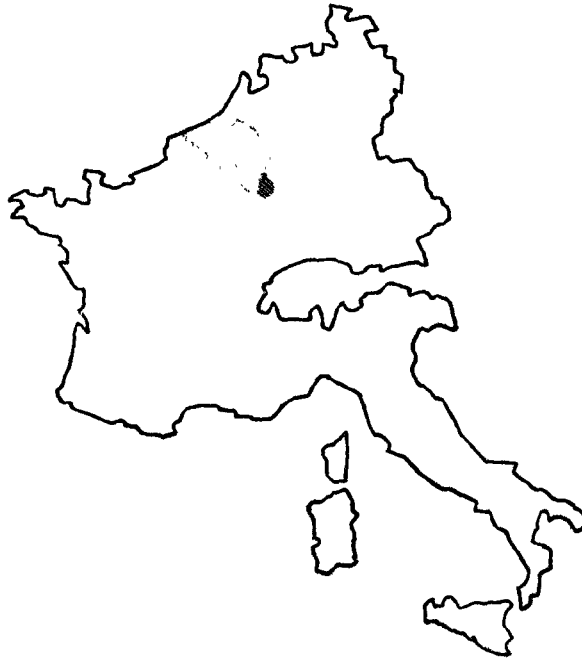


EUROPEAN
ECONOMIC
COMMUNITY

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**THE ECONOMIC SITUATION
IN THE COMMUNITY**

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SEPTEMBER

QUARTERLY SURVEY

1962

Commission of the European Economic Community
Directorate-General for Economic and Financial Affairs
Directorate for National Economies and Economic Trends
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EUROPEAN ECONOMIC COMMUNITY

COMMISSION

The Economic Situation in the Community

SEPTEMBER 1962

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I. THE OVERALL ECONOMIC SITUATION

The pace of economic growth in the Community continued to be relatively moderate in the second quarter and—as far as can be judged at this stage—in the summer months also. The trend of demand became an increasingly important factor in economic expansion, even though in certain countries and branches physical obstacles still set limits to growth.

Overall demand again went up, but apparently the pace was once again somewhat slower. The improvement in exports to non-member countries in the first quarter gave way to another phase of relative stability from May onwards. In fact, exports in the second quarter were up only about 1 % (in value) on the corresponding figure for the previous year. Furthermore, the tendency for the growth of gross fixed asset formation to fall off became definitely more marked, although building investment rose strongly in the second quarter—a reaction after the stagnation caused by exceptionally bad weather early in the year. Finally, investment in stocks made hardly any contribution to overall demand. Against this, private consumers' expenditure—as a result particularly of sharp wage increases—again expanded somewhat more than in the early months. In terms of volume the growth of consumption was adversely influenced by rising prices, but even if this factor is taken into consideration consumption expanded at least as fast as in the first quarter. In most member countries outlay by the public authorities on consumption also showed quite a clear rise.

The slow growth of the Community's industrial output continued. The rise in the seasonally adjusted index of the Statistical Office of the European Communities was about 1 % from the first to the second quarter, when the level of output in the second quarter of 1961 was passed by about 6 %. Expansion in the services sector was probably a little more rapid.

The expansion of production in certain member countries and branches continued to be handicapped by labour shortages, but the effect of this factor seems to have declined somewhat here and there, particularly in important branches of the capital goods sector, where the greater amount of slack to be taken up is attributable rather to more sluggish demand against a background of steadily expanding capacity.

The total number of persons in employment again rose slowly and there was a further fall in unemployment. In industry, however, the growth of numbers employed was relatively small, and was moreover almost completely offset by shorter working hours. However, productivity per man hour again increased somewhat more rapidly. Almost the entire increase in industrial production over the second quarter of 1961 is probably attributable to the rise in output per man hour.

Partly under the influence of extraordinary factors, such as heavier buying of foodstuffs, imports from non-member countries were quite high. In the second quarter they were by value about 8 % above the level of the corresponding period of the previous year. The trade balance showed a deficit of almost \$500 million compared with \$169 million in the second quarter of 1961. Nevertheless, the balance of payments, both on current account and overall, was probably in surplus, although distinctly less so than at the same period of 1961.

The upward pressure on prices went on building up until July. This was mainly attributable, however, to higher prices for certain foodstuffs owing to bad weather. Since July there have been some downward adjustments. Apart from this extraordinary movement, prices of services and industrial products continued to rise though they seem to have slowed down somewhat in the case of the latter.

The outlook up to the end of the year suggests no important change in these general economic trends. This being so, there are still no grounds for amending the estimates given at the beginning of the year for 1962 as a whole (real gross national product + 4.5 % - 5 %, industrial production + 5.5 %).

A survey of probable development trends in 1963—in the first instance, chiefly the outlook for the first half-year—indicates that the Community's growth rate will continue to flatten out. To begin with the weaker expansion in most non-member

countries' economies—particularly the United States'—and the fact that demand from the developing countries may well be practically stationary, will probably keep any increase in Community exports within quite narrow limits. Secondly, the growth of investment in the Community will again slow down. The foreseeable further rapid expansion of private consumption will probably not fully make up for the effects on overall demand of the consequent loss of momentum. Finally, the growth of income and consumption will itself not be entirely unaffected by the slowdown in the growth of exports and particularly of investment.

In view of this outlook, economic policy will have to come to grips with the difficult problem of preventing above all any excessive falling off in investment, and therefore economic expansion in general while at the same time combating trends towards higher prices which will probably continue far into 1963, even though they may spent some of their force.



A. Demand

During the second quarter, and very likely also during the summer months, economic expansion in the Community rested largely upon domestic demand.

Demand from abroad—as reflected in the actual exports of goods and services from the Community—has probably not expanded greatly. This is certainly true of commodity exports, which weakened in June and July after having picked up from March to May. When allowance is made for seasonal fluctuations, total exports in the second quarter are not likely to have exceeded those of the first. The level of a year earlier was exceeded by only 1 % (in value), after rising 4 % in the first quarter. In terms of volume the year-to-year growth rate was 2 % as compared with almost 3 % for the first quarter.

In interpreting these export figures it must be remembered that exports from the Community to Algeria declined rapidly in the second quarter and that, had this not happened, the growth rate shown by the overall value of exports from the Community would have been around 3 % instead of the 1 % noted above. In the first quarter too this factor had played a part, but it was at that time of less importance. At any rate, there does not seem to have been any major change in the pace at which other exports, when taken together, expanded between the first and the second quarter.

Demand from abroad clearly reflects the present economic situation in the world, which is marked by a weakening of investment demand. This applies both to most industrial countries and to the developing countries. Owing to the structure of exports from the Community—these consist largely of investment goods, especially in the case of the Federal Republic of Germany—any decline in investment demand from other countries has a relatively sharp effect on the Community's exports. Trade in consumer goods, which is expanding fairly rapidly in most countries, gives exports from Community countries a relatively smaller boost, because in other countries capacity is great and competition very keen. As they call for less specialization than investment goods, the increase in costs—which has recently been appreciably more marked in the Community than for instance in the United States or the United Kingdom—has a relatively great effect.

Exports from the Community to the United States have none the less continued to develop favourably in the second quarter. The fall in the year-to-year rate of growth from 25 % (in value) in the first quarter to 15 % in the second was largely due to the exceptionally brisk rise from the first to the second quarter of 1961.

This development of exports was in part the result of the continued expansion experienced in the United States during the second quarter of 1962. It has, however, become clear that the relatively poor results attained in the United States during the first quarter are only to a small degree due to passing or fortuitous factors, and that the rate of expansion has fallen considerably since the rapid recovery of spring 1961. Expansion

was damped not only by fixed investments rising more slowly than expected but also by special factors which affected the amount of stocks held by industries which process iron and steel; at the beginning of the year considerable stocks were piled up because of the threatened strike, and these are now putting a brake on the output of steel. When allowance is made for seasonal fluctuations, the gross national product nevertheless rose 1.4 % between the first and the second quarter of 1962, and industrial production went up by 2 %. Provisional figures show that industrial production may well have increased by a further 1 % to 1.5 % during the third quarter.

The year-to-year growth rate of exports from the Community to the EFTA countries has declined further, from 6 % in the first to 4 % in the second quarter (in value). Sales to Switzerland and Denmark in particular were unmistakably higher than those of a year earlier; exports to Sweden and Austria hardly increased at all, and those to Portugal and Norway were much below the previous year's level. Exports to the United Kingdom were at first hesitant during the second quarter but rallied strongly in June, with the consequence that there was an overall rise in exports of 6 % in value over the second quarter of 1961. A significant factor may have been that this country's general situation—at any rate short-term—has improved again. Its real gross national product, adjusted for seasonal variations, has increased by 2 % in the second quarter over the first. The corresponding increase for industrial production was 2.5 %. Compared with the second quarter of 1961, however, the advance in industrial production was only 1 %, and in the gross national product it was even less. The slight recovery from the setback which occurred in the second half of 1961 and in which restrictive measures had played a not unimportant role, was mainly due to improvement in exports, which in the second quarter were 5 % (in value) above the corresponding level of the previous year. Mention should be made of the increase of exports to the EEC countries which amounted to 13 %. Domestic demand, however, increased more hesitantly, especially as fixed investments by industry appears to have declined further.

After some degree of stabilization in the first quarter, the exports from the Community to the developing countries again took an unfavourable turn in the second. Their total value was 8 % less than a year earlier. Though this reduction is mainly due to the turn taken by exports to Algeria—an adventitious factor—demand from the developing countries seems to have fallen off generally. In some of these countries this may be connected with the great extension in the past few years of their capacity to produce raw materials and fuels (e.g. petroleum), though this will rather entail smaller imports of capital equipment from now on; to some extent, however, it may also be a direct or indirect result of the relatively low imports by the industrial countries—and not least by the Community—of raw materials from the developing countries. If these countries do not want to see a deterioration in their foreign exchange reserves, which had risen a little last year but are still extremely low, they must be cautious in their import arrangements. So far the increase in development aid from the industrial countries has not altered this situation, because the fall in earnings caused by the reduction in volume of raw materials and other tropical produce exported—as well as by the weakening of prices—has probably

been greater than the rise in development aid and other imports of capital reaching the developing countries. In this connection various capital outflows from the developing countries, mostly attributable to their political and economic situations, may have played a part. The weakening of exports from the Community in the second quarter affected Asia and even more Africa; here there has been no rise in sales, even to the countries and territories associated with the Community. Exports to Latin America remained steady, whereas deliveries to the Pacific area recovered in the second quarter.

While therefore demand from abroad remained almost unchanged in the second quarter, domestic demand and especially private consumption again provided a considerable boost.

The expansion of gross fixed asset formation has, however, shown some tendency to slow down despite the continued vigorous increase of public investment noted in some Member States; this is due to a weakening in the expansion of fixed investment by firms. Though the year-to-year growth rates of their outlay on investment were still very considerable, the trend now shows a loss of momentum. The propensity to invest has declined generally, although the extent of the decline varies from country to country. (France seems to be least affected so far, but it must be remembered that this propensity has never been as marked there as in some other countries.) Some of the present heavy outlay on investment is moreover due to the delivery of investment goods ordered previously, whereas orders received by the investment goods industries have been showing a clear tendency to decline.

The reason for the considerable increase of building investment in the second quarter as against the first—an increase going beyond the usual seasonal expansion—is to be sought in the inclement weather which in the first quarter interfered with building more than is usual. In residential, industrial and commercial building, the real tendency seems to have been for the pace of expansion to slow down somewhat. In some member countries there is, however, still an unsatisfied demand due largely to the demand for housing, which is high in relation to building capacity, limited by shortage of labour. In Italy, Belgium and the Netherlands there does, however, seem to be some slowing down in the cyclical growth of demand. The fact that the number of dwelling units completed in the Community during the second quarter was about 6 % lower than a year earlier is however probably mainly attributable to extraordinary factors such as delayed starts, higher quality standards and so on.

Investment in stocks has probably contributed but little to the trend of overall demand in recent months. After purchases of certain raw materials and semi-finished goods had recovered a little around the turn of the year, the processing industries and trade returned to more cautious planning during the second quarter. This is true in particular of demand for raw materials and semi-finished goods in the basic materials and investment goods industries. Moreover, the shortening of delivery dates, especially in the investment goods industries of some member countries, indicates that the total volume

of goods being processed has grown less rapidly than hitherto. It is only in dealers' stocks of consumer goods that may have been built up a little more rapidly in this or that member country—and fairly certainly in the Federal Republic of Germany.

In contrast to demand from business firms, the relatively rapid upward move of public expenditure has continued almost unabated in nearly all member countries. It has already been suggested that this is also true of investment expenditure in some countries. In addition there has been a vigorous expansion of public consumption, especially as a result of salary and wage increases in the public services.

Expenditure on private consumption, which had already been considerable at the beginning of the year, quickened in the second quarter. However, price increases have hampered any real expansion of private consumption. The rise in household incomes, especially among wage-earners, was definitely more rapid than in the first quarter. Although the rise in numbers at work was probably less noteworthy, earnings in almost all member countries showed a greater tendency to rise. In some, such as Italy and Belgium, this speed-up was partly due to the sliding wage scale. In the Netherlands many collective agreements postponed at the beginning of the year entered into force in May and June. Moreover, a reduction of the income and wages tax meant that there was an additional increase in disposable incomes. Finally, household incomes in the Community as a whole have increased as a result of higher transfer incomes charged to the public budget; in Italy for instance a very marked increase of pensions came into force on 1 July.

Vigorous expansion of private consumption is clearly reflected in the trend of retail trade turnover, the value of which exceeded the level of a year earlier by more than 10 % in several member countries. Apart from the additional outlay on foodstuffs due to the higher prices, the rise in expenditure on consumer goods affected durables and services more than the traditional items, purchase of which, moreover, suffered at times from the unfavourable weather conditions. In the Federal Republic of Germany, France and Italy over 20 % more new passenger cars were licensed than in the second quarter of 1961. Expenditure on travel and holidays showed a marked increase everywhere.

B. Supply

Internal supply made a further advance in the second quarter of 1962. It is true that the growth of industrial production flagged a little, mainly because of the feebler expansion of exports and of investment by enterprises, but progress in the services sector was in all likelihood once again considerable.

Early harvest reports show that agricultural production in the Community—despite drought in Italy and some districts in France—was on the whole much higher than last year. At 54 million metric tons, cereals output would seem to have set up a new record, exceeding last year's figure by 10 %. Livestock production went on rising steadily.

The slow growth of the Community's industrial production continued. The seasonally adjusted index of the Statistical Office of the European Communities only rose by about 1 % from the first to the second quarter. The year-to-year increase for the second quarter of about 6 % was much the same as for the first quarter (5.5 %). With the exception of the Federal Republic of Germany, results were generally less than satisfactory, especially in June. In the Benelux countries there was little or no cyclical rise in production, and in the case of Luxembourg it was in fact down on the corresponding figure for 1961. In Italy growth was perceptibly less than in the first quarter.

Mining and some basic industries were once again handicapped by the weakness of demand for their products. For example, coal output in the second quarter was 4 % down on the corresponding 1961 figure, and iron ore 5 %. The output of iron and steel also lagged more than 2 % behind the previous year's figure. In addition, the growth of production in most capital goods sectors except electrical engineering, has begun to falter.

By contrast, chemicals and most consumer goods, except certain textiles, again made substantial progress. Many consumer durables, especially private motor cars, showed a particularly sizeable increase over the year before.

The vigorous expansion of private consumption not only gave a lift to output in various industrial sectors but also caused a marked increase in services. The wholesale and retail trades in particular, and all sectors whose services directly affect end consumption, recorded a large increase in real added value. On the other hand, some transport sectors, for example the railways, whose activity is largely governed by sales of raw materials, showed only a moderate growth.

The main feature of the employment and labour market was the fact that the number of persons employed in industry probably rose but slightly. In view of the cuts in actual working time, the effects of which were plainly noticeable in the Federal Republic of Germany but also began to be felt in France and Italy, it is probable that the total volume of industrial employment in the second quarter was hardly any higher than it had been just this time last year. To a very large extent, therefore, the 6 % increase in output

over the same period may be taken as representing a gain in productivity (per man-hour). This suggests that productivity has been developing very satisfactorily since the turn of the year unlike preceding months during which it suffered a distinct setback.

In contrast with industry, there was a further big rise in the numbers employed in the services sector, in which an increased number of vacancies has also been noted and the improvement in productivity is broadly speaking less marked.

By and large, there was a continued downward trend in unemployment in those countries in which manpower reserves are still available. This is mainly true of Belgium, but also of France and Italy. In France, however, there was hardly any increased strain on the labour market, since repatriates from Algeria, the natural growth of the working population and the prospects of shorter military service are compensating factors. In Italy, which is still suffering from widespread structural unemployment, shortages—limited to specific areas and trades—are still making themselves felt. Unemployment figures remained exceedingly low in the Federal Republic of Germany and in the Netherlands. Relatively high numbers of school-leavers in the latter did not appreciably ease the situation.

C. The balance of the markets

The Community's imports from non-member countries continued to increase at the higher rate already reached in the first quarter. Customs returns showed that in general imports of goods were 7.5 % up in the second quarter both in volume and in value on the figure for the second quarter of 1961. This was about the same year-to-year rate as had been recorded in the first quarter. However, it should be noted that this growth is due largely to a boom in agricultural imports (mainly cereals)—a result of the poor 1961 harvests in all the member countries except Italy, the effects being naturally most noticeable in the last months before the new harvests. On the other hand, imports of consumer goods have risen in step with the general trend inside the Community, whereas imports of capital goods began to fall off and raw materials and semi-finished products were no more than hesitant.

Imports from the United States, mainly comprising agricultural products, raw materials and capital goods, followed conflicting trends according to their varying nature but remained higher than they had been a year previously (6 % in value, as against 7.5 % in the first quarter). The vigorous growth of imports from the EFTA countries continued and exceeded the comparable 1961 figure by 9 %. In this connection it is worthy of note that the year-to-year growth rate of imports from the United Kingdom alone reached 13 % in the second quarter. However, in trade with the developing (mainly primary producers) countries, the Community imported 8 % more, mainly in the form of greater purchases of grain, than during the second quarter of 1961 though imports from these particular countries were at that time comparatively small.

The growth of trade between the Community countries has slowed down a little since the beginning of the year. In terms of value, trade was 11 % up in the second quarter on the corresponding 1961 figure: in the first quarter the rise was almost 16 %. This is probably accounted for by the reluctance of importers to place orders before 1 July, the date on which the 10 % cut in internal duties was due. The same phenomenon occurred at the time of the last tariff cuts. At all events, the partial returns for July point to a certain recovery in the expansion of internal trade. The decline in purchases of capital goods, which figure prominently in the Community's internal trade, also indicates, however, a certain loss of momentum due to cyclical factors. On the other hand, trade in consumer durables, especially motor cars, developed appreciably. As at the beginning of the year, the same applies to trade in agricultural products, with substantially increased imports in countries where the last harvest was poor.

Once again, the individual member countries' balance of trade figures with the Community as a whole have undergone hardly any change worth mentioning. The Italian trade balance showed a slightly higher deficit than just a year ago, whereas the balance for the Benelux countries improved a little.

Developments in Italy are doubtless related to the heavy increase in internal demand, with imports rising faster than exports, although there was a fairly big increase in the latter due to plentiful supplies of fruit and vegetables. In the case of the Benelux countries, the improvement in their balance of trade with other members must have been mainly due to a difference in growth rates that stimulated exports more than imports.

In France and in the Federal Republic of Germany, on the other hand, the growth rates in trade within the Community were essentially the same for imports and exports. In Western Germany this trend was accompanied by a marked decline in expansion on both sides of the trade balance sheet: the weakening in the partner countries of the propensity to invest must have had a comparatively powerful impact on German exports, which consist largely of capital goods. On the import side there was, it is true, continued growth in the case of consumer goods and agricultural products, but purchases of raw materials, for example of iron ore and semi-finished products, showed a tendency to decline.

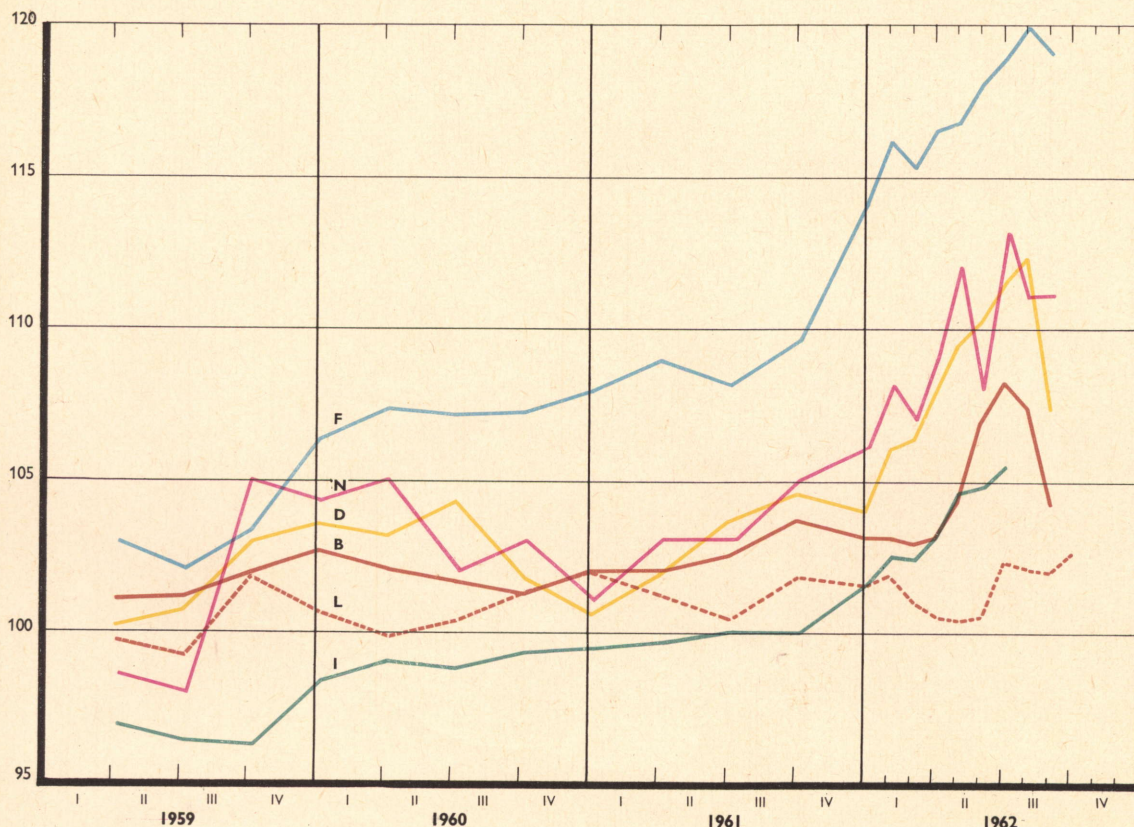
The upward price trend steepened again a little in the second quarter, mainly due to extraordinary factors, such as the unusually large seasonal increase in prices of plant products following the poor harvests of 1961 or the cold spell during the first half of 1962. This was a contributory reason for the increases—with variations from one country to another—in the June consumer price indices as compared with 1962 : France 6.6 %, Italy 4.7 %, Federal Republic of Germany 4.0 %, the Netherlands 4.8 %, Belgium 2.9 % and Luxembourg 1.2 %. Nevertheless, in the Benelux countries, these rates fell away again in July, in some cases substantially, and a fairly similar tendency would seem to have emerged in the other countries from August onwards. But prices of industrial products, and even more of services, by no means came to a halt; in most member countries however, the rise has flattened out in the case of industrial products. This was true of consumer goods, despite much heavier demand due to keen competition from abroad—with EEC trade also contributing—and of investment goods because of dwindling orders. In general, reduced raw material prices had a favourable effect on prices of finished goods. Wage costs per unit of output admittedly rose again and were once more partly passed on by way of higher prices. But this practice of passing on higher costs has become even more difficult than before. In the Federal Republic of Germany the growth of wage costs also tended to slow down—in industry at all events—because productivity again developed favourably whilst wages rose rather less steeply than before.

Since imports distinctly outpaced exports, the tendency noted in the first three months of the year for the Community's balance of trade to deteriorate was accentuated in the second quarter. The deficit was almost \$500 million compared with \$275 million in the first quarter of this year and of \$169 million in the second quarter of 1961.

The Community's surpluses on current account in the second quarter must, however, have again risen as services transactions more than offset the worsening of the trade balance. In any case, there was again a heavier outflow of capital abroad—particularly

CONSUMER PRICES FOR FOODSTUFFS

1958 = 100



Partial indices based on the national consumer price indices or cost-of-living indices, exclusive of beverages and tobacco. Tea and coffee are, however, included in the Netherlands index.

Any comparison between the curves for the various countries must take into account alterations in exchange rates since the beginning of 1958.

Quarterly averages: with the exception of 1962, for which the monthly indices are given. This method has been adopted in order to ensure a sufficiently clear presentation of the curves concerning the period prior to 1 January 1962, and to bring out details of the trend in recent months.

in the form of drawings in the member countries' own currencies through the IMF and advance repayments on public debts.

The overall balance of payments would seem to have been once again favourable, although noticeably less so than at this time a year ago. Member countries' official gold and foreign exchange reserves rose by about \$360 million in the second quarter, but the commercial banks' net foreign exchange holdings dwindled considerably over the same period. In July, however, as a result of further advance debt repayments, there was a slight fall in official reserves.

The trend in the balance of payments resulted in a new increase in liquidity both for the banks and the economy at large. In France, Belgium and the Netherlands this was indeed the biggest factor in developments on the money and capital markets; despite a continued and, in some cases, very vigorous growth of credit, and despite a very pronounced increase in notes and coins in circulation during the summer months, the money markets were very easy and on the capital market the tendencies for interest rates to fall continued or—as in the Netherlands—regained the upper hand following a certain period of strain. On the other hand, in the Federal Republic of Germany and in Italy the expansion of credit had generally grown stronger, and trends towards tighter conditions predominated, for in these countries the balance of payments trend hardly increased domestic liquidity, whilst at the same time operations by the public authorities had the effect of reducing it. The situation was also affected by the prospects of bigger government issues in Western Germany together with, in Italy, certain extraordinary political and psychological factors influencing developments on the capital market. On the whole, rates of interest on long-term capital tended to rise a little in both countries.

In the Community as a whole, the public authorities' cash position in the second quarter was once again mainly characterized by heavily increased Government spending and a slowdown—due to the general business trend—in the rate of growth of revenue. Deficits accordingly increased in most of the member countries, and in the Federal Republic of Germany the cash surpluses of all public authorities were smaller. Doubtless these deficits (incidentally, the German federal budget showed a deficit) were once again mainly financed by running down public cash holdings or having recourse to short-term credit from the Central Bank and the rest of the banking system; in general, however, the public sector also tended to draw more heavily on the capital market.

In most of the member countries the monetary authorities have countered, mainly through open-market operations, such temporary strains as have appeared; but generally speaking they have refrained from pursuing an active policy of promoting greater liquidity.

D. Outlook

The general economic trends reflected in the above analysis are unlikely to undergo any important change between now and the end of 1962.

The impact of external demand on the economic situation within the EEC will continue to be rather slight. It might even be prudent to anticipate a further reduction in the year-to-year increment of exports of goods to industrial countries outside the Community, because economic growth in some of them is evidently tending to flag. This applies particularly to the United States, where from January to July there was practically no increase in orders received by the manufacturing industries. Furthermore, the June business survey of investment expansion programmes for the next twelve months shows a drop of 12 % as compared with the March survey. However, the June figures in general probably felt the psychological backwash of the break in the stock market at the end of May. Orders for durable goods, which dropped 4 % in June, went up by 5 % in July. In addition, the trend in construction seems to be fairly satisfactory. But the general impression remains that the upturn in American production has somewhat slowed down again.

In the United Kingdom the new upward trend may well continue for the time being mainly on account of the buoyancy of exports to the Community. However, as investment is not developing favourably, growth will probably remain rather hesitant, or at any rate hardly likely to induce any lasting new stimulus for Community exports to the United Kingdom.

There is little prospect that the foreseeably sluggish general trend in exports to the industrial countries will be offset by a corresponding spurt in exports to the rest of the world (notably the developing countries), the more so as exports to the franc area—particularly Algeria—might continue to be held back. The reasons for the comparatively low purchasing by primary producer countries have already been discussed in the survey of the latest developments.

As regards the probable future trend in internal demand, the previously mentioned decline in private industry's propensity to invest—which has not yet had a very marked effect on actual capital expenditure in most member countries—will probably become more pronounced. This can be inferred not only from the state of order books, but also from the trend in imports of capital goods for some time past. It is doubtful whether greater demand in the building sector, where the labour shortage is still one of the most important limiting factors, can offset this weakening of growth.

Private consumption will presumably maintain a fast growth rate. There may, however, be a slight loss of impetus as wage increases are likely to be definitely smaller in the Netherlands, and in Germany slightly smaller, than they were in the first half year.

Nevertheless, the real growth rate of private consumption may be quicker, since consumer prices should rise much less steeply than hitherto.

Overall production in the Community will therefore probably expand at practically the same rate as before, so the cyclical increase should remain slight. As there was a temporary cyclical speed-up during the closing months of 1961, the year-to-year growth rate of industrial production will lose pace somewhat: it may be about 4.5 % in the fourth quarter. In the services sector, however, relatively rapid expansion will persist.

The cyclical growth of imports will probably slacken somewhat, chiefly because agricultural imports which have been high up to now, will tend to fall. Also, there seems to be no reason why imports of raw materials and semi-manufactures should revive to any great extent. Lastly, there will be a slower growth rate for imports of capital goods too. It is only imports of industrial consumer goods that are likely to show any considerable increase. On the whole, however, taken in conjunction with the predicted slight growth of exports, imports should maintain sufficient pressure to make the balance of trade continue to deteriorate as compared with the corresponding period of 1961.

Prices are likely to rise substantially more slowly than in the first half of 1962, mainly because the upward trend in certain food prices recorded during the spring is now being reversed.

On the whole, the present outlook and developments to date confirm the forecasts for 1962 as a whole given in the first quarterly survey for the year. The increase in real gross national product in the Community may in fact reach 4.5 % - 5 %. Industrial output should also pretty well achieve the growth rate of 5.5 % indicated as probable in the survey of the first quarter. As for the appropriation of national income, the growth of domestic expenditure—particularly private consumption—is likely to be more than expected, whereas the increase of exports to non-member countries will probably fall short of estimates.

So far as any growth projections for 1963 (i.e. mainly the first half year) can be made at this stage, they indicate that progress within the Community will be maintained, though its pace may once more slacken.

The main reason will in all probability be slower expansion of internal demand. The inhibiting effect of this is unlikely to be even partly offset by any more vigorous growth of exports to non-member countries. It is to be feared that the tapering-off of economic growth in a number of industrial countries of the West will continue. In particular, this will be true of the United States, where there will most probably be a greater fall in the demand for investment, whose effects may partly cancel out the improvement in the remaining components of demand—especially Government expenditure. In any case economic growth will be appreciably slower than had been hoped—even if the incentives now being discussed, in particular the tax cut from 1 January 1963, are actually

injected into the economy. As they seem to be conceived, these can hardly affect the economic trend in the first half of 1963 and cannot altogether remove the uncertainty obtaining with respect to the development of the situation towards the end of 1963.

Similarly, economic growth in the United Kingdom, which has been livelier recently but is still quite weak, will not pick up very greatly during the first six months of 1963. The continuing expansion of private consumption resulting from slightly higher employment and some modest wage increases, together with an increase in public capital expenditure and perhaps also a replenishment of stocks, will doubtless stimulate growth. On the other hand, we can hardly count on such a quick revival of industrial fixed investment. Moreover, despite the fairly favourable sales prospects in the sterling area, the upward movement of exports may be retarded by the effects of the slowing-down of economic expansion in other industrial countries, notably in the Community.

Consequently, it cannot be assumed that the Community's exports to industrial countries will be stimulated very much by the economic situation in those countries. The outlook is no brighter for purchases by the developing countries; on the contrary, some degree of stagnation must be expected. True, these countries' trade balance has so far perceptibly improved in 1962 owing to lower imports, but as stated previously, this does not necessarily mean a corresponding improvement in their foreign exchange position.

Apart from these external factors, the effects on exports of the trend of costs within the Community will make themselves felt more sharply than before. On the other hand, the slower growth of domestic demand in a number of industries will provide an extra inducement to export and the possibility of switching supplies for the purpose. On the whole, it is only possible to hope for a very slight increase in the Community's exports to non-member countries.

The tendency for the growth of internal demand to slacken pace may persist in the first six months of 1963. This will particularly apply to capital expenditure by industry—partly for cyclical reasons, because the investment boom has brought about a very considerable increase in capacity; partly because expected profits will not be high enough in view of the rise in costs and the fact that prices cannot be increased correspondingly; partly because funds available for self-financing have become relatively scarce, and partly because (mainly in small- and medium-sized enterprises) it will be difficult to finance more from outside sources—particularly as the conditions on capital markets are not in all cases such as will enable enterprises to finance investment by increased borrowing.

The influence of all these factors will, of course, probably vary from country to country within the Community. For instance, the year-to-year growth rate of net gross fixed asset formation by industry in the first half of 1963 will be lower in the Benelux countries and Germany than the year before; in Italy the rate may, though falling, still be significant. In France it should drop only slightly.

As for investment in building, the growth of demand for industrial and commercial buildings must be expected to slow down in some member countries. Demand for housing ought to remain high. The overall picture is that growth will to an increasing extent be held back by limitations on productive factors rather than by the trend in demand.

There may also be some diminution in the expansion of private consumption in several member countries, in particular because employment is increasing at a rather reduced pace at the moment and wage increases—mainly in the Federal Republic of Germany and possibly also the Netherlands—are likely to be more moderate than in the first half of the year.

Public consumption and investment expenditure should be a factor making for the expansion of overall demand and according to initial budget forecasts are likely to go up considerably in some member countries.

Where the elasticity of demand is more or less restricted, there should be some improvement, mainly due to further gains in productivity. The strain on the labour market may relax somewhat, though labour shortages will not disappear altogether.

Under these conditions regarding demand and production factors, industrial production will again rise, though rather slowly. At the same time, imports are likely to continue to grow, though probably a good deal less rapidly than during the corresponding period of 1962.

During the first six months of 1963 the general price level should again be higher than in the corresponding period a year ago. To some extent this is a statistical consequence of price increases in 1962, but higher costs per unit of output in some member countries will also persist into 1963. In addition, were it only because of the trend of costs in the last two years, the authorities will adjust prices and charges. On many markets demand will be high enough for higher costs to be passed on to some extent. Nevertheless, there should be an improvement of the price situation in some member countries in 1963. In the first place, there are hardly likely to be any such increases in food prices as occurred from time to time in 1962; there may even be some downward adjustment, provided the weather does not again hamper production. Secondly, the decline in the growth of demand will have a moderating effect on the movement of industrial prices, particularly as wage costs per unit of output in some member countries may well go up less than in 1961-62 as a result of the slower wage increases and the higher productivity mentioned previously. Lastly, foreign competition plainly militates against price increases within the Community, though rising prices are still a problem.

This outlook sets the economic policy makers a highly complicated task. On the one hand they must endeavour to halt the rise in prices; on the other, they must watch that economic growth does not slow down too much, and in particular that the development of internal demand always has sufficient impetus to more than offset any recessive

tendencies, coming from outside the Community, that may make themselves felt in the course of or towards the end of 1963.

Besides being one of the direct economic policy aims of the Treaty—like the maintenance of price stability—the maintenance of a steady and adequate growth rate is also called for on grounds of balance of payments and monetary policy. To these must be added political considerations, such as the adverse effects on the economic situation of the developing countries of a too leisurely pace of growth or even a recession in the industrialized countries.

In these circumstances it will hardly be possible in the final months of 1962, or indeed in 1963, to apply global measures to curb demand in order to combat the rising price trends already existing or anticipated to varying extents in the different Member States. This is all the more so since in some countries these tendencies are the delayed effects of an earlier situation of surplus demand, rather than the reflection of the existing or prospective ratio of demand to supply.

Only in public spending is it advisable in some member countries to set limits to further expenditure, particularly in cases where the disbursements involved directly or indirectly stimulate demand in the field of consumption or of building investment. Such a policy is now to be applied, notably by the Federal Republic of Germany. In other Community countries, however, the short-term prospect suggests, if anything, that to curb Government spending would be inadvisable.

On the other hand, during the coming economic phase measures which slow down overall demand and affect the development of investments by enterprises could seriously endanger growth. This might come about precisely in a world economic situation calling for continued and lively expansion in Europe.

In fact it has been confirmed that the propensity of enterprises to invest is again flagging in all member countries, even though to differing extents. The present trend of investment expenditure points clearly in the direction of a standstill in its growth. This tendency ought not to be reinforced by economic policy measures. It will have a moderating effect on prices and wages without any such encouragement. To strengthen it would be to court the danger of letting the recessive growth tendencies get out of hand. What is more, of course, such measures put a brake not only on growth investment but also on rationalization investment, which is particularly important in offsetting higher wage costs—incidentally, with great advantage to price stabilization too.

In some countries—in the Netherlands and Belgium—a time is foreseeable when existing restraints on investment will have to be lifted or special incentives reinforced. In the other member countries, it is true, there is still no sign of any need for economic policy measures to stimulate investment, but here too, any measures which might make it more difficult (such as raising interest rates) should be avoided. Above all it will be

necessary to persevere with a monetary and credit policy which reduces possible strains on the financial markets to a minimum.

Rising price trends can and should be more effectively countered by measures affecting supply than through any policy of curbing investment, or more generally restricting demand. In this respect much can in fact still be done. We are here thinking of the possibility, repeatedly discussed by the Commission, of anticipated customs reductions vis-à-vis the EEC partner countries and (where the common tariff allows) vis-à-vis non-member countries, such as were introduced by Italy in August. Other possibilities are reinforced measures of competition policy, where there is reason to suspect that prices are being artificially kept up by restrictions on competition, or intensified vocational training and re-training. In addition, reductions in consumer taxes—the latter particularly on certain tropical products—might possibly be introduced in some member countries and would at the same time have the effect of attracting more imports from the primary producer countries concerned.

Resolute action to keep the value of money stable will also prove rewarding in the matter of important farm prices. The common agricultural policy should result in lower grain prices in part of the Community and therefore in lower foods costs. It is to be hoped that similar action will also be taken with regard to the common grain price, so that member countries with relatively low prices for this commodity may not be obliged to raise their food prices appreciably.

Finally, the State's own price policy should take into account the current overall requirements in this field. It is evident that certain "adjustments" in prices and tariffs for services by the State and public enterprises, such as are at present being introduced or mooted in some member countries, are necessary in themselves as a mean of avoiding overmuch subsidizing and in some cases enabling public corporations to finance their investments. But in this connection timing is all-important. When costs generally are still rising, such increases in prices and tariffs directly or indirectly aggravate the upward pressure on prices. But as the expansion of overall demand is plainly slowing down, they may also have certain adverse effects on economic growth, in that they add to firms' costs and therefore the pressure on profits and on resources for self-financing and so on the propensity to invest. The "adjustments" referred to may therefore have similar effects, as in the case of the increased costs per unit of output caused by wage rises, greatly in excess of any concurrent gain in productivity, over a fairly long period. For such reasons they should be limited to what is absolutely unavoidable.

As regards the actual wage trend and the problems of price and growth policy arising from it, there is little to add to what was said on the matter in the previous quarterly survey. It is true that, as pointed out there, these problems differ considerably from one member country to another; moreover, the significance of these problems seems to be waning in parts of the Community because—as has been repeatedly pointed out—the pace of growth of labour costs per unit of production is probably tending to slow down. However, no stabilization of these costs is yet in sight.

In these circumstances it is by no means inappropriate to advocate the co-ordination of wages and general economic policies, the more so as strains on the labour market can be expected to ease somewhat, on the one hand because of slower expansion of demand and a certain speed-up in the growth of productivity, and on the other hand in some countries because of the natural increase in the working population. This should clear the way for a policy of keeping wage movements within bounds compatible both with price stability and the desired economic growth. To this end, wage policy should perhaps be a little less backward-looking than heretofore, and primarily governed by future possibilities. Due heed will have to be given in this respect to the fact that the economy's growth rate has appreciably flagged.

Given the will to work together and the respect of decisions jointly arrived at, it is evident that such a "forward-looking" policy can be considerably facilitated by drawing up sufficiently detailed economic budgets and discussing them with both sides of industry.

**II. THE SITUATION IN EACH
OF THE COMMUNITY COUNTRIES**

A. Federal Republic of Germany

Expansion has continued in the second quarter and, so far as can be seen at this stage, in the summer months. Demand from abroad, however, has not provided any particular stimulus. Private investment expenditure has continued to show a notable increase, though not at the same pace as in the first quarter. Public demand has expanded rigorously. Private consumption has mounted considerably, which is especially due to the brisk upward movement of wages.

Despite sharp strains on the labour market, production and employment have both risen again. In the second quarter industrial production exceeded by roughly 5% that of the corresponding period of the previous year. Imports also have mounted strongly; the decline in surpluses on current account continued.

The upward price trend at first continued; this was mainly due to shortages of some agricultural products owing to weather conditions but also to manufacturers passing at least some of the higher wage costs on to the purchaser.

The outlook until the end of the year and for the first half of 1963 seems on the whole to indicate continued expansion. There is likely to be a slight upward movement in exports. The increase in equipment investment will slow down a little again, as business firms seem to be cautious in their new investment projects. Demand for building however exceeds production capacity by far, so that for the time being there is no end in sight to the strain on the building market. Public consumption will continue to increase rigorously, whereas expansion of private consumption may weaken a little.

Production is likely to rise further. Imports will continue to increase, though at an appreciable slower rate. The upward trend of prices is likely to weaken.

The real GNP will probably increase by about 4% in 1962. The present outlook—especially for exports, investments in trade and industry, and possibilities of an increase in employment—suggests that the expansion rate for 1963 will prove a little lower.

1. Recent developments

The trend of exports of goods and services rose only slightly in the second quarter. Foreign trade statistics show that the value of goods exported was 3 % above that of the corresponding period of the previous year and thus the same as in the first quarter. In July/August, however, they were 4.5 % above the previous year. Earnings from services—especially the tourist trade—were higher than a year ago.

The rise in internal expenditure has so far fallen off only a little. However, some slowdown is to be noted in the development of fixed investments, as the expansion of investment in equipment has recently lost much of its vigour. Though in general they were still quite high, the rates of expansion of domestic sales in the representative capital goods industries clearly declined from the first to the second quarter. Building, however, which in the early months of the year had been affected by unfavourable weather, made a strong recovery.

Investment in stocks has not on the whole provided much fresh stimulus in recent months. Nevertheless the rundown of stocks by the processing industries and trade seems to have abated in some important products, especially steel. Pithead stocks of hard coal and coke fell back in June to the relatively low level of mid-1958, largely because of reduced production and the exceptionally cold weather in the first half of the year. The boom in consumer expenditure caused the retail trade further to increase its stocks.

Expenditure on private consumption has indeed continued to expand and even gained momentum. In the second quarter the value of retail trade turnover was 13 % and its volume 8 % higher than a year earlier; in the period July/August the figures were 7 % and 3 %. Here, accidental factors slightly inflated the figures for the second quarter, and depressed them for July/August.

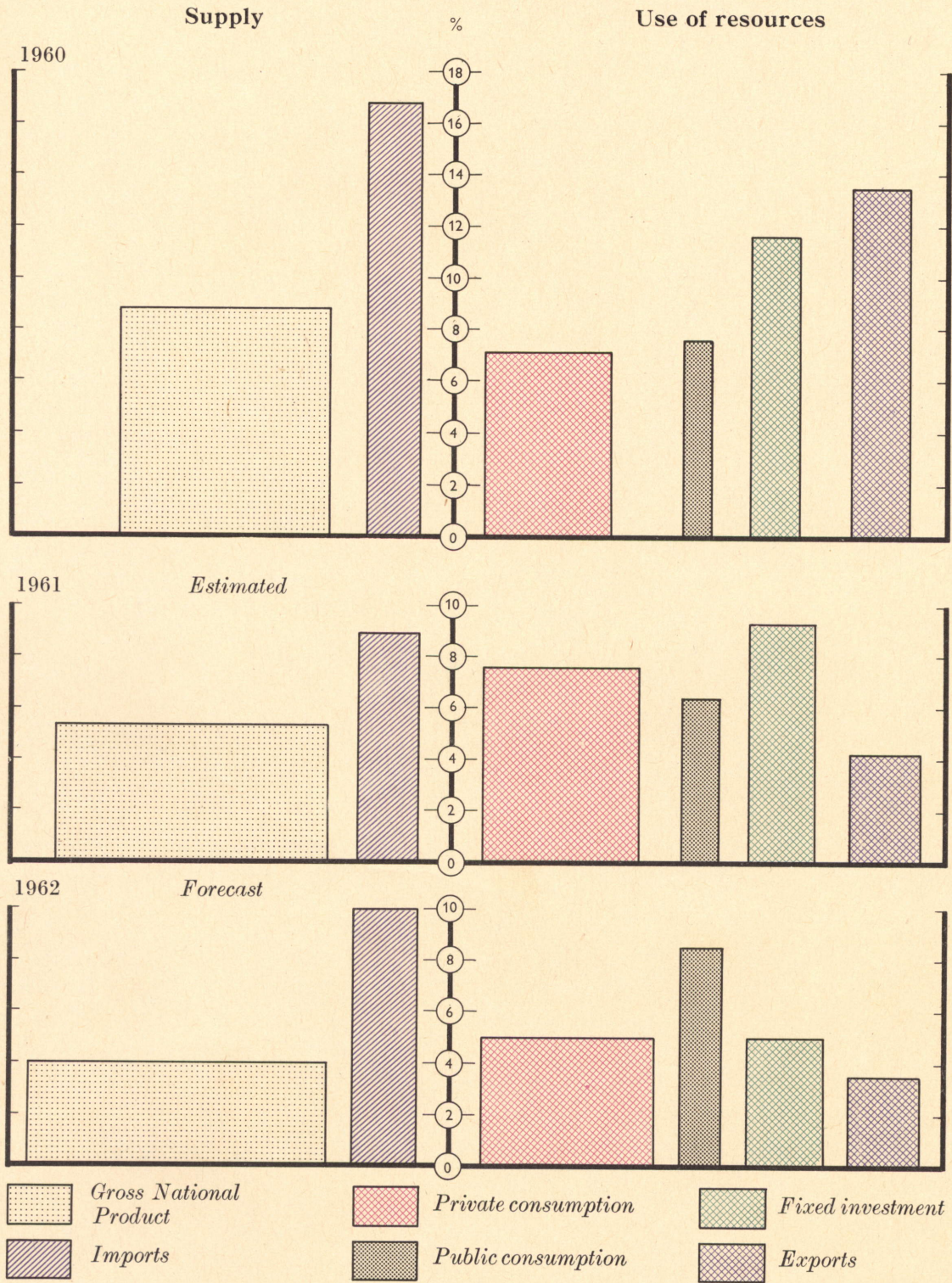
This expansion of private consumption is largely due to the marked increase in disposable household income, less being laid aside for savings (the savings rate declined slightly). In the second quarter hourly wages under collective agreements were 8.6 % up on the previous year, or almost as much as in the first quarter. Nevertheless the new agreements concluded seem to indicate a slowing down of wage increases. Effective earnings again rose faster than those under collective agreements.

Since transfer incomes have also risen appreciably, it is likely that—taking into account the rise in employment and the shortening of working hours—mass incomes have risen about 11 % over the second quarter of 1961, as compared with 10 % in the previous quarter of the present year.

Owing largely to the continued reduction of working hours under collective agreements, the labour market is still under considerable strain, although the number of employed has risen further, especially as a result of more vigorous recruiting of foreign labour. At

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
Percentages for 1960 exclude Berlin and the Saar, from 1961 on they exclude Berlin only*

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the end of August the number of unemployed reached a new low at 83 000 (or about 0.4 % of all persons in paid employment). The number of vacancies registered was fully seven times this figure.

Industrial production went ahead a little more quickly than hitherto. The year-to-year growth rate, i.e. the increase over production in the corresponding period of the previous year, rose from 1.7 % in the first quarter to 5.2 % in the second; but it must be remembered that the extraordinarily unfavourable weather conditions at the beginning of the year put a brake on expansion. In July the growth rate was 4.1 %. It would seem that the maturing of many of the investments begun in the boom period has improved the resilience of production despite the the shortage of labour. Overall expansion would have been even more vigorous in recent months were it not that in some capital goods industries, in contrast to all other important branches of industry, production declined.

Agricultural production continued to move forward despite the unfavourable weather conditions during the early months of the year. The harvest as a whole is likely to be better than that of last year. Animal products have also shown a further increase.

Imports of goods and services have again expanded considerably. According to foreign trade statistics the value of goods imported was 10 % above that recorded in the corresponding period of the previous year, and in terms of volume the increase was as much as 12 %. In July/August last year's figures were exceeded by nearly 14 %. Agricultural products and industrial finished goods again topped the list of imports whilst imports of raw materials were again below the level of the previous year. Expenditure on services abroad rose considerably, especially in connection with tourism.

Despite the continuing growth of production and a high level of imports, prices continued to rise—not least because of a further increase in labour costs. However, the upward trend became less marked. This was first reflected in the cost of living index in August. In that month the index of consumer prices was by then only 2.9 % above the corresponding 1961 figure because of a decline in food prices whereas the year-to-year increase had been 4.3 % for July.

The relatively slight increase in exports and the continuing vigorous rise in imports led to a further deterioration in the balance on current account. Including the growing deficit on unrequited payments, the balance on current account ⁽¹⁾ in the second quarter showed a deficit on DM 200 million as compared with DM 150 million in the previous quarter and a surplus of almost DM 900 million in the second quarter of 1961. In the

⁽¹⁾ The balance on current account and the trade balance have not been adjusted by the amount resulting from the inclusion in foreign trade statistics of goods held in bond (1st quarter 1962 : DM 411 million; 2nd quarter 1962 : DM 54 million).

second quarter the trade balance showed a surplus of DM 940 million as against DM 1 700 million in the corresponding period of the previous year.

The total gold and foreign currency reserves of the banking system (Bundesbank and other banks) fell by DM 360 million in the second quarter, an improvement in the central foreign exchange reserves by DM 770 million being more than offset by a deterioration of the other banks' foreign exchange position by DM 1 130 million.

The deterioration in the banks' foreign exchange position is mainly due to a heavy repatriation of foreign balances prompted by the shrinking margin of domestic liquidity. Not only did the influence of the altered balance of payments position make itself felt, but the cash transactions of the central authorities tended mainly to contract internal money circulation—although much less so than in the first quarter because the sharp rise in public expenditure was in general accompanied by a slowdown in the upward movement of revenue. The cash situation of the Federal Government deteriorated appreciably in the second quarter, as compared with both the previous quarter and the previous year. In order to meet its cash requirements, therefore, the Federal Republic issued, at the beginning of July, its first loan for some time on the capital market (DM 400 million).

Credit expanded a little more vigorously in the second quarter. More medium- and long-term advances were made to trade and industry, largely because of a decline in the internal financing ability of firms owing to narrower profit margins.

2. Outlook

Though on the whole the trend of orders from abroad was rather weak—in the second quarter they remained somewhat below current deliveries and also failed to reach the level of the corresponding period in the previous year—it is nevertheless possible that exports may move upwards somewhat more rapidly in the coming months of 1962. As ability to deliver is increasing in certain branches and in a number of the same branches domestic demand is slackening, firms are likely to concentrate more on exports again; some foreign order books are still very well filled. It is also possible that the tariff reductions put into effect by the Community and the USA towards the middle of the year may provide some stimulus. Finally, export business is likely to benefit increasingly from the provision of capital for development aid, which has not yet produced the expected effect on deliveries to the developing countries.

Domestic demand will continue to expand vigorously in the coming months, but the gap between nominal overall demand and real overall supply will narrow further. Especially there is likely to be a renewed decline in the growth of gross fixed investments. Though the high level of domestic orders for capital goods, which have accumulated during the investment boom of recent years, ensures a further expansion of equipment investment, firms are nevertheless displaying a cautious attitude in their new investment pro-

grammes. In mechanical engineering, for instance, domestic orders received during the second quarter were 10 % below the previous year's level and 12 % below current deliveries. Apart from other factors, such as less confident expectations of export business and keener foreign as well as domestic competition following an increase in supply capacities, rising wage costs and the resultant contraction of profit margins seem to be exerting a damping influence on the investment projects of firms. Investment for purposes of rationalization is however, rising vigorously. Whilst the IFO survey of investment projects suggested that, as compared with previous years, at the beginning of this year the emphasis was more on the expansion of capacity, the latest inquiries show that rationalization has again come to the fore as a reason for investment.

Despite an only relatively weak development in the volume of building for which permits were issued, building investment will continue to expand vigorously, mainly because of a heavy backlog to be cleared off. In the second quarter permits for industrial and commercial buildings still exceeded the previous year's level by two per cent, in terms of space enclosed, but this may to a large extent be due to the fact that in May many permits were issued for buildings which fall under the building stop which came into effect in June. In housing, the building permits issued in the second quarter, in terms of space enclosed, were a little down on the figure for a year earlier, but the backlog in this sector is particularly large. There has been a slight increase in permits issued for public buildings. Finally, investment in transport infrastructure is likely to expand again appreciably.

While the resistance of employers to trade union wage demands is hardening, there will still be a substantial increase in wages and salaries, though it may be a little less rapid than hitherto. In consequence, the lively expansion of expenditure on private consumption is also likely to continue.

The upward trend in industrial production will probably be maintained, especially in certain branches, such as the steel industry, where the order position has recovered to some extent from the restraining effect of the stock cycle last year. The production growth rate in the motor industry may also quicken a little as additional capacity becomes available and new models are introduced. Generally speaking, the pace of productivity increase could become faster again in those branches in which the investments of recent years are now maturing and in which the order position is favourable.

The growth rate of imports, on the other hand, will probably decline towards the end of the year, especially since there is likely to be a fall-off in the expansion of agricultural imports which, in the farming year 1961-62, was particularly heavy because of the very poor harvest in that year and because importers had anticipated the introduction of the first EEC agricultural regulations.

Despite the excess demand which still exists on the whole and despite the rise in labour costs per unit of output, which is certain to continue for a while, the upward trend of prices may weaken further in the coming months. In the first place the gap between

supply and demand is narrowing appreciably in a number of sectors, and secondly wage costs, as we have said, are rising less rapidly. A recent poll carried out in the EEC countries shows that business circles are expecting a less marked upward trend in prices than even at the beginning of the year. Lastly, further corrective adjustments of prices should take place for some agricultural products.

Developments since the beginning of the year and the outlook for the coming months, as sketched above, do not warrant any material change in the forecast contained in Report No. 1-1962 for the whole year. The real GNP may therefore be expected to increase by about 4 % and industrial production by the same percentage. Gross fixed asset investment and private consumption may increase by about 5 % expressed in constant prices. The rise of public consumption will be particularly vigorous this year. On the other hand with the volume of exports growing only at roughly the same rate as the GNP, and imports rising vigorously, the contribution from abroad will be notably smaller. Against this on the whole satisfactory development must be set the fact that in 1962 the domestic price level will have risen more than in the previous years.

So far as next year's trends can be forecast at this stage, the relatively slow rate of expansion can be expected to continue—at any rate for the first half of 1963. The impetus provided in the second half of 1962 by domestic demand—especially private consumption and public demand—will certainly still be effective. Building investment will also go on expanding vigorously, the real rate of growth in the first half of the year being possibly greater than in 1962 provided weather conditions are normal.

The development of foreign demand and of private investment by firms remains a factor likely, however, to curb expansion. On the whole it is unlikely that the growth rate of exports will be appreciably higher than in 1962, in view of the relatively poorer competitive position of German industry and especially if the economic trend in some important buyer countries were to be quieter than hitherto.

It is true that the rise in domestic demand from ultimate users, the severe shortage of labour—it is hardly likely that in view of the shortening of working hours, which can be expected to continue, the volume of employment will increase in 1963—and higher costs provide further incentives to capital investment, but it is not certain whether businessmen will be willing much longer to accept the need for more outside financing, already imposed by shrinking profit margins, especially when the terms and conditions for such financing are not particularly favourable.

The outlook being what it is, general measures of credit or fiscal policy to damp down demand are not advisable even were the price level to continue its upward movement for a while in 1962—a movement which is largely due to the after-effects (at present more especially in the form of rising costs) of over-strained boom conditions in previous years. The measures referred to above could hardly have any effect on this except—if they were stringent enough—at the cost of a recession. On the contrary restrictive measures might

in the long run accentuate price rises because they would necessarily affect productive investments. As it is, the investment boom which without doubt has been overheated at times has given way to weakening trends which, if they were to become more pronounced, might one day give rise to certain problems.

On the view that demand should expand to the point of working the capital goods industries to capacity—which would be in the interests of higher productivity—everything possible would therefore be done to make the financing of capital expenditure by firms more difficult. This means that a suitable credit and interest policy is required. In addition, further efforts must be made to halt rising wage costs per unit of production by exercising moderation in direct and indirect wage increases. It seems obvious that such action would have a favourable effect on prices—not least in the markets of goods and services for private consumption.

It is obvious, however, that, the outlook for prices and business conditions being what it is, an even stronger expansionary policy in the field of public finance is undesirable : the Federal Government intends to hold the growth of public expenditure under the estimated 1963 growth rate of the GNP in terms of value. Here, restriction should be concentrated on those expenditure items which influence building, where there will still be a considerable excess of demand in 1963. Here it is a question not so much of public building as of direct and indirect subsidies to housing.

B. France

Economic expansion continued in the spring and certainly also in the summer months. True, it ceased to be stimulated by overall foreign demand, since outlets in the franc area dwindled considerably, but internal demand maintained its vigorous upward trend. Investment showed further expansion. It was in private consumption, that growth seems to have been particularly large, as the rising level of wages and employment led to a substantial increase in mass incomes.

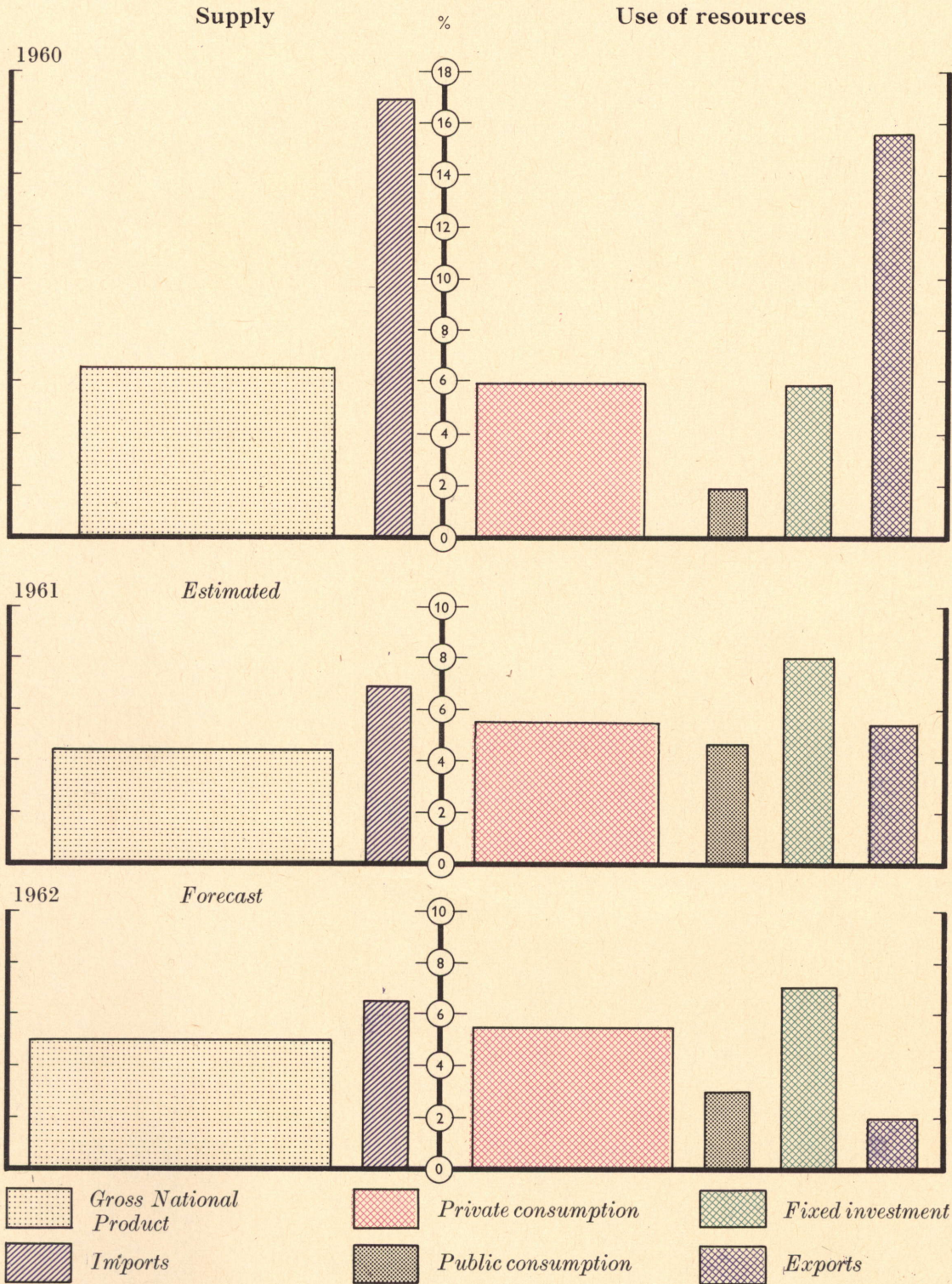
Agricultural production was not particularly favoured by the weather, but industrial production, on the other hand, again rose appreciably, being 7.4 % up on the second quarter of 1961. More recourse was had to imports to supplement domestic supply. Prices continued to rise. The general level of consumer prices rose by 1.5 % between March and July, when it reached a figure over 6 % higher than a year earlier.

The balance of payments continued to show very high surpluses. In the first seven months of the year net official foreign exchange reserves improved by about \$386 million although in the same period foreign debts were discharged to a total of about \$580 million, mostly advance repayment.

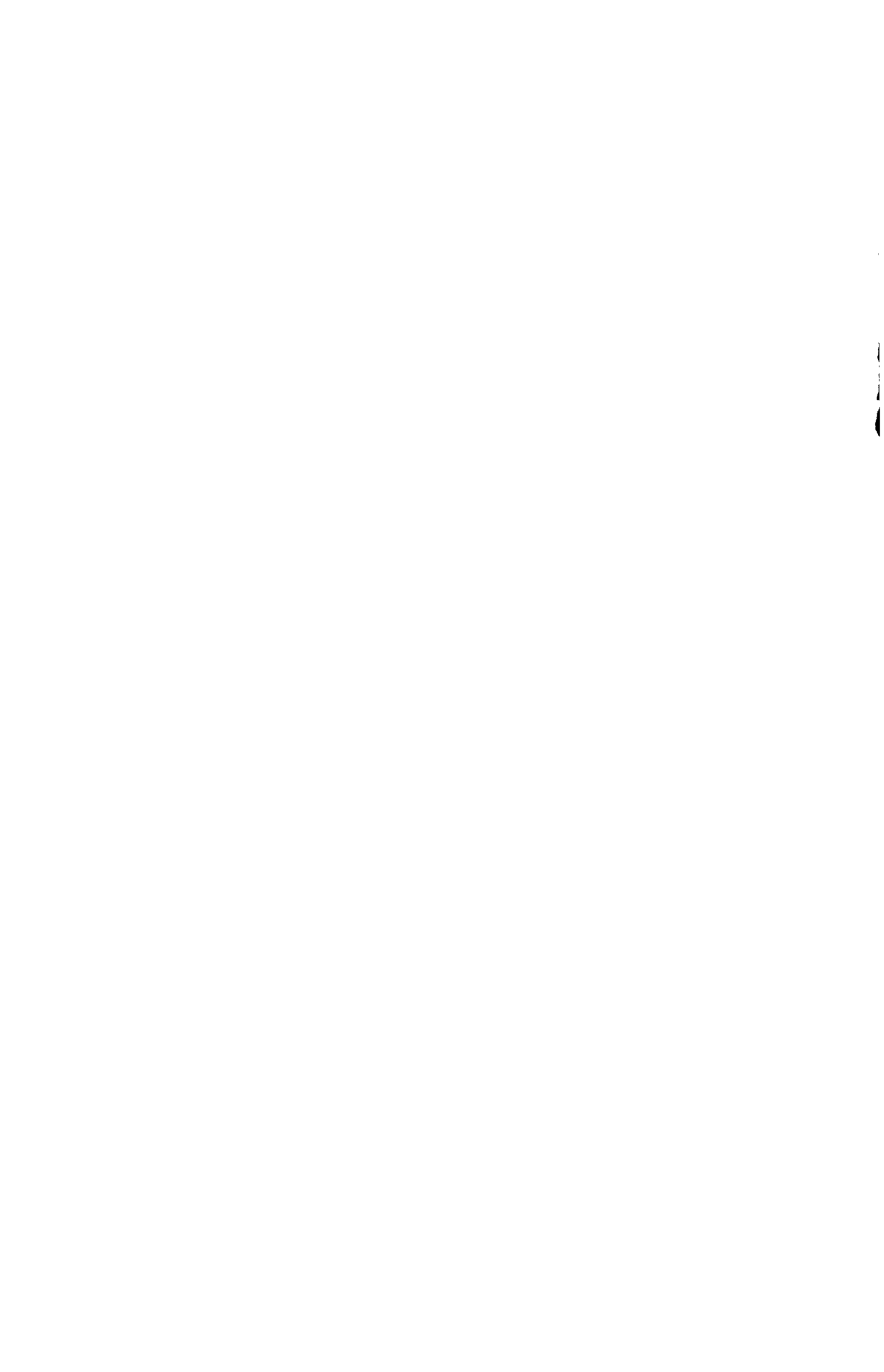
The relatively favourable economic trend is likely to continue for the rest of 1962 and into 1963, with internal demand still the main factor in expansion. While the outlook for exports cannot be thought particularly favourable owing to the still unsettled situation in Algeria and uncertainties over growth prospects in some non-member countries, there are adequate incentives for a continued expansion of investment and particularly for a further powerful expansion of private consumption. It is highly improbable that there will be any need in the near future for measures to stimulate demand. Looking further ahead, the integration of repatriates from Algeria may, of course, set new problems of economic policy. But at the moment the most urgent problem seems to be to stabilize prices, and here a national incomes policy, as foreshadowed by the September review of wages (the "rendez-vous de septembre"), could go a long way towards a solution.

SUPPLY AND USE OF RESOURCES GOODS AND SERVICES

Change in volume in relation to the preceding year



The width of each column is in proportion to the corresponding figure (in terms of value) for the preceding year



1. Recent developments

Foreign demand for goods and services, which had still been expanding at the beginning of the year, failed to provide any further stimulus to the growth of overall demand in the second quarter, and, if seasonal variations are discounted, exports of goods even fell off slightly. According to foreign trade statistics they were 0.1 % below the 1961 figure in the second quarter, after showing a year-to-year growth rate of 6.1 % in the first. In July, too, exports were no higher than a year earlier.

The reason for this lay in a further heavy decline in sales, not only in Algeria but also in many other countries and territories in the franc area, representing a total fall on the previous year of 15 % in value in the first quarter and 30 % in the second. Furthermore exports to countries outside the franc area expanded rather more slowly in the spring months, the growth rate falling from 14 % in the first quarter to barely 10.5 % in the second. True, exports to the other EEC countries continued to rise at nearly their previous rate, but exports to other industrialized Western European countries showed a somewhat more hesitant trend and exports to the United States seem to have suffered a temporary setback.

Exports of services were definitely higher than in the second quarter of 1961.

Economic activity was again vigorously stimulated by internal demand. The growth of fixed investment by enterprises seems to have slowed down less than had generally been feared at the beginning of the year on account of the growing pressure on profit margins. At any rate, the INSEE survey at the beginning of June showed that the figures forecast for private industry in 1962 as a whole could be put slightly higher. Since investment by State enterprises in building and equipment and direct investment by the State also continued to expand, and housing benefited from improved weather conditions in the second quarter, total fixed investment probably reached a level appreciably higher than that of a year earlier.

Investment in stocks does not seem to have reached a very high level. In view of the supply situation on world markets, there was little incentive for industry to increase stocks of raw materials. Though the volume of goods in process must have gone up as output expanded, according to an INSEE survey of trade and industry, stocks of finished goods declined. In agriculture, the trend in stocks was probably mainly determined by seasonal factors.

Expenditure on private consumption clearly increased at a somewhat faster rate. Wage and salary disbursement went up considerably, due to fresh pay rises and a slightly higher employment level. Moreover, transfer incomes grew more rapidly as various social benefits were raised and, in particular, as the system of financial aid to repatriates from Algeria came into operation. Furthermore part of the funds brought back from

Algeria helped to swell consumption. Finally, it is possible that less of disposable household income went into savings in the spring months. At any rate, the net amount of liquid and short-term savings (time and savings deposits, Treasury bills) in the second quarter was only half as much as a year earlier.

As in the first quarter, the increase in consumption was mainly in consumer durables, particularly motor cars and certain household appliances. But sales of textiles and footwear, too, made a distinct recovery.

Public consumption, particularly expenditure on wages and salaries, continued definitely upward.

Whereas on the markets for industrial products supply was elastic enough to meet demand, the tightness on agricultural markets was clearly aggravated. Agricultural production, which had already been held up by the cold spring, was further handicapped by the dry summer. Certain fruit and vegetable crops were rather poor in quantity and quality; the production of meat, milk and dairy products was affected by the fodder shortage.

Industrial production in general further expanded in the second quarter, reaching a figure 7.4 % higher than a year earlier. The fact that, according to the seasonally adjusted INSEE index, the increase of 1 % on the preceding quarter was only half the increase recorded between the last quarter of 1961 and the first quarter of this year is due to the very steep trend in output in the autumn and winter of 1961, when the new motor car models were introduced. On balance there has been no real decline of the growth trend in industry since the beginning of the year. Only in textiles and certain domestic appliances and investment goods was there a slight slow-down. In almost every other sector, particularly motor cars and chemicals, expansion continued briskly. A distinct improvement was recorded in metal production and first-stage fabrication. In general the production trend followed closely the placing of orders. The position regarding order books and delivery dates remained practically unchanged.

According to information supplied by employers, the labour shortage in industry as a whole again grew slightly more severe between March and June, despite a large increase in foreign labour employed. The proportion of undertakings where labour shortages render the expansion of production either difficult or impossible went up from 31 % to 33 %. After a hesitant trend in the first quarter, a distinct increase was recorded in the number of vacancies. True, the number of persons seeking employment also increased in the summer months owing to the growing number of school-leavers and of persons returning from Algeria, but present labour reserves do not seem in all cases to meet the need from the point of view of age, skills or geographical distribution. Metal production and fabrication and the building sector are particularly hard hit by this imbalance between supply and demand in labour.

Imports of goods and services made a somewhat greater contribution to the increase in total supply than in the early months. At any rate foreign trade statistics show that, if seasonal variations are discounted, there was again a more marked rise in imports of goods ⁽¹⁾, which in the second quarter were up on the previous year by some 7 % to 8 % in terms of volume. In July the growth rate even climbed to about 16 % to 17 %. In particular, more foodstuffs and manufactured consumer goods were imported, whereas imports of investment goods slowed down somewhat. The volume of raw materials imported was again less than a year earlier.

Expenditure on services also rose, because of increased transfers of investment income and an increased outlay on foreign travel.

The price rise continued. Where foodstuffs in particular were concerned, producers and distributors raised prices considerably, so that prices to the consumer were 2.4 % higher than in March and 9.5 % higher than in July 1961. Market conditions for industrial products also made it possible to pass on to the consumer part of the continuing increase in wage costs per unit of output. Since the upward tendency in prices for services also continued, the general level of consumer prices went up by 1.5 % between March and July 1962, reaching in the latter month a figure 6.3 % higher than a year earlier. Similarly, building costs also continued to rise and were 4.9 % up on the second quarter of 1961.

Falling exports, rising imports and more or less unchanged terms of trade meant that the deterioration of the balance of trade, after coming to a halt in the first quarter, continued in the spring months. This only applies to trade with the franc area, however, considerable surpluses being again recorded with countries outside the area. The overall balance of payments, too, showed a heavy surplus. The gold and foreign exchange reserves of the Banque de France and the Exchange Stabilization Fund went up by \$393 million, despite the fact that in the first seven months of the year foreign debts were repaid, mostly in advance, to a total of about \$580 million. In this period the net foreign exchange position of the monetary authorities improved by about \$386 million. By contrast, the net foreign exchange position of the commercial banks has deteriorated, by about \$100 million since the beginning of the year.

The net inflow of foreign exchange and the repatriation of funds from the franc area increased liquidity on the money and capital markets. Furthermore the Treasury's cash position again showed a deficit, following a surplus in the first quarter. From the beginning of May the strain on the market, which had temporarily made itself felt by a steep rise in call money rates, was rapidly eliminated. There was a fresh and substantial increase in the flow of credit to trade and industry, although at a somewhat slower rate than a year earlier. Also, less demands were made on the capital market than in the second

⁽¹⁾ Both here and for the balance of trade, which is discussed below, certain items carried over from 1961 and added for purely statistical reasons have been omitted from the January import figures.

quarter of 1961 but this was simply because of the earlier timing of certain issues made by savings institutions and public bodies. Industry again raised more capital on the market than in the previous year.

2. Outlook

The general economic situation is not expected to change substantially in the last months of the year. The trend in demand, production and employment will, on the whole, remain expansive.

Foreign demand, however, is likely to provide very little stimulus. Even if the situation in Algeria soon becomes more settled, it is not very likely that exports to that country will make a firm recovery before the end of the year. It is to be feared that even in the longer term the market for French products has shrunk in Algeria as in many other countries and territories in the franc area. The further expansion of exports to countries outside the area is hampered by some elements of uncertainty, in particular the economic outlook in the United States and some EFTA countries. Sales to other EEC member countries are likely to rise further, but as regards exports in general business circles are taking a more pessimistic view. The EEC business survey shows that orders from abroad are coming in more slowly, and it is thought that order books are less well filled than a few months ago.

Internal demand, on the other hand, should maintain its strong upward trend. Extensive capital projects are under way in private industry and in the public sector. In addition the agricultural sector will probably show a greater propensity to invest, farm incomes having been higher than last year, thanks to bigger sales at higher prices. The influx of repatriates from Algeria is providing an added stimulus and entailing higher expenditure in the housing sector. Public housing schemes have already been expanded and 15 000 of the 50 000 additional dwellings planned should be under construction by the end of the year.

Private consumption will be powerfully stimulated by the continued expansion of income. Further wage increases are likely in both the private and public sectors, since the recent rise in the cost of living and the strong position of the worker on the labour market will make it easier, from both the psychological and practical angle, for trade unions to press wage claims. An additional stimulus to private consumption will probably come from the increase in transfer income, particularly payments to repatriates from Algeria.

With these prospects of development in demand, industrial production will doubtless show a further rise. The labour shortage may well, however, still constitute a bottleneck, at least for some time. True the post-war population bulge is now finding its way on to the labour market and the shortening of the period of military service will also gradually

make itself felt; on the other hand, net immigration of Algerians, which provided a labour force of over 33 000 in 1961, will probably fall off. Moreover, returning French citizens will not rapidly enter productive employment because, so far at least, they lack occupational and geographical mobility.

Domestic supply will again be heavily supplemented by imports. If harvests come up to expectations less foodstuffs will have to be imported, but imports of semi-finished and finished industrial products will probably continue to increase.

The results of the first six months and the prospects outlined above suggest that the gross national product in real terms for the whole year of 1962 will show an increase over 1961 of 5 %, which was the forecast made at the beginning of the year in Quarterly Survey No. 1-1962. Though the growth rate for exports of goods and services must be expected to be much lower because of the unfavourable market conditions in the franc area, there should be a somewhat greater increase in private consumption than was forecast in the spring, thanks to a faster growth of household income.

So far as it is possible to make forecasts for 1963, a continuation of general economic expansion is indicated, at any rate for the early months of the year. True, the prospects for further progress of French exports as a whole are not thought to be very encouraging, but there should still be enough internal stimulus to swell the aggregate demand. As regards fixed investment, though industrial concerns may not at present have any special incentive to lay out capital in order to expand capacity, they may well feel more strongly urged to rationalize in order to cut costs and maintain their competitive position. Public undertakings will in any event continue to increase their expenditure on building and equipment under existing programmes. In the housing sector, the additional demand for dwellings for repatriates from Algeria will have its full impact in 1963. A steep increase in direct public investment can also be counted on. As regards public consumption also, the preliminary budget proposals for 1963 indicate that there will be a further increase in expenditure. Last, but not least, private consumption will show a further increase, since the expansion of income seems destined to continue. Hence, all the necessary conditions are present for a fresh growth in output and employment.

Consequently there will in all probability be no need to resort to special economic measures to boost overall demand in the coming months and on into 1963. The aim should rather be to maintain a pattern of demand which is most beneficial to the economy, thus ensuring a balanced expansion. Hence the desired integration of repatriates from Algeria into economic life can probably only be brought about by stepping up investment and this consideration should outweigh any propensity of the public or private sectors to increase their consumption at the expense of the margin available for expansion. Particular importance will have to be attached to this in approving additional government expenditure. At the moment, however, the estimated additional expenditure does not appear to exceed the anticipated increase in revenue arising from economic growth and higher prices, so that probably the finance bill for 1963 will again assume only the usual

deficit of NF 7 000 million. But there is no saying that expenditure will not exceed expectations if assumptions prove incorrect as to the numbers of persons returning from Algeria and the difficulty of placing them in productive employment. The need to spread the burden could, it is true, be met by higher taxation, but in the present circumstances this would only be judicious, from the economic angle, in so far as it affected household income and did not, as a cost factor, increase the pressure on profit margins or push up prices.

In any case, the trend of profit margins already requires the special vigilance of those directing economic policy. In industry, wage costs per unit of output have, for some time now, been rising faster than prices. If this trend continues, it could threaten the propensity of businessmen to invest, especially if they are unable to tap outside sources of capital arising from increased savings. A solution might lie in the national incomes policy under consideration, since of course no continuation, still less acceleration, of the price rise is desirable. It is therefore to be hoped that the "rendez-vous de septembre" will achieve some positive result, thanks to the sense of responsibility and co-operative spirit of all parties.

This is all the more important because otherwise the price rise will certainly continue. While there are signs that food prices are now steadying, the situation as regards industrial products has lately deteriorated. More significant cuts in customs duties and fresh efforts to make domestic competition keener by shortening and modernizing distribution would be effective methods of stabilizing prices.

C. Italy

The weakening of economic growth continued in the spring, though losses of production caused by strikes also played a part in this. Whereas foreign demand for goods and services advanced at a rather slower rate and the development of investment lacked assurance, it would seem that private consumption once again afforded a definite stimulus to expansion. Wages again rose sharply.

Mainly because of the strikes, the seasonally adjusted figures for industrial production rose though only very little. They were nevertheless still almost 10 % up in the second quarter on the corresponding figure for 1961: the year-to-year increase for the first quarter had been 12 %.

There was again a marked upward price trend in the second quarter, mainly due to a further rise in food prices. In June wholesale prices rose by 3.3 % and the index of consumer prices by 4.7 % as compared with the year before. In accordance with the sliding wage scale, cost-of-living allowances were raised very substantially on 1 May and on 1 August. In view of the fact that harvest prospects have recently become considerably less promising, it would not, perhaps, be reasonable to predict that the upward pressure on prices will ease off towards the end of the year.

Despite the usual seasonal improvement in the balance of current transactions (on a cash basis), official gold and foreign exchange reserves were further run down in the second quarter, to the tune of \$40 million, by certain capital outflows. But without the extraordinary payments made in July, they would have risen again appreciably.

The current slow expansionary trend should continue until the end of 1962; however, mainly because of the rapid growth in the last quarter of 1961, there is likely to be an increase for the whole year of about 6 % in gross national product at constant prices and of 9 % in industrial output in 1962.

*The outlook for next year remains expansionary. Besides continuing support from private consumption and foreign demand, expansion should get a powerful boost from public investment. Against this background private investment might well pick up again, although for the time being the propensity to invest seems to be falling off. This calls *inter alia* for a flexible credit and financial policy, since self-financing margins are getting somewhat tighter. Further measures to facilitate imports may, like the supplementary tariff cut just implemented, help to keep prices steady.*

1. Recent developments

Foreign demand for goods and services taken as a whole continued to expand in the second quarter of 1962. But this trend, which had however been exceptionally vigorous towards the end of last year, seems to have again slowed down somewhat. Admittedly, customs returns show that in terms of value the year-to-year growth rates for exports of goods rose from 15.9 % in the first quarter to 16.3 % in the second. At the same time, however, exports of services seem to have risen more slowly despite the continued brisk expansion of tourist receipts.

Exports of important capital goods progressed at a faster rate. But high and rising growth rates were also recorded for exports of textiles and clothing. By contrast, the growth of exports of foodstuffs, metal products, transport equipment and also agricultural products declined. Exports of transport equipment were probably however, affected by the reluctance of purchasers in EEC countries to place orders before the 10 % cut in internal customs duties which came into force on 1 July.

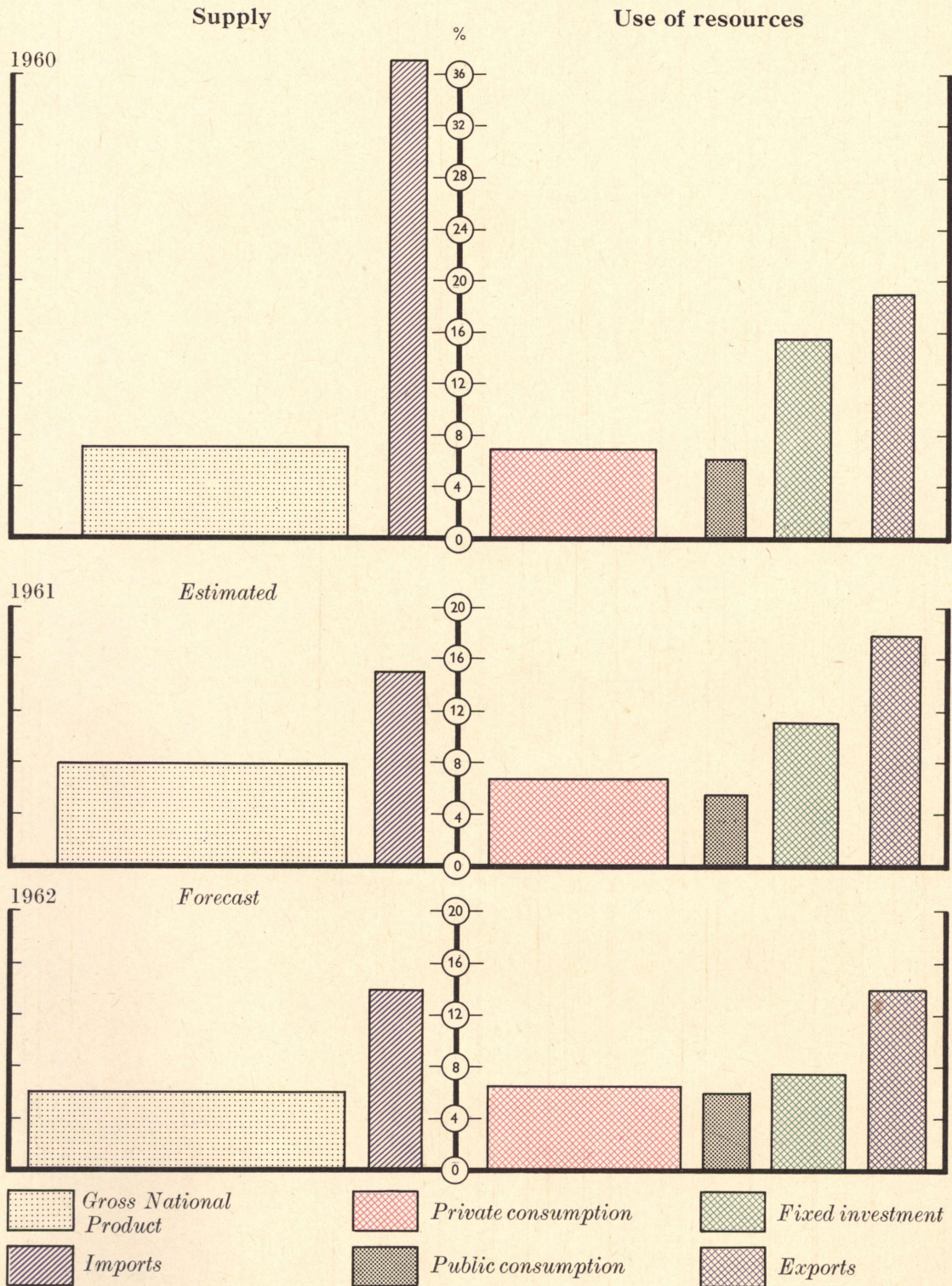
The small spurt in exports of goods noted in the second quarter was solely accounted for by sales in the developing countries. It contrasted with a slight slowing down in the growth of exports to the major groups of countries, including for the first time for many months, the other Community countries.

Domestic demand also continued to grow. This was true for fixed investment, although its general expansionary trend seems at the moment to have suffered a distinct loss of momentum. From the first to the second quarter the year-to-year growth rate of machinery production declined, partly, however, as a result of exceptional factors. There was also a slowing down in the corresponding output of transport equipment. The development of external trade in plant and equipment does not seem to have offset this loss of pace in the expansion of production. At all events, revenue from the turnover tax on domestic sales of some main investment goods, was, by the second quarter, no more than 13 % higher than the year before, as against 18 % in the first quarter.

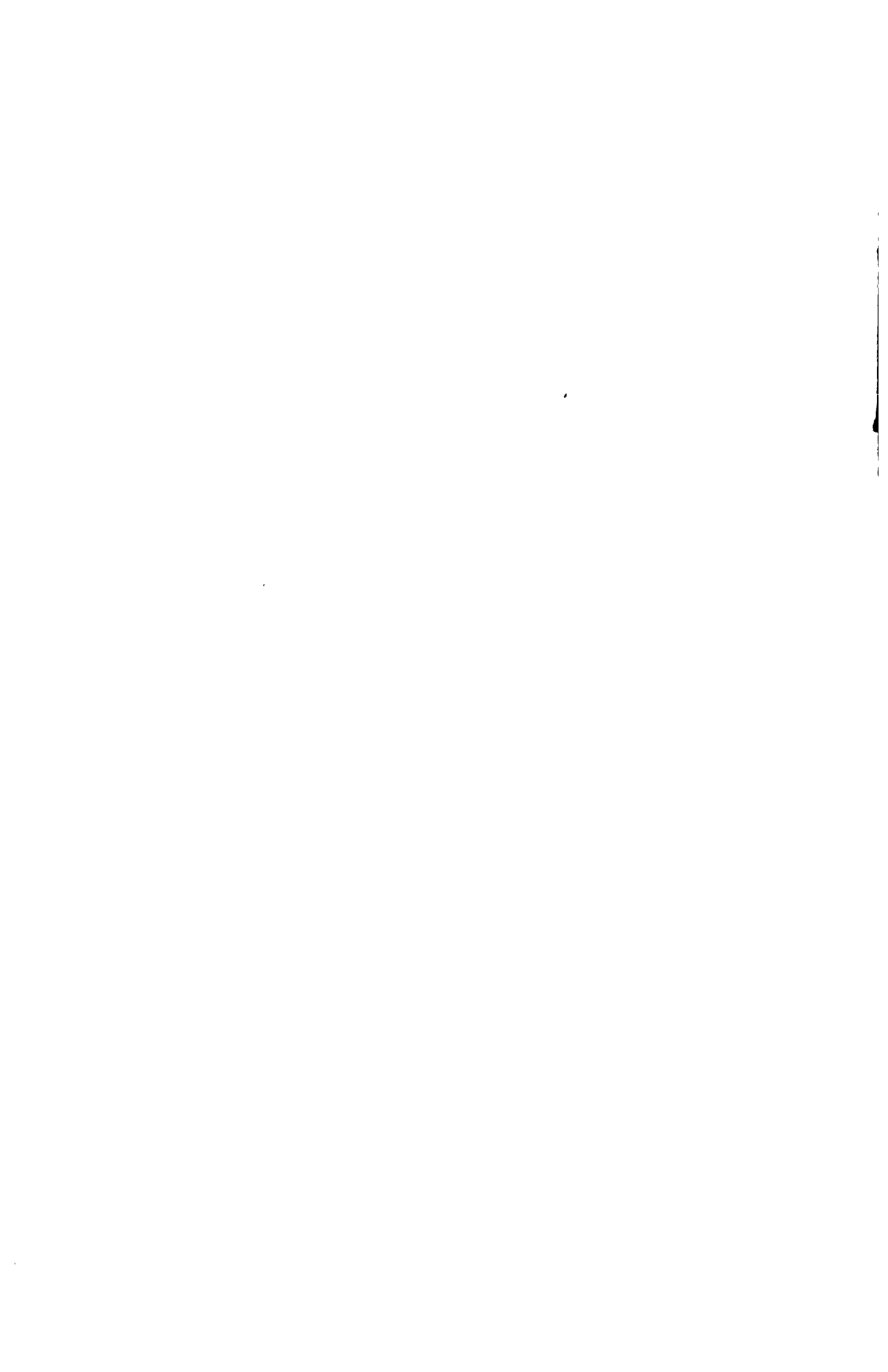
The progress of construction investment, disregarding seasonal and accidental factors, also seems to have been rather hesitant in the second quarter. True, the number of completed dwellings units was only 10 % down on the corresponding 1961 figures, as against 13 % in the first quarter; moreover, the quantitative increase in new industrial and commercial buildings may well have reached once again the level of a year ago, as compared with a 7.5 % drop in the year-to-year result for the first quarter; lastly, production growth in the cement industry, which was running at an annual rate of 7 % in the first quarter, rose to almost 19 %. But it should be borne in mind that building activity was considerably hampered by the weather in the first quarter of 1962, whilst the year previously dry warm conditions had enabled an early start to be made. The underlying trend in the spring of 1962 was therefore unquestionably less favourable than the comparison of annual rates would suggest at first sight. Growth rates for home sales of

SUPPLY AND USE OF RESOURCES GOODS AND SERVICES

Change in volume in relation to the preceding year



The width of each column is in proportion to the corresponding figure (in terms of value) for the preceding year



building materials and for the production of steel building elements even registered a pronounced fall. Public works, excluding housing, which despite the bad weather, still showed a 5 % improvement in the first quarter on the comparable 1961 figure, plummeted in April-May to 17.5 % below the results for the corresponding months of 1961.

Private consumer demand would seem to have made a more vigorous contribution to business activity. Mass incomes are likely to have again grown appreciably. The employment figures were up again, and, above all, income per head rose sharply. In industry and commerce, agreed minimum wages, including family allowances, were respectively 7.6 % and 5.2 % higher in the second quarter than a year ago; the rate even reached 12.9 % in transport, and 18.4 % in agriculture. Civil service pay was 13.2 % above the corresponding 1961 level. The trend in actual earnings was probably even more marked. Cost of living allowances were raised substantially in May under the sliding wage scale agreements. In July social security pensions were increased by about 300 000 million lire.

In contrast with the first quarter, agricultural production enjoyed favourable weather in the second. Consequently, the wheat harvest was again good. On the other hand, the originally very favourable prospects for the other crops were largely spoilt by persistent drought in the third quarter. Moreover, it is doubtful whether livestock production picked up.

The seasonally adjusted index of industrial production (ISCO) registered no further rise worth mentioning in the second quarter, although, despite exceptionally vigorous previous growth, it had risen by 1.6 % in the first quarter. The year-to-year growth rate declined over the same period from 12 % to just under 10 %. However, appreciable production losses were caused by the strikes already mentioned, so that the general trend might well have been kept up. The disparity between the rate of growth of investment expenditure and that of private consumer demand is clearly reflected in industrial production even if the fact that the investment goods industry was particularly hard hit by the strikes is taken into account: whereas the seasonally adjusted output of investment goods declined in the second quarter that of consumer goods continued to expand. In certain cases the shortage of skilled manpower—sporadically in the building sector, for example—may have put a brake on production. With the possible exception of the machine-tool industry there was ample production capacity in all sectors: the average amount of surplus capacity may have even risen.

According to the latest ISTAT survey (July, 1962), the increase in numbers of wage-earners has also slowed down. None the less, there were again considerably fewer unemployed: Ministry of Labour returns show a decrease of 18 % in the second quarter over the corresponding figure for 1961.

The continued expansion of demand engendered a further, though perhaps rather slower, growth of imports of goods and services. At all events, the index of goods imports

(ISTAT) showed an increase for April and May of 10.6 % in volume as against 11.2 % in the first quarter. However, as the average value of these imports had increased marginally, their growth rate in terms of value as compared with 1961 even gained very slightly from 10.6 % in the first quarter to 11 % in the second. According to the Exchange Control, the rate of growth of imports of services may have suffered a setback.

Imports of agricultural products and of foodstuffs and textiles increased at a faster rate because of the particularly sharp rise in spending by private consumers. The slump in the year-to-year growth rate for vehicle imports seems mainly attributable to reluctance to buy pending cuts in customs duties.

Imports from non-member industrialized countries and from the countries of Eastern Europe advanced more rapidly in the second quarter. An exception was imports of goods from the United States, which were even lower than a year ago.

The steep upward price trend which began last autumn continued in the second quarter. After rising by 1.5 % from December 1961 to March 1962, wholesale prices were again up 0.6 % the following quarter. The corresponding consumer price increases were 1.6 % and 1.2 %. At the end of June wholesale prices were therefore 3.3 % and consumer prices 4.7 % above the level of June 1961 and the cost of living was as much as 5.8 % higher. Bad weather during the early months of the year, in Italy as elsewhere, with, as a result, much higher prices for certain important foodstuffs such as early fruit and vegetables, contributed largely to this price increase in the second quarter. On the other hand, although wage costs per unit of output have probably increased again, the prices of finished investment goods rose only very slightly; prices of accessory materials continued to fall.

Seasonally adjusted customs returns indicate an improvement in the trade balance for the second quarter; the deficit on goods, at \$316 million, was also a trifle smaller than a year ago when the figure had been \$331 million. Despite the sharp increase in income from services, the seasonal improvement of the balance on current account (on a cash basis) was however relatively weak only, since the terms of payment had worsened. In addition, capital exports again got the upper hand in the second quarter, whereas in previous years there had been a net capital inflow. For this reason, in contrast with the same period of 1961, the balance of payments on a cash basis showed a deficit in the second quarter (\$25 million). Official gold and foreign exchange reserves therefore declined again, this time by \$40 million, to \$3 239 million. In July they fell again, by \$87 million; however, advance repayments of debts to the United States totalling \$178 million were made during the month.

In conjunction with fresh government cash surpluses and with the seasonal increase in notes and coin in circulation, this movement in the balance of payments caused a certain reduction (in the second quarter) in bank liquidity. Nevertheless, notably because of the flexible credit policy evidently pursued by the monetary authorities, the volume of bank credits could be increased at a growing rate. Thus loans and share purchases by banks

specializing in short-term operation were 25 % up in the second quarter on the corresponding 1961 figure. The more rapid expansion of the demand for credit is explained by the somewhat narrower self-financing margins of enterprises, itself due to the fact that wage costs per unit of output were running ahead of producer prices. The particularly vigorous expansion in the volume of short-term credit was also due to special developments on the capital market, on which prices slumped not least because of the decision to nationalize electricity. The net yield on Treasury Bills, which had been declining since the autumn of 1961, rose sharply in May and June and fell back only slightly in July.

2. Outlook

The general business trend in the second half year should be one of further comparatively moderate expansion.

The outlook for foreign demand still seems fairly good. It is true that the findings of the EEC business surveys carried out by the ISCO-Mondo Economico might suggest that the backlog of orders from abroad had if anything dwindled further by the second quarter. But of the industrialists polled, there were still half who regarded the situation as normal, and 17 % of them even reported particularly well-filled order books. The Mondo Economico's independent half-yearly survey indicated that almost half of those questioned—businessmen and representatives of other economic circles—anticipated an increase in exports, whilst 40 % expected the situation to remain stationary: in point of fact, given the proposed new increase in allocations to the Government's export guarantee fund, the further cut in internal customs duties within the Community on 1 July, world business conditions which by and large are not unpromising, and above all the maintenance of Italy's still comparatively strong competitive position, there should be a further expansion of exports of goods in the second half year. To this should be added, in the services sector, a further and appreciable increase in foreign tourism.

This outlook for foreign demand, plus what is certain to be a vigorous upsurge in expenditure on private consumption, taken with the need for rationalization stemming from what is now, in Italy as well, an appreciable increase in wage costs, suggests that investment will continue to be heavy. The above-mentioned surveys indicate that the backlog of domestic orders is still quite high but is tending to be reduced. At the same time public works should expand appreciably from now on; moreover, large-scale projects are likely to be put in hand in the autumn. Prospects for new housing may, perhaps, become somewhat brighter.

The chief sign of a new and substantial development in private consumption is the present and prospective growth of incomes. In addition to wage increases granted or to be granted under new collective agreements, the progressive introduction of equal pay for women, and the organization by stages of a new system of wage areas, a further increase in cost-of-living allowances in August, and higher pension-rates should result in heavier

consumer spending in the second half year. The higher earnings resulting from the continuous drift of workers from the land and certain service sectors to industry will have the same effect.

There are reserves of production capacity and also, despite a growing scarcity of skilled workers, of manpower, so that production will be able to keep pace with the expansion of demand without any noteworthy difficulty. Imports should again increase, especially since, following the 10 % reduction on 1 July in duties on internal Community trade as part of the programme to speed up the advent of the Common Market, practically all duties were again reduced up to 10 % ⁽¹⁾ at the end of August.

The fact that contrary to what had been expected until very recently, considerable growth in crop production is likely now, means that the upward curve in consumer prices is unlikely to flatten out in the second half year as much as was hoped.

The balance of payments might be restored, since the net outflow of capital should not continue, or at any rate not to the same extent as in the first two quarters, and there should be further surpluses on current account.

The trends observed so far and the prospects up to the end of the year promise satisfactory results for 1962 as a whole, although there has been a distinct loss of momentum, this year, in economic growth as compared to 1961—as predicted in previous quarterly surveys. Mainly because of the very rapid expansion in the last quarter of 1961, the rate of growth of industrial production and that of the gross national product in real terms might none the less reach 9 % and 6 % respectively as against 9.1 % and 7.8 % in 1961. Thus the actual figures will not quite attain the growth rates predicted by the Commission's services early in the year, mainly due to fortuitous factors—the sudden deterioration in the harvest prospects and production losses caused by the strikes.

The economy will undoubtedly continue to expand during the early months of 1963, though the general growth rate is unlikely to be much faster than the average for 1962.

Indeed, the previously mentioned improvement in government export credit guarantees and above all Italy's continuing strong competitive position, once again warrant an optimistic forecast for exports, although world business trends are not exceptionally promising for this period. In addition, there are excellent prospects of a further increase in foreign tourism in Italy. Private consumption may also be considered as a factor certain to make for expansion.

⁽¹⁾ However, unlike the tariff cut of 1 July the maximum reduction of 10 % made at the end of August was not applied to the high duties in force on 1 January 1957 but to existing rates of duty as already scaled down in previous EEC tariff cuts. Vis-à-vis non-member countries the cut was less than 10 % for some products where the full cut would have brought the duties below the future common external tariff.

As for investment, its development may even trigger off a rather faster rate of growth. The outlook for private industrial investment is not particularly bright, however, in view of the present sluggishness of the propensity to invest. Even although investment is being stimulated by the expected development of exports and above all of private consumption, as well as by the need to streamline production in order to digest the wage increases, the rising ratio of wage costs and prices is precisely acting as a brake by making the financing of more investment more difficult. The effects on liquidity and on the capital markets of a perhaps somewhat tighter payments situation in the future and of certain political factors should also be borne in mind.

In view of the situation, it is important that the Government should, as announced, effectively step up its investment more rapidly than it has done so far. Already, as mentioned above, a number of major public infrastructure projects are likely to be speeded up this autumn and considerably expanded in 1963. At all events, the appropriations under the 1962-63 budget for the financing of such long-term projects total no less than 850 000 million lire or 540 000 million lire more than for the previous financial year. Taken in conjunction with the expected expansion of foreign demand and private consumption, the growth of public investment would be a positive factor in the propensity to invest of private entrepreneurs. However, it is also important, if satisfactory development of private investment is to be secured, that entrepreneurs' forecasts regarding business trends should remain sufficiently optimistic. A significant point in this connection is that both sides of industry and recognized experts are co-operating with the Government in the Commission for the Plan, which was set up at the beginning of August with the task of preparing a comprehensive long-term economic development plan.

To ensure an adequate growth of investment, it is important that the Government's credit and finance policy should be very flexible, particularly as long as the securities market remains unsettled. As there is some slack in the Italian economy and foreign exchange reserves are high, there is no risk in the further pursuit of a credit policy for growth, without endangering prices. The sharp price increase over the nine months ending in June was not so much due to an excess of demand over supply because of a shortage of manpower and/or of production capacity—the main reason was rather, that agricultural output had been held up by the bad weather. Besides, it will always be open to the Government to introduce new import incentives in order to keep the prices stable.

D. Netherlands

For the last few months economic expansion in the Netherlands has been relatively slow, although it may well have advanced at a slightly faster rate since June.

Exports went up again, though less rapidly than in the first quarter. Investment probably continued to grow, although here, too, a tendency for the pace of growth to slow down became apparent. While the year-to-year growth rate of fixed investment in the second quarter was higher than in the first, this was probably due in the main to the improved situation in the building sector, which had suffered quite heavily in the first quarter from the particularly bad weather. On the other hand, private consumption, in which progress during the first quarter had been modest, advanced somewhat more firmly, thanks in particular to the expansion of incomes due to the more rapid rise in wages and salaries.

Supply expanded more slowly in the second quarter. Hardly any rise was recorded in industrial production, but since June growth seems to have picked up again slightly. For imports in the second quarter there was even a drop in the overall figure, although finished goods, particularly consumer goods, continued to be imported on a large scale. From July, however, a recovery was recorded in imports too.

The level of consumer prices went up appreciably, largely because of the much higher prices fetched for a time by some crop products and the index number of consumer prices rose 1.6 between the end of March and the end of June. In July, when these unusually high prices came to an end, the index reverted to the March level. It was 2.5 higher than in July 1961, which can mainly be attributed to the continuing rise in prices for services. The balance of trade improved somewhat and the balance of payments closed with a slight surplus. Although the commercial banks' foreign exchange reserves fell between the end of March and the end of July, the gold and foreign exchange reserves of the Nederlandsche Bank went up by almost 400 million guilders.

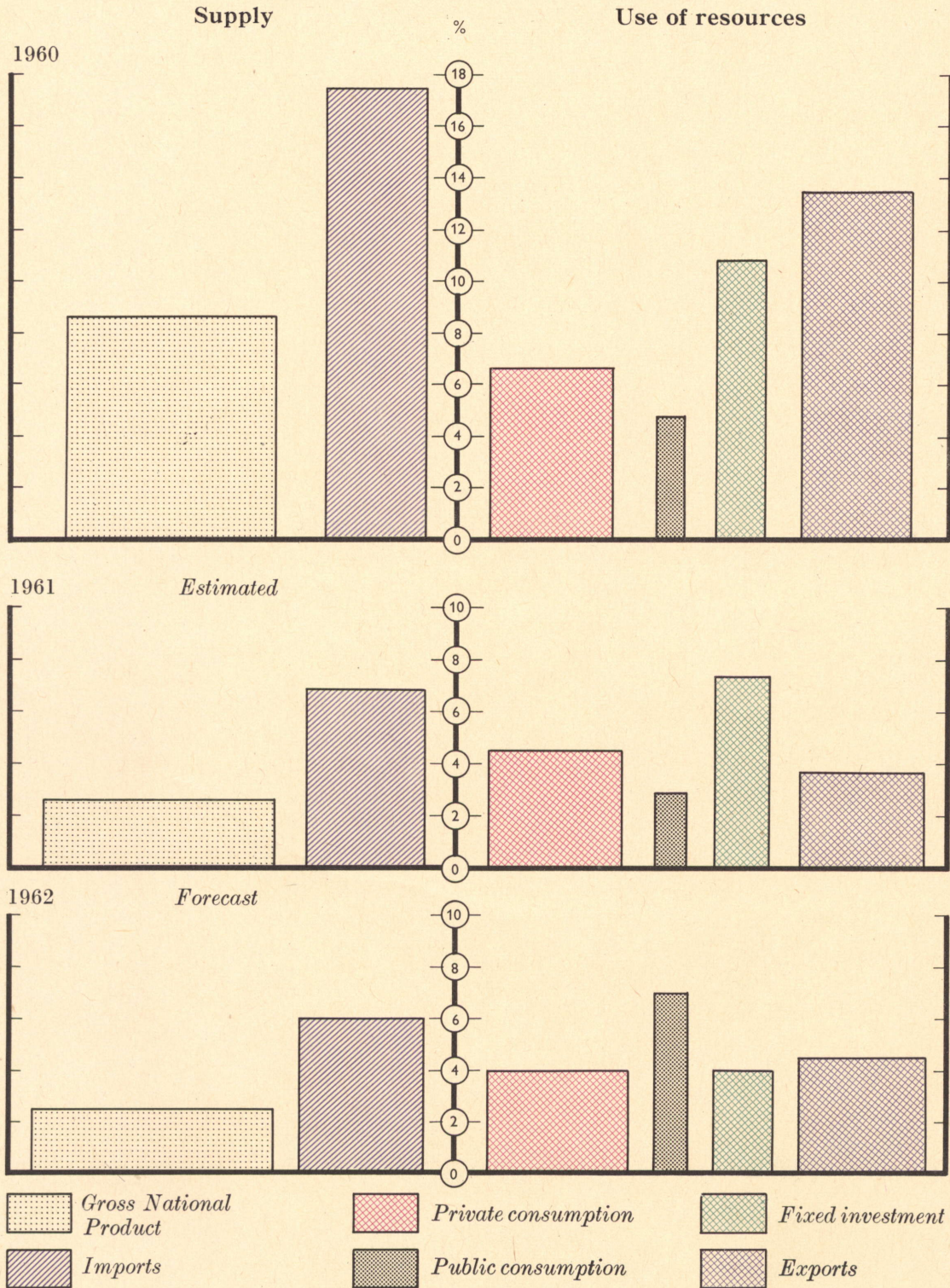
In the last months of 1962 and in the early months of 1963 the slow rate of expansion can be expected to continue. Exports and private consumption will doubtless expand fairly briskly, but it is not impossible that the trend in investment will become still more hesitant.

With the greater elasticity in production which should result from the possibility that the numbers in employment will be increased, it should be possible to adapt output more rapidly to the trend in demand.

As soon as production seems to be growing more elastic, those in charge of economic policy will have to ensure that the weakness which marks some elements of demand does not get out of hand. If it shows signs of doing so, the restrictive policy on investment must be relaxed in good time and investment itself should be channelled to a greater extent into schemes which will stimulate economic growth.

SUPPLY AND USE OF RESOURCES GOODS AND SERVICES

Change in volume in relation to the preceding year



The width of each column is in proportion to the corresponding figure (in terms of value) for the preceding year



1. Recent developments

The recovery in foreign demand, which had begun in September last year, was particularly vigorous in the first quarter of this year and has continued since. The rate at which goods were exported, however, has been growing somewhat more slowly. True, foreign trade statistics show that these exports in the second quarter were up on the corresponding 1961 figures by about 10 % in value and 8 % by volume, after rates of only 0.5 % and 3 % in the first quarter. But this was solely a reflection of the way exports fell off in the second quarter of last year, mainly because of the rapid cuts in the working week. The seasonally adjusted figures available show that, in terms of national accounts, the growth in exports of goods between the first quarter of 1962 and the second at 2.5 % was less than the 6.5 % increase recorded between the fourth quarter of 1961 and the first quarter of 1962.

In July-August the value of exports shown in the foreign trade statistics was 4.5 % higher than a year earlier.

Nevertheless, the upward trend can be regarded as quite satisfactory. It largely reflects a brisker flow of foreign orders, especially orders for consumer goods. Higher prices, however, particularly for the agricultural products exported, were in part responsible for the higher value figures for total exports. Finally, the fact that industry may well have been in a better delivery position plays a role for a number of goods.

Deliveries to other EEC countries, particularly to the Federal Republic of Germany, went up again. By contrast, sales to non-member countries appear to have levelled off. Individual branches of industry, particularly chemicals, did extremely good export business, but foreign demand for various metal and textile products was still slack.

Domestic demand increased—one main factor being the rise in gross fixed investment, although here development varied from one sector to another. For example, the growth rate of fixed investment by enterprises seems to have been higher than in the first quarter, when particularly bad weather had so hampered commercial and industrial building that total fixed investment by enterprises was only 2.5 % higher in value than a year earlier. Investment by enterprises in machinery and equipment, on the other hand, which in the first quarter still had a year-to-year growth rate of 11 % (in terms of value), does not appear to have maintained this rate in the second quarter.

Leaving out of account the effects of the bad weather on activity in the building sector, the pace of gross fixed asset formation by enterprises appears to have slackened. The trend in imports and the rate at which domestic orders from investment goods are being received also suggest that the propensity to invest has weakened. The fact that opportunities for financing suffered from the slight fall in the income from entrepreneurship in 1961 and from action taken to keep economic expansion in check through measures

affecting credit facilities and depreciation allowances probably had a dampening effect. Moreover, the quieter world economic conditions and the rapid expansion of productive capacity as a result of the investment boom might have combined to make businessmen less optimistic concerning their sales.

After the difficulties caused by the weather at the beginning of the year, not only industrial and commercial building but the whole building sector expanded with exceptional speed in the second quarter. The year-to-year growth rate was 14 % in terms of value (6 % in housing, 22 % in industrial building), whereas in the first quarter it was more than 17 % lower than a year earlier. In housing, the number of starts was still out of proportion to that of completed dwellings and this led to a fresh increase in the number of dwellings under construction which, in the second quarter, was about 11 % higher than a year earlier.

Public investment showed an appreciable increase in the second quarter after a decline due to the bad building conditions in the first quarter.

Investment in stocks does not seem to have provided any stimulus for overall demand. A slight increase in the stocks of some finished goods held by industry appears to have been offset by an appreciable running down of stocks of raw materials and of primary and intermediate products.

The growth rate of private consumption, after flagging in the first quarter, has moved ahead again with increased momentum in recent months. In the second quarter year-to-year growth rates were 8 % in value and 5 % by volume, compared with 4.5 % and 1.5 % in the first quarter.

Incomes grew much faster than at the beginning of the year, when there had been a lull due largely to the fact that the implementation of wage agreements was postponed. Many revised agreements entered into force in the second quarter, particularly in May and June. Standard hourly wages for men working in industry went up by an average of about 3.5 % between the end of March and the end of June. More than a third of the rises were retroactive to 1 January. It should, however, be noted that the rise can in part be put down to the fact that increases in hourly wages which had been granted earlier as optional rates, mostly in connection with the cuts in the working week, have now under the new wage agreements been made compulsory, and thus been included in the index. In the second quarter the average of wage rates throughout the private sector was more than 7 % above the corresponding 1961 figure. Total income from wages and salaries probably went up still further, since substantial increases have also taken place in the salaries of civil servants. The cut in wage taxes and the raising of old age pensions in July further increased the disposable income of households. There are indications that a sharp recovery has occurred in demand for consumer durables and services. Public consumption continued to expand.

In several branches of manufacturing industry the effect of this relationship between the different components of demand was for a time to hamper production. In other branches, output was again hampered by the severe shortage of manpower. At any rate industrial production, after the rise recorded in the first quarter, showed hardly any increase in the second. True, the unadjusted index figure of the Central Statistical Office was about 3.5 higher than a year earlier, but the various seasonally adjusted series available point to hardly any growth, or only relatively weak growth, compared with the first quarter. However, output does seem to have been picking up again slightly from June onwards.

In the steel industry and some branches of textiles the trend of demand has for some time been causing output to develop hesitantly and in the second quarter the first signs of weakness began to appear in other sectors also, such as commercial vehicles and paper-making. In yet other branches output was restricted by the effects of the bad weather or, as already mentioned, the labour shortage.

Shortages on the labour market continued. At 23 000 the unemployed were slightly fewer towards the middle of the year than a year earlier, when the figure was already low. From July onwards the number of young people seeking employment was somewhat higher than in the previous year, as those leaving school belonged to a year with a high birth-rate. No further notable increase in the number of vacancies was occasioned by cyclical factors and this could mean that there has been no worsening of the shortages on the labour market.

Imports in the second quarter even tended to fall. Customs returns show that only 3 % more by volume and 4 % in value was imported than a year earlier and, according to the seasonally adjusted figures, imports of goods in terms of national accounting were about 4 % lower, both in value and by volume, than in the first quarter of the year. This can partly be put down to a drop in imports of raw materials and semi-finished products as a result of the stocks policy of firms and the slow growth of output. Imports of finished goods, particularly consumer goods, remained high. Total imports also seem to have picked up again somewhat in the summer. In July-August, foreign trade statistics show the value of merchandise imports to have been 14 % higher than a year earlier.

The upward trend in the price level continued. The index number of consumer prices ⁽¹⁾ rose 1.6 % between the end of March and the middle of the year, chiefly because of the exceptional rise in the prices of certain forms of farm and horticultural produce, such as potatoes and fruit, and was 4.9 % higher than in the middle of 1961. These prices fell again in July, when the index was only 2.5 % higher than a year earlier—an increase due largely to the higher prices paid for services.

⁽¹⁾ This also includes rents and the prices of other services.

In the balance of trade, a distinct improvement was recorded due mainly to the slackness of imports and to a temporary improvement in the terms of trade; there was, however, still a high deficit of 730 million guilders, compared with 950 million guilders in the first quarter and almost 900 million guilders a year earlier. However, the current account (on a cash basis) closed with an overall deficit of 80 million guilders because of the relatively unfavourable net position on service. On the basis of transactions the deficit amounted to about 160 million guilders, compared with 227 million in the second quarter of 1961. Thanks to considerable imports of private long-term capital, however, the overall balance of payments for the quarter showed a surplus of 43 million guilders. Whereas the net foreign exchange reserves of the commercial banks fell by 274 million guilders, the official foreign exchange reserves held by the Nederlandsche Bank went up by 209 million. The net position with regard to the International Monetary Fund improved to the tune of 109 million guilders on account of drawings of guilders by Argentina and Canada.

Despite large-scale repatriation by the banks of money invested the slight strain noted on the money and capital market at the beginning of the second quarter continued in the ensuing months abroad, especially as the Central Bank has maintained the measures intended to slow down the expansion of credit—the agreement made with the commercial banks on this matter was extended till the end of December—and even raised Bank Rate by a 1/2 % to 4 % at the end of April. Credit was still in quite heavy demand in the private sector. The banks' special deposits—held by the Central Bank as a disciplinary measure for exceeding the limits of credit expansion—reached a peak of 180 million guilders at the end of June, since when they have fallen slightly. The situation on the money market has eased since July, particularly after the Central Government had made its quarterly payments to the municipal authorities, and this was reflected in repeated reductions of the rate for call money. With effect from 22 August the Central Bank lowered the minimum reserve rate from 8 % to 7 % in view of the fact that a Dutch banking consortium was taking over a 125 million guilders debt owed by KLM in the United States.

Features of the capital market were an increase in capital by Philips (731 million guilders) and the brisk activity in the issue of industrial bonds. From July onwards foreign bonds were being placed on the capital market for a larger total for the first time since January.

2. Outlook

There is nothing to indicate that in the remaining months of 1962 the economic climate is likely to undergo any substantial change. The slight recovery noted since June might assume somewhat larger proportions.

Overall demand will continue to expand; according to the business survey conducted by the Central Statistical Office the slight fall in the backlog of orders—calculated

by months of working assured—may well be more attributable to an expansion of capacity than to a decline in orders received.

The trend in exports will probably continue upwards. Export orders can on the whole be expected to increase, even despite a possibility that the trend in orders may remain weaker for investment goods than for consumer goods. Keener competition on foreign markets, due to the general expansion of capacity and in some products the rise of production costs in the Netherlands are together hampering the increase in exports. On the other hand, exports may benefit from the slight easing expected on the labour market and the consequent increase in the elasticity of production. Prospects for the export of agricultural products seem to be good. It should be taken into account that the new arrangements for agricultural markets in the Community which take effect on 1 August will shortly begin to have some effect on the sales of certain agricultural products.

Fixed investment will continue to expand, although the pace of the rise in investment by enterprises may well slacken even further. Equipment investment will continue to be stimulated by rationalization plans, but the restrictive policy on credit—the effect of which has been heightened by the growing need of available money being experienced by business firms—together with the rules on depreciation allowances introduced in 1960, will probably continue to act as a brake on investment. A survey on business investments indicates that there has been already a decline in the propensity to invest. The total investment expenditure which businessmen expect to make in 1962 is, it is true, 8 % more than was planned a year earlier for 1961, but it is less than the amount actually invested in that year. The amount invested in building and contracting will certainly continue to be limited by the fact that building capacity is being used to the full. Public investment may well make further progress.

The growth of private consumption will continue to benefit from the raising of agreed wages already referred to and from a slight increase in employment. The lowering of wage tax and income tax and the raising of old age pensions will probably also contribute to this growth.

Domestic production might become distinctly more elastic, mainly as a result of an increase in the labour force. Industrial production might then expand somewhat faster than previously, although some hesitation in demand might play a part in deciding just how output in textiles and some sectors of the iron and steel industry will develop.

Stimulated by the growth of domestic demand and industrial production and by the tariff cuts made in the middle of the year, *imports* will probably continue to expand appreciably in the last months of 1962.

There will probably still be a tendency for prices to move upwards. It has already been decided, for instance, that controlled rents can be raised by 10 % - 12 % on 1 September, and prices for other services may well rise again. Railway freight rates will also go up from 1 September.

In view of the way things have developed so far this year and the outlook for the coming months, the forecasts made at the beginning of the year for the whole of 1962 still hold good in the main. The growth rate of fixed investment will, however, be less than expected owing to the setback suffered by the building trade early in the year, which it was impossible to make up, and to the decline in the propensity to invest. The rate of progress in industrial production may fall slightly short of what was forecast. Consequently, the increase in the gross domestic product at constant prices is likely only to be about 3.5 % and not 4 % as predicted. The growth rate of the gross national product might be under 3 %, because of the unfavourable development of net factor income from abroad.

In the early months of 1963 economic activity is likely to maintain its modest rate of progress. In the first six months at least foreign demand may well rise further. True, in conditions of somewhat less brisk world business competitiveness will assume greater importance, but on the other hand exports may benefit as a result of the more moderate trend expected in domestic demand.

This may expand somewhat more slowly than previously. The growth rate of fixed investment will fall off, although it is true that demand in the building sector is likely to remain vigorous, particularly for housing. Equipment investment will, however, probably develop less briskly. The reduction in corporation tax, which is due at the beginning of 1963 and will in part offset the effects of higher wage costs, thus stimulating the propensity to invest, can hardly influence what is actually invested in 1963.

The budget estimates for 1963 indicate only a moderate increase in public expenditure. Private consumption will continue to rise relatively rapidly; it should be remembered that there will not only be an increase in employment, but that in addition important collective wage agreements are due for renewal, particularly in the metal industry. On the other hand, an increase in pension contributions can be expected. The supply of industrial products is likely to be marked by greater elasticity, which will largely be attributable to the expected increase in employment and the benefits obtained from the investment already made for productive purposes. There is, however, a risk that the trend in output will reflect more clearly than in 1962 the decline in demand for certain products.

While, then, economic expansion in the Netherlands will continue at the modest pace characteristic of its development in 1962, the reasons for the relatively slow growth rate differ from those which affected development in 1961 and perhaps 1962 as well, since they are to be found partly in the weak development of some components of demand rather than in the inability of supply to follow changes in demand.

Although the decline in the propensity to invest—which is characteristic of this economic trend—can for the present be welcomed as a factor which makes it easier to reduce economic strain, the demand for investment must not be allowed to fall away too

far, as this could lead to a drop in economic activity, particularly in investment goods, or, in the longer term, prove detrimental to economic growth. Should such tendencies appear, the existing measures of restraint must be relaxed in good time and the pattern of expenditure on investment must be adapted so as better to serve the aims of growth policy. Finally, improvements to the system of export credit insurance, which are being studied at the moment, could facilitate the expansion of markets in the developing countries.

A memorandum on wages policy recently prepared by the Economic and Social Council could, in the circumstances, lead to a revision of policy in this field. If, as proposed, the productivity of each separate branch is no longer taken as the main criterion for wage differentiation but increased stress is also laid on considerations of profitability and growth in the different sectors, this could perhaps foster the balanced expansion of the Dutch economy.

E. Belgo-Luxembourg Economic Union

Belgium

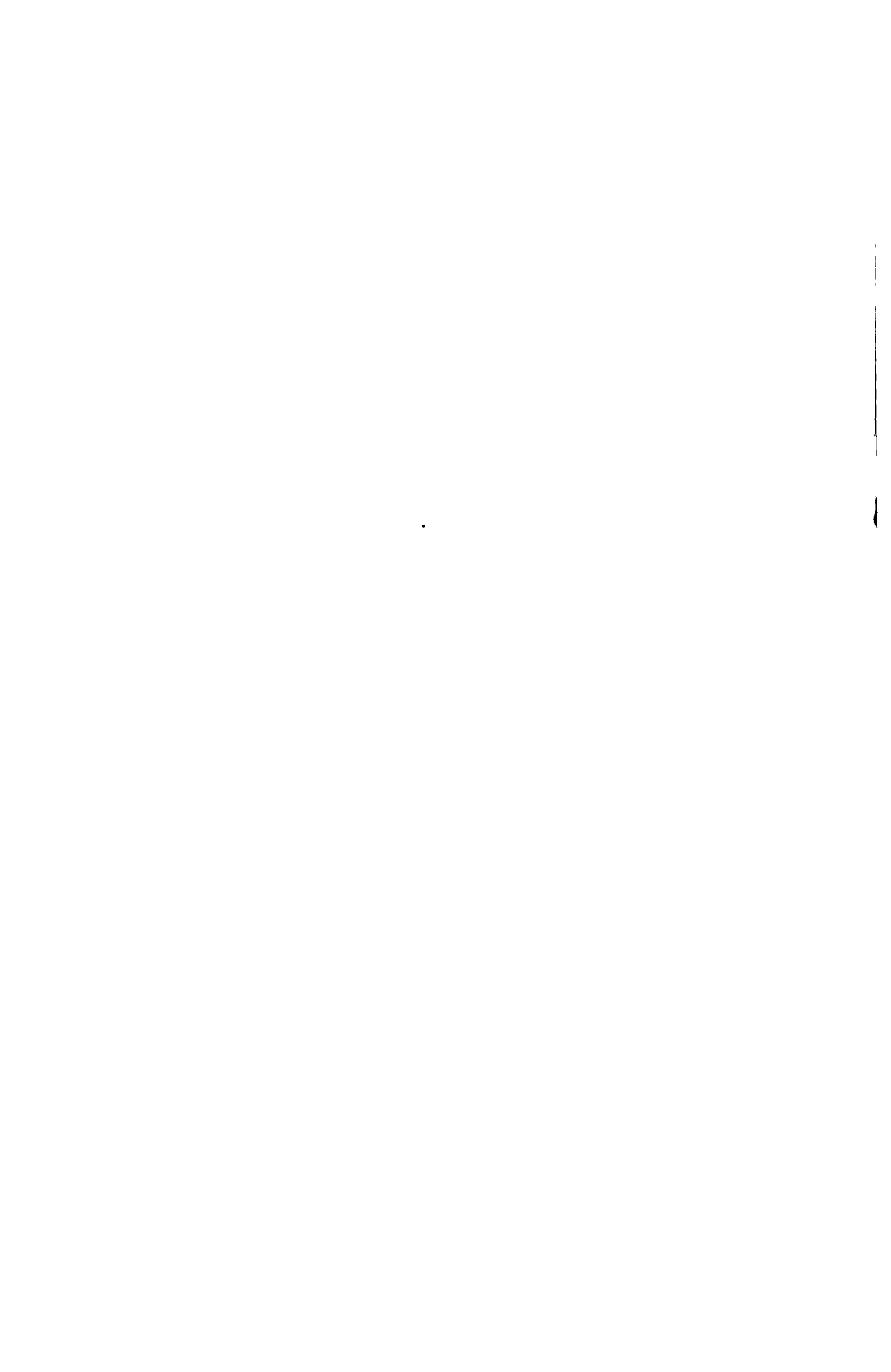
In recent months the expansion of economic activity in Belgium has again been moderate. Exports, which mounted steadily throughout the second quarter, were once again the mainstay of business activity. Domestic demand improved only slightly and this improvement was mainly due to an increase in private consumption resulting from a sharper upward trend in wages. Despite brisk investment activity in the public sector, fixed investment in general hardly seems to have afforded a further stimulus to economic activity to any appreciable extent, though the level of investment remains very high.

The main feature of domestic supply was a slight rise in industrial production: in the second quarter the IRESP index showed an increase of nearly 2% on the corresponding figure for 1961. Heavier final demand was satisfied to a relatively large extent from increased imports and by way of cuts in stocks of many basic materials and semi-finished products.

Sharper competition continued to exert pressure on the wholesale prices of many industrial products. The rise in the retail price index, which rose by 2.3% from March to June, was largely attributable to a temporary hardening of certain food prices. It led, none the less, to fresh wage increases in many sectors towards the middle of the year.

Owing to the slight deterioration of the balance of trade and a deficit on official movements of capital, the balance of payments for the second quarter showed a deficit of about S 50 million. Internal liquidity nevertheless remained at a high level, which was an incentive for the Central Bank to continue its cheap money policy; in August, the Bank Rate was again cut by $\frac{1}{4}$ %.

The outlook for the rest of the year does not suggest any fundamental changes in trends of economic activity. A slight decline of the growth rate is not to be ruled out, for the propensity of industry to invest seems to be showing signs of flagging, and this will also affect expansion in 1963. The longer current trends persist, the more the results for next year will fall short of the results for this. In view of these prospects, it may in the near future become necessary to strengthen expansion policy if the longer-term growth objectives of Belgian economic policy are to be attained.



1. Recent developments

Foreign demand, which had already been the main stimulus of business activity in the first quarter, grew again in the second. Customs returns show that exports of goods were up in terms of value by about 8 % over the comparable figure for 1961, whereas the year-to-year growth rate for February and March had been 6 % ⁽¹⁾. The rate of growth in terms of volume was probably even higher, since average export prices appear to have again fallen slightly. In July exports even reached a figure 13 % higher (in value) than for July 1961.

The improvement in exports was mainly in products for which Belgian industries had become more competitive because of relatively short delivery dates, and in certain cases because of a more favourable trend in costs in recent years than has obtained in the industries of many other countries. The sharp rise in processing traffic also increased the percentage of goods having a high incorporated value—machines, chemicals and textiles—in the total of exports, the more so since sales of steel products, at prices which were lower again, only barely exceeded the level reached in the same period of 1961.

The recovery in deliveries to France and the Federal Republic of Germany which had already become apparent in the first quarter continued in the second, so that exports to the Community countries as a whole reached a new peak, although sales to the Netherlands remained static. Exports to the United States again progressed favourably and there was also a slight improvement in sales to the United Kingdom, but exports to the other non-member countries fell away.

Domestic demand in general also seems to have advanced, although at a modest rate, because of a tendency for investment activity to ease off. Indeed, gross fixed investment, as compared with the first quarter, seems to show hardly any further advance, especially when allowance is made for the extraordinary factors which accentuated the seasonal rise in building between the first and second quarters. In particular the propensity to invest has become more hesitant in the private sector. Only in mechanical engineering (mainly for purposes of rationalization) and petro-chemicals (where the object is expansion) does the level of investment seem to be higher than hitherto, while in certain branches of basic materials industry investment showed a tendency to decline, notably because growing surpluses of capacity are exerting pressure on prices.

Building activity in general increased, after being seriously hampered by unusually bad weather in the first quarter. Housing construction in the second quarter continued at a very high level, although the number of building starts in April and May was again appreciably lower than in the comparable period of the previous year. This latter de-

⁽¹⁾ The growth rate taken over the whole first quarter is misleading owing to the figure of 56 % recorded for January which is explained by the strikes of January 1961.

velopment is partly attributable to a reduction of expenditure on "social" housing. Moreover, the faltering demand for certain other kinds of housing, which was already to be noted in some areas, may possibly have had a more marked effect on the general position.

On the other hand, building activity in the public sector once again made marked progress and broadly speaking investment by public authorities probably also increased.

Incomplete information available suggests that investment in stocks by the processing industries may have declined. Though the running down of stocks of iron and steel products seems to have come to a halt, a similar trend probably affected other branches in the second quarter, notably non-ferrous metals and certain branches of the textile industry. There were also further reductions in coal stocks.

After a hesitant trend in the first quarter, private consumption recovered, although continuing bad weather depressed the demand for certain traditional consumer goods (e.g. textiles and beverages). It was mainly demand for consumer durables (e.g. motor cars) and services which increased, largely owing to higher workers' incomes: the rise in wages went on, and even at a more rapid pace, and the number of those in paid employment once again rose slightly.

The development of the various components of demand led to a slight expansion in industrial production. The IRESP index showed that this was about 2 % up (provisional figure) in the second quarter over the comparable period in 1961—following a year-to-year growth rate of about 1 % for February and March. Moreover, only the processing industries succeeded in maintaining their growth rate of 3 %. The early figures for July and August would seem to suggest that these trends are continuing.

The moderate growth rate reflects a weakening of demand in several branches of industry. Moreover, it must be noted that part of the growth of exports is due to a rapid increase in re-exports of certain industrial products in which the value added by Belgian processing is not very high. Again, the aforementioned tendency to run down stocks has retarded the advance of industrial production. Lastly, the recovery of private consumption has mainly affected imported goods.

In industry in general unused production capacity seems to have increased, owing not only to the demand situation but also to the noteworthy extension of capacity in recent years.

Despite this trend, the situation on the labour market has not materially changed. The total paid labour force has no doubt slightly increased, largely because of the continuing expansion in the services sector. A certain tightness which had already been felt for some time, particularly in industry, showed little sign of easing in the second quarter. Building and mechanical engineering again experienced a severe shortage of skilled workers. Similarly, a shortage of manpower was noted in the mines, due mainly to the

drift of miners to other industries. Although workers were laid off in some branches of industry and the number of school-leavers rose, the number of unemployed remained low; the figure was 77 000 in August as against 89 400 a year earlier. Yet the number of foreign workers in Belgium varied little, which was not the case in neighbouring countries.

In contrast with domestic production, imports rose very sharply. From customs returns it appears that the year-to-year growth rate for imports of goods rose in terms of value from 3.5 % in the first quarter to 8.5 % in the second and nearly 10 % in July. This would seem, however, to be explained largely by an increase in purchases of agricultural products determined by exceptional factors. Trends in other imports followed more or less closely that of internal demand; in particular imports of many consumer goods rose steeply.

In the second quarter, in contrast with the trend of exports, imports from non-member countries, principally the United States and Great Britain, increased faster than those from EEC member countries. This may have been partly due to expectancy of the new intra-Community tariff cuts fixed for 1 July.

The increase in certain food prices was in the second quarter the determining factor in the rise of the retail price index, which, at the end of June, was about 3 % up on the corresponding figure for 1961. Towards the middle of the year this set in motion the sliding wage scale in most industries and in the public sector. In July, with the return of potato prices to normal average retail prices began to drop back. They were 2 % higher than in July 1961.

The exceptional hardening of the wholesale prices of agricultural products was largely offset by a further fall in the prices of industrial raw materials and semi-finished products. In June the price index was 2 % higher than in June 1961. In July the price correctors for various agricultural products brought the index practically back to the previous year's level.

Since imports increased more rapidly than exports and the terms of trade once again moved slightly against Belgium, the deficit on trade increased. It reached Bfrs. 2 300 million in the second quarter as against Bfrs. 700 million in the first quarter and Bfrs. 1 900 million in the corresponding period of 1961. The net balance on services and on current transfers showed a surplus which almost offset the deficit on trade. As private capital transactions, however, were roughly in balance and public capital transactions showed a deficit, there was finally a small deficit (about \$50 million) on the overall balance of payments. The Central Bank's gold and foreign exchange reserves fell by \$24 million—from \$1 654 million at the end of March to \$1 630 million at the end of June—and the net foreign exchange position of the banks declined by an amount corresponding to the remainder of the balance of payments deficit. In July there was a further decline in reserves to the extent of about \$10 million, due to the conversion into dollars of the loan in Belgian francs granted by Belgium to Canada through the International Monetary Fund.

In spite of this development in the balance of payments, the relatively weak expansion in investment and production and the policy of the monetary authorities led once again to a relatively high degree of liquidity on the money and capital markets. Only in June and July was there a slight tightening of the situation under the impact of certain seasonal factors and the Government issue of a consolidation loan of Bfrs. 8 100 million, of which Bfrs. 4 000 million had been subscribed and paid up at the end of July when the issue was closed. Including this loan, the growth of public indebtedness in the first seven months of the year totalled Bfrs. 9 700 million ⁽¹⁾, as against Bfrs. 12 000 million for the corresponding period of 1961. On 9 August, for the fifth time in twelve months, the Banque Nationale cut Bank Rate by $\frac{1}{4}$ %, bringing it down to $3\frac{3}{4}$ %.

2. Outlook

The factors accounting, in the first half year, for a rate of expansion which was on the whole only moderate should continue to govern development in the latter months of 1962. The possibility that the growth of overall demand may even slacken off a little is not to be ruled out.

Exports will probably remain the dynamic factor in economic development, even if their rate of progress should again fall off slightly. The growth of sales to abroad will be favoured by what has so far been a relatively moderate increase in wage costs, whereas strain will continue in the countries which are Belgium's chief competitors on international markets. Abundant capacity in many sectors may also help Belgian industries to compete by enabling them to offer earlier delivery dates. It is true that the international economic situation suggests that the inflow of orders to the mechanical engineering sector from abroad will once again slow down; however, it is quite possible that this loss will be offset in other industrial branches, notably in certain textiles, by continued expansion of sales to EEC member countries. Moreover, there was a slight increase towards the middle of the year in the volume of foreign orders for the iron and steel industry. It is also unlikely that the present upward trend of sales to the United States should materially decline in the near future.

On the other hand, the slowing down of the growth of *fixed investment* might continue in the coming months, despite the still favourable development of public investment, and might perhaps be slightly accentuated in some sectors as and when the programmes in hand are completed. Many entrepreneurs seem to feel that present production capacity can meet without difficulty any normally foreseeable growth of demand. Moreover, foreign investors will henceforth have to reckon with the fact that skilled manpower reserves are virtually exhausted in Belgium. However, keener competition on the world

⁽¹⁾ Not including the increase in the IMF's holdings of Treasury Bills as a result of repayments in Belgian francs made by the Bank of England.

market—with its repercussions on prices and the pressure it exerts on profit margins when production costs rise— together with the manpower shortage, will be an incentive for many industrialists to press forward their rationalization programmes.

Activity in the housing sector will probably reflect a fairly substantial reduction in comparison with 1961 in the number of building licences granted and of building starts. Though the demand for low-cost housing remains largely unsatisfied, the present supply of housing in certain other categories—representing on the average of recent years about four-fifths of total supply—is now likely to exceed demand in various areas. It is therefore probable that expenditure on new housing will remain at much the same level as it reached in the last months of 1961.

The growth of private consumption should continue in coming months at a rate comparable with that of the second quarter, for which, as was noted earlier in this chapter, rather faster growth was recorded in comparison with the first months of the year. However, because of the known structural factors expansion will on the whole be relatively weak, and will afford only a very moderate stimulus to the development of production.

Household income will none the less increase as a result of the measures taken early in the summer (an almost general increase in incomes under sliding scale arrangements, higher family allowances, increase in civil service pay and wage rises in various sectors), the more so since the numbers in paid employment might well show a further increase over the level reached in the second half of 1961. Moreover, real income has been favourably affected from July and August onwards by the tendency for certain food prices to return to normal.

In view of this probable development of demand, industrial production will probably only slightly exceed in the coming months the level reached in the first half year, despite the upward trend of exports. Imports of goods will probably still run at a high level, but the growth rate will—for the full year—be substantially lower than that for exports.

As for the *general results* for 1962, there is no reason, having regard to recent business trends and the prospects for the last months of the year, for any material change in the forecasts made in the quarterly surveys early in the year. The annual growth rate of the gross national product at constant prices might reach 3 % to 3.5 % and the expansion of industrial production 3.5 % to 4 %. It should, however, be noted that part of this increment does not represent expansion but is attributable to the fact that in January 1961 production was seriously affected by strikes, which explains the extraordinary high growth rate for January 1962.

It is unlikely that the trends which have emerged during the year will change substantially in 1963, at least during the first half year. A slight fall-off in the rate of expansion is perhaps to be expected; all the factors making for demand seem to have lost some of their vigour. Fixed investment will grow relatively slowly, and private con-

sumption will once again make a moderate advance. Household income is likely to rise owing to an increase in minimum weekly wages now being negotiated and the progressive alignment of women's pay on that for men. It is, however, improbable that the resulting increase in wage costs and any pay rises under the new social planning agreement which is to come into force at the beginning of next year will substantially affect the competitiveness of Belgian production on foreign markets. The growth rate of exports should therefore—as in 1962—exceed that of the other factors of demand, but it would seem that imports, too, will continue to increase at their relatively high rate.

The growth rate of the gross national product might once again prove to be lower than the average of the other EEC countries and fall short of the long-term target set by the Belgian Government.

Although these prospects should not cause undue anxiety—since the Belgian standard of living is high and full employment will probably continue—it would none the less seem advisable to make more vigorous efforts to stimulate expansion. Monetary and credit policy may appropriately be held on their present course, or perhaps even be shaped to promote more rapid expansion, and efforts for a further improvement of the situation on the capital markets might be continued. In addition more energetic encouragement might be given to the investments of enterprises in order to channel them towards overcoming known structural weaknesses inhibiting growth. It has several times been suggested that recently established institutions such as the “Société Nationale d'Investissement” can do valuable work in this field : if strongly enough geared to expansion their action can encourage economic growth even in the short term—i.e. as part of policy for dealing with current developments. Other measures to encourage investment could be taken, for example special depreciation allowances for machinery and other capital goods. This would not be irreconcilable with plans to put the public finances on a sound footing, provided it does not compromise the aim of the tax reforms now under consideration, which is to re-adjust and increase the Government's current budget receipts.

The balance of payments situation places no obstacles in the way of a continued policy of long-term expansion; on the other hand, the labour market may pose certain problems. Training or refresher courses for skilled workers have been in existence for some time, and action on these lines should be pressed forward and extended.

Grand Duchy of Luxembourg

Foreign demand for iron and steel products, which had weakened in the last few months of 1961 and so led to a drop in industrial production, was scarcely more vigorous in the second quarter than in the first. Since exports and output of iron ore have now been falling as well, the slight expansion still observed in domestic demand was not enough to produce a further appreciable increase in the general level of economic activity. In some sectors the growth of output is also hampered by the shortage of manpower.

Since the outlook for the rest of the year suggests that current trends are hardly likely to change, the real gross national product will probably, for the first time since 1954, be slightly below that of the previous year.

In the present phase of economic activity, which looks like continuing till the beginning of 1963, it would appear advisable to use whatever instruments of economic policy are available to give all possible support to economic activity and private incomes. It seems appropriate to combine this with greater efforts to check one-sided developments in the economic structure and to strengthen competitiveness—not only in the iron and steel industry but also in the rest of the economy.

1. Recent developments

In recent months the Luxembourg economy has shown hardly any substantial recovery after the setback it suffered at the end of 1961 and beginning of 1962. Economic activity has remained below the level reached a year earlier.

Foreign demand in the second quarter was not notably different from that in the first. Deliveries of iron and steel products—which at the beginning of the year were the lowest since 1959—rose but little and remained below those of a year earlier. Orders received from abroad for iron and steel products were slightly above deliveries in the first quarter but in the second quarter there was a tendency for this situation to be reversed, owing to the slackness of demand from non-member countries, and order books thinned out again in consequence. Exports of iron ore had already been falling at the beginning of the year, and the average of the figures for April-July showed a still further drop.

Domestic demand continued to grow at a moderate rate. Fixed investment showed a further rise. Falling productivity and the unfavourable conditions still prevailing on world steel markets were evidently leading to increased efforts to rationalize production in the iron and steel industry and so to offset the repercussions of these factors on profit

margins as much as possible. Both investment by other industries in equipment goods and building activity have probably been rising again, although in the building sector the year-to-year growth rate (in terms of the number of man-hours worked) fell from 9 % in the first quarter to 6.3 % in the second quarter. Capital investment by the public authorities went up as a result of heavier expenditure from the "Special fund". Despite the smaller bonuses paid out by the steel industry, the income of those in paid employment rose as a result of the increase in employment and higher wages under collective agreements. Consequently, there has been a further rise in private expenditure on consumption. True, demand for some traditional consumer goods was temporarily depressed by the bad weather, but some recovery was apparent for a time in the demand for consumer durables (motor cars and television sets). In July and August, however, car sales once more dropped below the corresponding level for the previous year.

To judge from current Government expenditure, public consumption in the first half of the year may well not have been as high as it was a year earlier.

Because of the way these various components of demand were developing, there could not be any great change in the underlying trend of industrial production which had been observed in the winter months. The seasonally adjusted index shows that the level of production, which had fallen in the last quarter of 1961, remained more or less the same in the second quarter as in the first. The drop in the national index compared with its level of a year earlier—when there had still been some tendency to expand—was, at 6.8 %, greater than in the first quarter (4.8 %). While in both the first and the second quarters of 1962 the quantity of iron and steel produced was 6 % less than in 1961, there was also a definite tendency for iron ore output to decline as well. Although production also fell off in the metal-processing industry, the second quarter saw some increase in the output of foodstuffs and non-metallic minerals.

Shortages on the labour market probably continued to hamper economic activity in some sectors, particularly in some branches of services and in building and contracting. The increase of some 3 % in the number of persons employed in industry and in building and contracting is almost exclusively attributable to the recruitment of foreign workers: some 8 % more were employed in the second quarter than a year earlier. The difficulties experienced on the labour market were in part due to hoarding of workers, particularly in the iron and steel industry where, despite the less favourable trend of business the numbers employed remained more or less unchanged. There has, however, been a certain tendency to cut down manpower in some sectors, particularly in mining.

It appears from the way the official cost-of-living index in Luxembourg is moving that the rise in prices—particularly that of foodstuffs—has not assumed the same proportions as in the other countries of the Community; true, there was a slight upward movement in the second quarter, and this stemmed largely from the rise in prices for agricultural products, which, however, came to a halt in the summer. In September the general price level was only 1.3 % higher than a year before.

2. Outlook

The outlook until the end of the year shows no signs of any noteworthy change in the economic situation.

Exports will probably remain at more or less the same level as in the first six months. Such information as is available indicates that no substantial improvement can be expected on the iron and steel market, although prices for several products in this sector hardened during the summer. Nevertheless, the high level of activity likely to be experienced in all the Member States, particularly in building and contracting and in engineering, will probably keep foreign orders flowing in fast enough to prevent a further fall in output and even to make some slight improvement possible. Sales abroad may also receive something of a stimulus from the entry into force in early autumn of the measures intended to promote exports.

Although investment in the steel industry is still subject to various elements of uncertainty, gross fixed capital formation in the industry will most probably be maintained. Moreover, important investment programmes are being pursued in various other sectors, to judge for instance from the heavy borrowing on the capital market recently by the Société Electrique de l'Our. In addition, the Act of 2 June 1962, which is designed to stimulate those forms of investment which will improve the general structure and the regional balance of the economy and those which will encourage economic growth, will provide a certain incentive to invest in small-scale and medium-scale industry. Finally, the steady demand for housing and the extensive public works programme—despite difficulties on the labour market—suggest that activity in building and contracting is likely to rise once again. Here, the recent decree granting aid to housing for foreign workers may be regarded as a positive factor.

Although conditions in the industrial sector will still not be particularly favourable, the income of households may well climb slowly, chiefly as a result of improved conditions in the other sectors of the economy. Private consumption, however, will exert little influence on the trend of economic developments.

Industrial production, particularly the production of iron and steel, will probably continue unchanged at the level reached in the first quarter with not inconsiderable variations from one branch to another. There will once again be a reduction in iron ore mining, but the effect of this on the general level of industrial output might be partly offset by the entry into production of a number of new factories in other branches.

Industrial production for the full year 1962 may well be about 5 % lower than in 1961. While agricultural production is unlikely to increase, output in the services sector may well rise again. In all probability the gross national product at constant prices will fall slightly for the first time since 1954. On top of this, the drop in export prices may cause a proportionately steeper fall in national income.

A vigorous expansion of foreign demand is not to be expected in the first months of 1963. It is probably too early to attempt detailed forecasts of the situation on world steel markets, but it may be presumed that the surplus capacities which are depressing markets at the moment will continue to hamper the development of Luxembourg's iron and steel output. However, export prices for steel might show something of an improvement on the low prices in 1962.

Domestic demand will probably be marked by a further increase in private consumption, due mainly to the improvement of civil service salaries and possibly also of wages in the steel industry. In investment, in the other hand, there is little likelihood of a further rise.

Although the possibilities open to those responsible for internal economic policy are naturally restricted by the structure of Luxembourg's economy and external trade and by the shortage of manpower, those instruments of economic policy which are available should nevertheless, in view of this outlook, be used as swiftly and as extensively as possible to support economic activity, for something must be done to minimize the harmful effects on domestic economic activity and total private income which stems from the low level of production of iron and steel and iron ore. Here, an appreciable increase in public expenditure might prove beneficial. Expansion in the other economic sectors will need to be further encouraged, and in this connection greater efforts to achieve a more balanced pattern of business activity and exports and greater competitiveness would be appropriate. Linked with the export drive already launched (Office du Ducroire) and efforts to boost investment (Economic Expansion Act), budget policy could make a positive contribution to stepping up demand. The same applies to public investment, which it should be possible to step up if and when this proves necessary.