the other hand, will hardly show any advance, since visible exports did not increase in the first six months of the year—owing in part, it is true, to the effects of the strike—and a drop in the export of services is to be expected. According to all available indexes there can hardly be an increase of more than about 2.5 % in either private or public consumption. As the increase in the volume of goods and services imported can be put fairly high (about 7 %), the balance left to be met by domestic production appears, in view of the high proportion of imports in total supplies, to be only about 2 % up, despite the briskness of investment activity.

In view of these conditions and of the sharp expansion in construction in the metal processing industry and in some services, the growth rate in industrial production can hardly be appreciably higher than has in fact been shown so far in the IRES index. Substantially higher growth rates for industrial production—such as the rates of increase "calculated" in certain private quarters in Belgium—would not be compatible with all the other components of the national accounts, as these emerge from the figures and indicators now available.

The expansion of the Belgian economy might well continue in the *early months of 1962*. A brisker upward trend in private consumption cannot, however, be expected unless there is a significant increase in wages—and this is not very likely at the beginning of the year. A more rapid increase in exports is also hardly to be expected, although the economic prospects in other European countries are not unfavourable and although Belgian goods, too, ought to benefit from the recovery of business activity in the United States, with the repercussions it will have on the world economic situation. The slackening of demand for steel products and certain textiles might well persist for a while at least. The expansion of exports may also depend on the pace of investment activity, in so far as this places the Belgian economy in a better competitive position.

In the first half of 1962 investments may well be—as in 1961—the essential factor in ensuring that economic expansion will be maintained at a satisfactory level. Not only might public investment expand further in 1962, as is indicated by the current increase in orders placed, but private investment activity also shows a tendency at present to go on rising.

In view of the wish for a further expansion of investments and the need to establish better international co-ordination of policy on interest rates, the high rate of discount fixed by the Central Bank provided grounds for some criticism. The lowering of bank rate by  $\frac{1}{4}\%$  to  $4\frac{3}{4}\%$  on 24 August 1961 was a step—albeit a small one—in the right direction. However, even a larger reduction would have comparatively little effect, as the proportion of self-financing in Belgian business is very high. Since, however, enterprises will have less means of their own to be used in 1962, owing to the fall in profits to be observed in a number of export industries, it seems that the growth of investment will be maintained only if the structural measures are intensified—though apart from this Belgium does not at present need to pursue generally expansive economic policy.

## Grand Duchy of Luxembourg

*Economic developments of Luxembourg continued on the whole to be satisfactory. Exports were running at a very high level and home demand, due to both industrial or public investment in capital goods, increased noticeably. At the same time, private consumption has continued to develop, principally as a result of the increase in transfer incomes. The index of industrial production for the second quarter was 5 % higher than in the corresponding period of the previous year. Steel production registered a year-to-year rate of increase of 5 %. The prospects for further expansion are not unfavourable, despite a certain falling off in the flow of orders in the steel industry during the summer months. The backlog of orders was still such that as far ahead as one can see the level of production should remain high.*

### A. Recent developments

The increase in demand seems on the whole to have continued. *Exports* have continued at a high level and visits by foreign tourists have noticeably increased in comparison with 1960.

Domestic demand continued to expand. There was further *investment* for the modernization and extension of capacity in the steel industry and progress was made in the conversion of those enterprises in the leather industry whose production has ceased. Further, there was in the second quarter of 1961 a noticeable increase in public investment which had in the first quarter been considerably below that of the corresponding period in the previous year. This was due, in part, to a speeding up of road building and of dam construction, and the level reached in the second quarter of 1960 was exceeded by about 9 %.

*Private consumption* has also increased once again. New expenditure has been principally upon services and upon durables.

The increase in private consumption reflects the continued rise in incomes. Although wage rates have remained practically unchanged since April, the income of private households has increased as a result of rises in other components—principally in transfer income. Thus, the benefits paid out by the “National Solidarity Fund”, created in August 1960, have been augmented and many types of pensions and of sickness benefit have been increased as from 1 July.

Supplies have expanded *pari passu* with demand. The rate of increase of *industrial production* moved up slightly in April and May, but in June it has fallen again slightly. The index of industrial production for the second quarter was 5 % higher than for the corresponding period of 1960, the rise in production of crude steel having been 5 %.

The production of electricity increased slightly as a result of two dams on the Sûre being brought into service. In construction the level of activity was noticeably higher than in the previous year, mainly on account of the increase in public works. Housing, on the other hand, showed on the whole some signs of flagging.

It seems that production in *agriculture and wine-growing* may, in general, prove to have been satisfactory, despite a slight reduction in comparison with 1959 and 1960, which were particularly good years. Whereas the crops of coarse grains and the production of wine appear to be as good as in 1960, wheat and rye are 15 to 20 % down on the previous year. Milk production has improved and the fruit harvest, with the exception of cherries, apples and pears, was excellent. The heavy rainfall has certainly affected the quality of certain products such as potatoes and feeding stuffs, but the damage to these was less than in 1960.

A noticeable expansion has also occurred in *services*, particularly in those branches concerned with tourist travel, and in banking and insurance. In the summer, railway traffic, which at the beginning of the year had suffered from the effects of the strikes in Belgium, once again exceeded the level of the summer of 1960.

Moreover, it appears that the supply of goods was added to by *imports*, which again increased. *Consumer prices* rose slightly and in August were about 1 % over the level of August 1960. This increase was due in part to the rise in the cost of certain imports and of some foodstuffs. In the capital there have recently been increases in the cost of transport, of electricity, and in the rate of the land tax and entertainments tax, and these have had some effect on the level of the cost of living.

The favourable development in the economic situation is reflected in a considerable increase in the *revenue* of the State. In the first six months of 1961 the budget produced a surplus of 89 million Luxembourg francs. As a result of the favourable situation of the Treasury it may be possible to defer for a while the loan which was to have been floated at the beginning of the autumn.

## **B. Outlook**

The expansion of the Luxembourg economy seems to be assured until the end of the year. Although during the summer the steel industry suffered a certain reduction of orders, which caused a slight lowering of prices accepted from non-member countries, orders booked were none the less quite appreciably above last year's level. *Exports* should continue at a very satisfactory level until the end of the year.

Maintenance of the *investment programmes* established by existing industries, as well as the efforts made by the public authorities to promote new industries will probably ensure a relatively high volume of private investment. The prospects for the development of public investment are also good, especially as a start has recently been made on the canalization of the Moselle and the improvement of the approach roads on the Luxembourg bank of the river.



A further increase in *private consumption* may be expected. Indeed, although further wage increases are hardly to be expected during the months to come, a quite considerable increase in transfer incomes may take place before the end of the year.

Although *industrial production* will, it seems, continue at the high level already attained, the rate of increase may flatten out for a time. Indeed, in July, the production of crude steel was a mere 2.5 % above that of July 1960.

This means that for the full year 1961 the rate of increase of industrial production may prove to be about 4 %, with steel production about 2 - 3 % up on the level for 1960.

It is difficult at the moment to foresee how the Luxembourg economy will develop during the *first half of 1962*. This depends basically on the way world steel markets develop; the short-term prospects seem to involve uncertain factors but, on a rather long view, these seem to be by no means unfavourable.

True, the possibilities of action open to those responsible for economic policy are certainly limited by the extent of the country's dependence on developments abroad; but the Government has considerable funds at its disposal, quite apart from the loan which it is intended to issue at the beginning of the autumn. A law of 7 August 1961 allocates 400 million francs for improvements to and extension of the capital, and a Bill for the construction of a port on the Moselle has been laid before the Luxembourg Parliament. The outlay involved is to be met by the issue of loans. In addition, the payments to be made by the Federal Republic of Germany at the end of the year and at the beginning of 1962 could in part be used to influence current economic developments, should it appear necessary to apply special measures.

On the other hand, the trend of prices is again occasioning disquiet, for their level may once more be affected by the upward movement of prices in the Federal Republic of Germany from which Luxembourg draws one third of its imports. Moreover, the rise in the land tax in the city of Luxembourg may involve an increase in rents. This upward pressure on the cost of living may be partially compensated for if the Bill to exempt certain important foodstuffs from turnover tax is adopted.