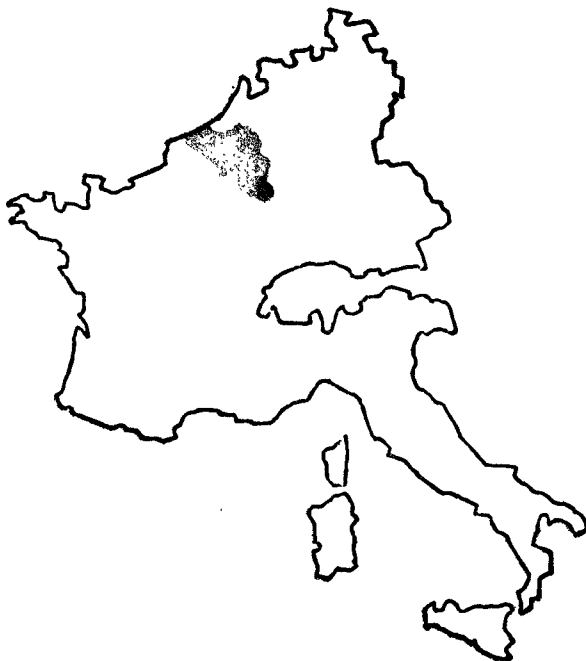


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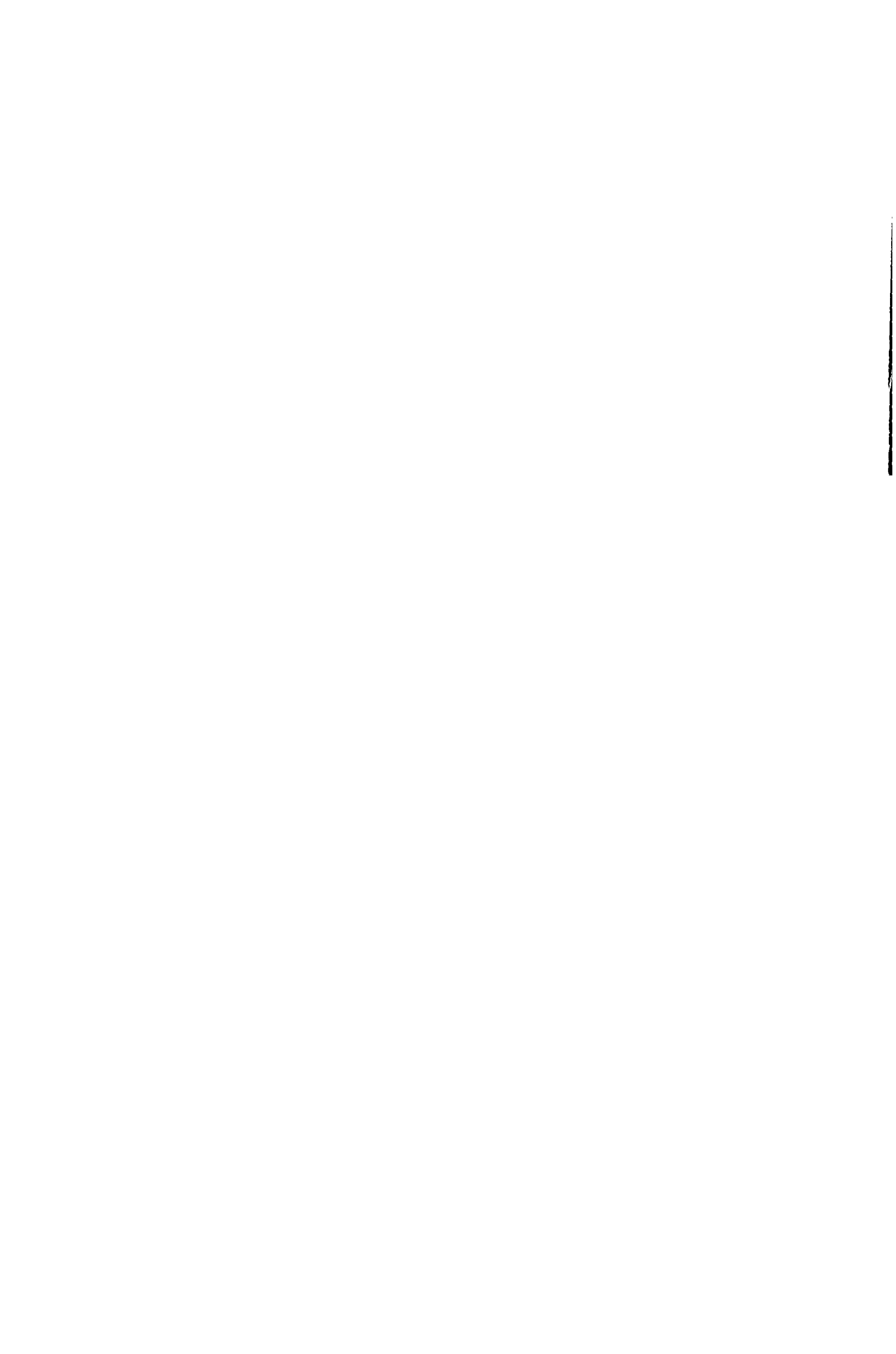
**THE ECONOMIC SITUATION
IN THE COMMUNITY**

4

DECEMBER

QUARTERLY SURVEY

1961



EUROPEAN ECONOMIC COMMUNITY

COMMISSION

The Economic Situation in the Community

DECEMBER 1961

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I. THE OVERALL ECONOMIC SITUATION

In the third and—as far as can be seen—in the fourth quarter, the economy of the Community continued its advance. The pace of expansion may however have slackened to some extent owing, perhaps primarily, to the strained situation on the labour market, but in part also to the trend of demand. In 1961 total industrial production in the Community will probably exceed that of the previous year by about 6 % and the real gross national product may prove to be approximately 5.3 % higher ; in 1960, the rates of growth were 13 % and 6.9 % respectively.

Exports to non-member countries rose quite appreciably in the third quarter. They were 10 % higher in value than in the corresponding period of the previous year and were largely influenced by favourable economic trends in the United States and by demand from other European countries—except Great Britain.

In the third quarter the expansion of internal demand was somewhat less vigorous than that of external demand. Nevertheless, fixed investment in general continued to grow—though at a slightly slower rate and was considerably above the

level of a year earlier. The movement of stocks had a generally damping effect on economic expansion, which is most clearly reflected in a weakening of the demand for raw materials and semi-finished goods, especially for iron and steel.

In the third quarter the rise in consumers' expenditure continued and even accelerated slightly in the Federal Republic of Germany and in France, and probably also in Italy.

Internal supply expanded only slightly in the third quarter and industrial production hardly registered any further increase; allowing for seasonal variations, the expansion of production from the second to the third quarter was only about 0.5 %, compared with a rise of 1 % in the second and 2 % in the first quarter. This slowdown is to be attributed mainly to the severe strain on the labour market in most member countries. In the Netherlands and in the Federal Republic of Germany there has even been a drop in the actual hours worked. Nevertheless the trend of demand may also have caused a slowdown in the expansion of production or even a restriction of production in some sectors.

Whilst growth in the services sector was again vigorous, especially in tourism, the rise in agricultural production was only slight, because of less favourable harvests in all countries except Italy.

Despite the expansion of demand, in general still quite marked, and the slowdown in the rate at which domestic production has been growing, imports have not gained further momentum. There has even been a fall in their value, which in the third quarter was only 2 % higher than in the corresponding period of the previous year, whereas in the first half of 1961 the year-to-year growth rate had been 6 %. Whilst purchases of certain raw materials, semi-finished goods and some agricultural products weakened, imports of finished goods—especially of consumer goods—continued to expand.

Because of the slackening of imports and the expansion of exports the Community's trade balance had a surplus of \$ 320 million in the third quarter after a deficit of \$ 160 million in the second. Nevertheless, the official gold and foreign currency reserves of the member countries have risen only slightly because there have been considerable exports of capital.

The prospects for the first half of 1962 indicate that expansion will continue. As however in some countries and in some sectors certain factors are damping the expansion of demand, and as physical obstacles will remain, the rate of expansion is likely to be slow.

In most member countries the growth of fixed industrial investment may well decline. Nevertheless, private consumption will continue as an important factor making for expansion, and external demand may be expected to provide a further stimulus.

It will depend on the strength and duration of such factors, and on the financial policy pursued in the Community, whether the rate of investment will increase further in the latter part of 1962 and whether as a result the growth rate of demand will pick up. Since by then productive capacity may have been brought more fully into line with such a trend of demand, economic expansion could well be more rapid in the second half of 1962. The task of short-term economic planning would seem to be to promote the necessary changes by pursuing appropriate policies on liquidity and interest rates, and thereby creating the conditions for an adequate expansion in investment, and eventually for a quickening in its pace; further, financial policy would have to be set on a course which would best ensure expansion.



A. Demand

Despite a continued and fairly marked expansion of exports to non-member countries the growth of total demand in the Community may have slackened somewhat.

In the third quarter exports to non-member countries were more than 10 % higher in value than a year earlier—the year-to-year growth rate having been 5.8 % in the second and no more than 0.1 % in the first quarter. However, the recovery in the year-to-year growth rate does not indicate any further advance, as last year's figures for the third quarter were marked by a slight fall-off connected with the recession then current in the United States. Nor do such export figures as are available for October 1961 indicate any new trend towards rapid expansion.

Community exports have benefited from the very favourable economic situation in the world, developments in the United States in particular having done much to stimulate demand both directly and indirectly. Though the improvement in the United States' situation has continued, expansion has been rather slower than previously; after adjustment for seasonal variations, the real gross national product increased by 1.5 % from the second to the third quarter whereas the growth from the first to the second quarter had been 3 %. In September there was even a slight drop in the seasonally adjusted index of industrial production. This was partly due to a slower replenishment of stocks. Strikes in the motor industry also played a part, this industry normally showing high production figures during these months because of the introduction of new models. In August and September private consumption also increased more slowly than before, in line with the production trend.

Though this doubtless reflects a certain pause in the expansion—after the very rapid growth in economic activity in the spring—it does not suggest any early levelling off of the economic trend in the United States. At any rate the seasonally adjusted index of industrial production for October was already pointing to a continuation of the upward trend.

The economic advance in America began to stimulate the rest of the world economy fairly soon. The trade surplus, which had already fallen in the second quarter, showed a further marked decrease in the third. Whilst this was in the first place mainly due to a weakening of exports, imports rose clearly in the third quarter—even more than exports, where a slight improvement was registered. Community sales benefited particularly from the increase in imports: in the third quarter the Community's exports to the United States exceeded by 12 % those of the corresponding period of the previous year, whilst in the second quarter they had only just reached the previous year's level. But this improvement should not be overestimated, because in 1960 American imports from the Community had been affected by the recession.

By contrast, exports to the EFTA countries had risen steadily in 1960; it is all the more remarkable that in the third quarter of 1961 they have again shown a higher rate of growth, slight though the increase may be 14 % over a year earlier, against 11 % in the first half-year.

Once more, exports to the United Kingdom have contributed but little to this development; it is true that their year-to-year growth rate rose from 1 % in the second to 4 % in the third quarter, but this was partly due to some slackening-off between the second and third quarters of 1960. In fact economic activity in the United Kingdom has again expanded only slightly. In the third quarter industrial production was approximately 2.5 % greater than a year ago. But the very smallness of this growth, coinciding in all probability with a tendency to cease running down stocks of imported goods, meant that the improvement in the trade balance, which had been observed since February, has not continued in the last few months although the deflationary measures meanwhile taken by the Government begun to have some effect. Investment activity seems to have passed its peak and sales of industrial goods, especially motor-cars, dropped slightly in August and September. But despite this slowdown in internal expansion, exports hardly increased, whilst imports recently showed a tendency to rise further.

Exports from the Community to the other European countries progressed favourably. Greece deserves special mention, its association with the Community having now reached the stage of parliamentary ratification. In recent months Community exports to Greece have benefited from a very lively expansion in business activity, and from the rise in incomes in that country; in the third quarter their value was approximately 40 % higher than in the third quarter of 1960.

The Greek economy has in fact been making great strides. Recent estimates put the increase of the real gross national product for 1961 at 10 %. This very rapid growth is largely due to the considerable rise in agricultural production—estimated at 15 %—which accounts for $\frac{1}{3}$ of the gross national product. But industrial production too has risen vigorously. Here the very marked expansion of investment—especially in the public sector—has been a major factor. The lively increase of domestic demand has led to considerably higher imports, which are estimated to have risen by 23 % in the first eight months of this year, whereas exports rose by only 7 %. This deterioration in the balance of trade was however largely offset by greater net income from services (especially in the transport and tourist sectors). As a result, the gold and foreign currency reserves of the Central Bank have fallen only slightly since the beginning of 1961. This year's good harvest and the improved outlet prospects—due especially to the 50 % reduction to be made by Community countries in their duties on certain agricultural products from Greece once the association agreement is ratified—could bring about a more rapid expansion of Greek exports to the Community.

The exports of the Community to the developing countries were 7 % higher in the third quarter than a year earlier. The decline in exports to the French overseas

departments was largely halted in the third quarter, and deliveries to the overseas countries and territories associated with the Community showed a more vigorous expansion. Thanks to the great volume of purchases by Argentina, the Community's exports to Latin America attained a 10 % growth rate in the same period. On the other hand, sales to the Middle and Far East showed a slight fall-off in recent months.

The increase in internal demand in the Community as a whole may have been a little less marked than that in external demand. Investment in stocks, in particular, seems to have increased only very slightly.

Fixed investment by enterprises has in general continued its upward movement, though it too may have expanded a little less vigorously. In some of the Member States the reasons for this are largely physical; but it does seem that the level of demand has become a little more restrained in some sectors. There was a clear fall-off in the expansion of imports of machines and other equipment. Nevertheless, deliveries by the investment goods sector were considerably higher than a year earlier, while commercial and industrial building activity also showed a continuous upward movement.

Total expenditure on building in the third quarter has no doubt considerably exceeded the level of the corresponding period of the previous year, although slightly fewer dwelling units were completed. In some member countries the need for housing remained so high in relation to supply that building prices rose still further.

In the period under review stock-building trends varied and were marked by a very cautious attitude on the part of the processing industries and of dealers. As can be seen from import figures, this is true not only of investments in stocks of raw materials and semi-finished goods from non-member countries, but also of the demand for certain domestic raw materials, certain base products (especially iron and steel) and a number of goods which have undergone initial processing (especially in the textile industry); in these, demand was relatively weak owing to cyclical changes in stocks. In addition, we must take into account the braking effects of the general slowdown in the growth of production, of the "structural" tendency to rationalize stock-holdings, perhaps too of liquidity problems—profit trends also play a part in this—and finally of expected price changes. These expectations are explained in part by a new decline in world market prices, but possibly an excessive extension of capacity in certain base industries also gives rise to the assumption that prices cannot be kept indefinitely at their present level.

Against this, there has been a steady and very pronounced upward movement of public investment and consumer expenditure in all the Community countries.

The overall level of consumers' expenditure continued to rise in the third quarter. In the Federal Republic of Germany, in France, and in Italy the pace may even have quickened somewhat. The effects of repeated and fairly substantial wage increases may have been accentuated in Germany and France by a slight drop in the rate of saving and

in Italy by the great increase in farm incomes due to a harvest which was considerably better than in the previous year. In the Benelux countries the trend of consumption was weak—mainly because of the static wage situation and probably also because of a higher rate of saving.

The rise in consumers' expenditure was again fairly strong in the services sector—especially during the summer quarter. Purchases of some consumer durables, on the other hand, increased less than before; this applies in particular to the sales of new motor cars, although the position here was affected by special factors such as the expectation of new models at the Frankfurt and Paris Salons in the autumn.

B. Supply

The expansion in domestic supply was, by the third quarter, only slight.

With the exception of Italy—where the harvest was more plentiful than in the previous year—agricultural production in the Community has risen only slightly, although there was a further noteworthy increase in livestock products, especially in dairy produce. Grain harvests were less satisfactory, the decline in wheat being particularly marked.

Industrial production in the Communities has hardly risen at all in the period under review. According to the index prepared by the Statistical Office of the European Communities, the production level in the third quarter was only 4 % above that in the corresponding period of the previous year—as against a year-to-year growth rate of 7 % in the second and of 8 % in the first quarter.

It seems that from the second to the third quarter there has been hardly any rise in the seasonally adjusted figures for production (approximately 0.5 %). At any rate the slowdown of growth is remarkable: in the first quarter of 1961 the index figure had risen by about 2 % above that for the last quarter of 1960, and from the first to the second quarter of 1961 the rise had been approximately 1 %.

This marked slowing of expansion in the third quarter is however in part due to factors which have nothing to do with the trend of demand. In the first place working hours have been further reduced in the Netherlands and in the Federal Republic of Germany, despite the extreme shortage of labour in both countries. In the Netherlands this factor assumed such importance that in May/June it caused a drop in the absolute figures for production, from which there have since been only slight signs of recovery. In the Federal Republic of Germany, too, there has for similar reasons been a slight fall in production, which was however smaller than that in the Netherlands. In the former country, as in a number of others, a tendency to lengthen holidays was another factor. Finally, the motor vehicle production graph showed a marked dip during the summer, which may well have been largely due to the introduction of new models, but also to certain tax modifications.

On the other hand current developments in the trend of demand have also led certain branches of industry to reduce the rate at which they have been expanding production, if indeed they have not actually cut back output. The most important of these developments is the decline in demand, already referred to, which stems from the stock policy being pursued by enterprises; this has affected in particular the iron and steel industry and some sections of the textile industry. Other sectors, such as coalmining and shipbuilding, continued to suffer from structural weaknesses.

In other industries, especially in those producing investment goods, but also in various branches of chemicals, expansion of production continued. Nevertheless there seems to have been a certain loss of pace in the expansion of investment goods, partly due to lack of capacity and of skilled labour. In the Federal Republic of Germany

there has for some time been a slowdown in the flow of new orders in a few industries, so that the tendency has been to spread existing orders over a longer period. The chemical industry is under heavy and growing pressure from imports.

The very slight rise in industrial production at a time when industrial employment has continued to increase, albeit more slowly than in the past, implies a further fall in productivity per worker.

Few overall figures on recent developments in the services sector are available. There are however signs that expansion has been vigorous in those branches directly linked to private consumption, such as tourism and the hotel and catering trades. In terms of value, the expansion of inland goods transport is likely to have been less marked as a result of the slower increase in production, the drop in the deliveries of raw materials and semi-finished goods, and the slower increase in trade between the member countries.

Despite the less marked increase in domestic supply and the progress apparently being made in rationalization, there have been no important changes in the labour situation in the Community. In Italy, where production has maintained its upward movement, unemployment has further decreased. In Belgium, too, the fall in the number of unemployed has continued. In the Federal Republic of Germany and in the Netherlands the shortage of labour has remained marked; this could mean that certain branches are hoarding manpower. On the other hand, as already mentioned, working hours have been considerably reduced in these two countries, which results in demand for labour being maintained in spite of stagnant production. The number of unemployed has remained extremely low. In France, too, more widespread shortage of labour than has hitherto been experienced has recently appeared.

C. The balance of the markets

The slowdown in the expansion of domestic supply has not led to a more rapid rise in imports. On the contrary, these fell in the third quarter, and this suggests that demand factors have played a part, the most important being the cautious stock-building policy of firms. Consequently, the fall in imports was particularly notable in certain raw materials and semi-finished goods such as cotton, rubber and non-ferrous metals. Imports of some agricultural products also decreased. On the other hand, the demand for finished goods, especially consumer goods, continued to grow.

The total value of Community imports from non-member countries in the third quarter was only 2 % higher than a year earlier, whereas in the first six months there had still been an increase of 6 % over the same six months of 1960. In terms of volume, however, the trend was more favourable, as import prices were falling slightly.

Imports from different areas showed very divergent trends, on the whole corresponding to the trends shown by various goods. The marked drop in Community imports from the United States—in the third quarter they were 9 % below the level of the corresponding period in 1960, whilst in the first half year they had still been 15 % above that level—is mainly due to smaller imports of grain and raw materials and fewer purchases of aircraft. It is, however, not entirely impossible that the current and expected rise of domestic demand in the USA and the slower expansion being experienced in the Community may already have restricted the upward trend that has been observed in the export figures of some branches of American industry.

Community purchases from the EFTA countries showed further considerable expansion; in the third quarter they were 11 % higher than in the corresponding period of the previous year, virtually the same advance as in the second quarter. Imports from Great Britain were approximately in step with the total imports from the EFTA countries.

Imports of the Community from Greece mounted particularly sharply in the third quarter, though the increase was perceptibly smaller than it was in exports to that country. Imports were nearly 19 % higher than a year earlier, after a year-to-year growth rate of about 7 % in the second and a drop of 16 % in the first quarter.

In the third quarter imports from the developing countries again failed to rise above the level of a year earlier: this stagnation is of course largely due to the hesitant trend in raw material imports. Exports to the Community from the associated African countries were again higher than in the previous year—in the third quarter the increase was about 6 %.

Trade amongst the Member States has expanded less vigorously in recent months. The seasonally adjusted figures for the third quarter show a definite slackening of growth, although in terms of value the increase was still 17 % over the corresponding period of the previous year. A similar slackening had occurred for a while in 1960. At that time the main reason had been the drop in agricultural trade as a result of the very much better harvest in some Member States as compared with 1959. The present falling off, however, seems to be due rather to certain peculiarities of the present economic situation, in particular, repercussions of the slower rate of expansion in production, and the cautious policy on stocks being pursued by enterprises.

The year-to-year growth rates in imports from other Community countries have increased in the Federal Republic of Germany and in Italy, whereas they have fallen slightly in the other countries. Netherlands deliveries have risen; those of the other countries—with the exception of B.L.E.U., whose exports were lower because of smaller steel deliveries, especially to Germany—were again markedly higher than a year earlier. In the third quarter there were no appreciable changes in the positions of member countries in trade with all other members of the Community; only in the Federal Republic of Germany was there some reduction of the high surpluses registered in the second quarter.

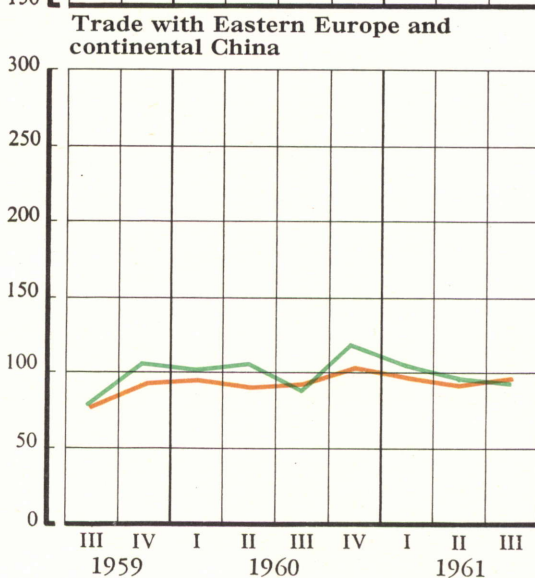
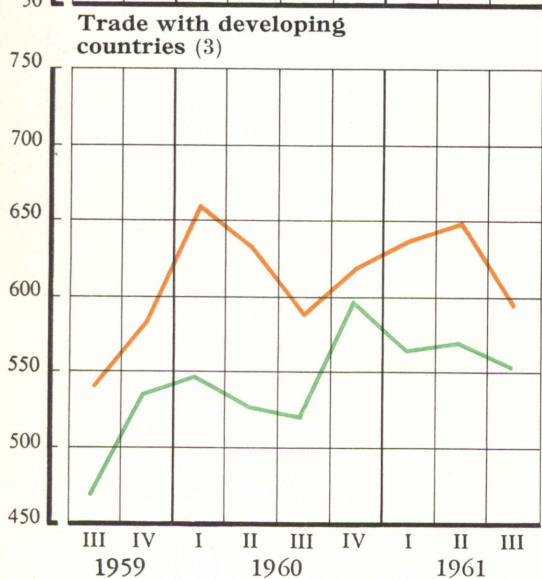
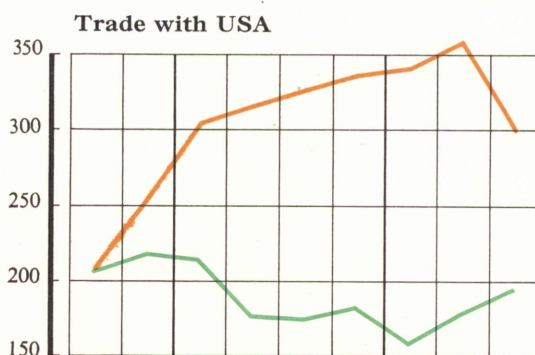
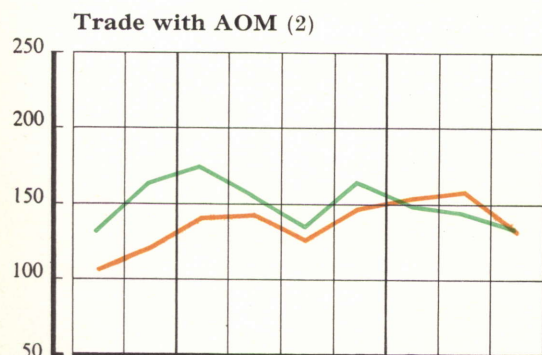
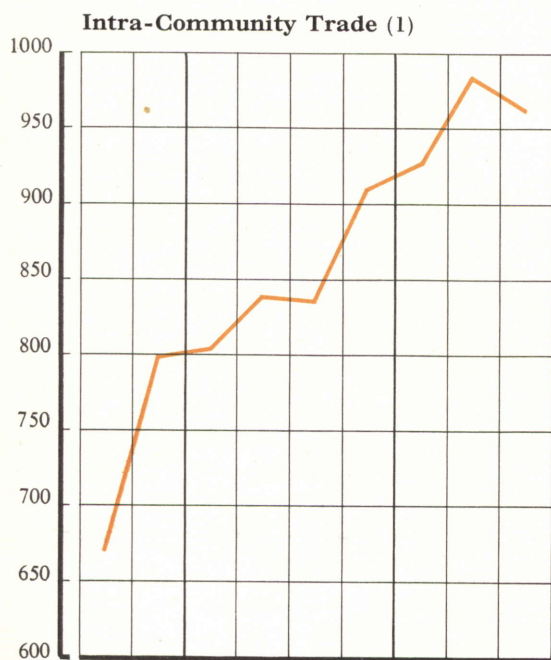
The slight tendency for prices throughout the Community to rise since the beginning of the second quarter continued in the third. For industrial products these rises have again been moderate, although wage costs per unit of output appear to have risen further, especially in those countries where there is a shortage of labour. In some branches where the order situation has tended to deteriorate there have even been marked price reductions, especially on export orders (notably steel and textiles). It seems that the state of demand—especially sales prospects—and the competition provided by imports of finished products do not allow prices to rise much. Furthermore, profit margins, favourable hitherto, have been large enough to enable many sectors to cover part of their increased costs out of profits. In services this is of course hardly possible, and here there was a definite tendency for prices to rise throughout the Community. In some countries there were further increases in controlled rents and rises in the rates charged for some public services (especially public transport). Food prices rose slightly, apart from certain seasonal fluctuations. This applies particularly to consumer prices, as processing and distribution margins had been widened in some cases. In France there was a sharp general rise in consumer prices; from June to October the increase was roughly 3 %. But this was largely due to government measures by which the prices of the main agricultural products were raised in order to increase farm incomes. This may have tended to slow down the rise in real wages and perhaps also in the volume of private consumption in France. The demand for foodstuffs being relatively inelastic, this development is likely to have affected purchases of industrial products and services.

The increase in consumer prices was encouraged or at least rendered possible by the considerable expansion of consumer spending in some countries. In Belgium, where there has been little increase in expenditure of late, prices remained virtually stable.

FOREIGN TRADE OF THE COMMUNITY

Monthly averages

In million dollars



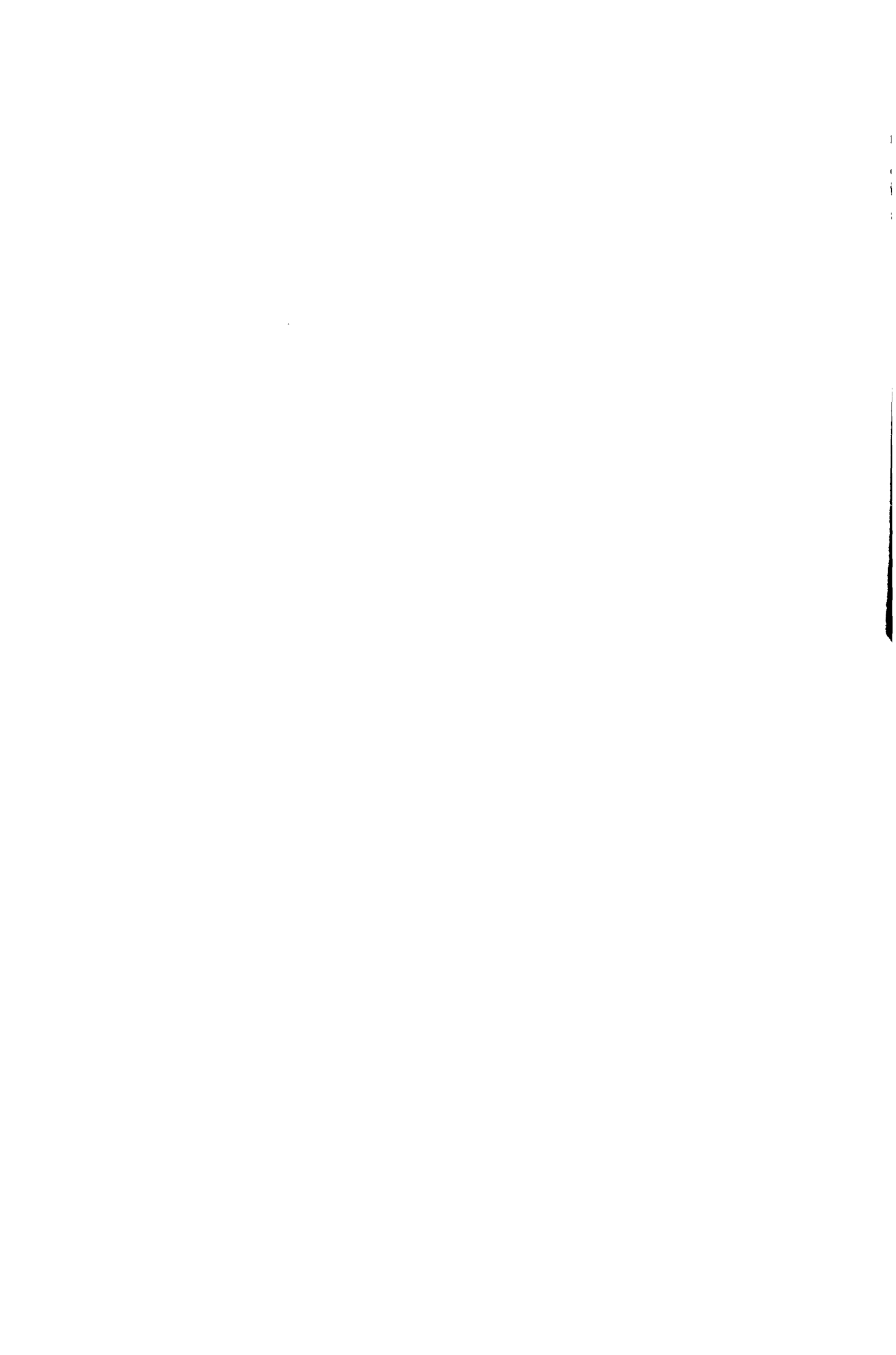
— Exports

— Imports

(1) Export values.

(2) AOM : overseas partners of the Community (departments, countries and territories).

(3) According to the GATT classification : non-industrialized countries, excluding AOM.



As was forecast in the last report, the trade balance of the Community again improved. The scale of the improvement was, indeed, very large, and was due largely to an actual drop in imports. In the third quarter the surplus was 320 million dollars, contrasting with deficits of approximately 160 million dollars in the previous quarter and of 60 million dollars in the third quarter of 1960. Allowing for seasonal variations, the improvement from the second to the third quarter of 1961 may be approximately 380 million dollars.

Despite the heavy surplus on trade and also, no doubt, on the current account as a whole, the payments position of the Community will probably show a deficit for the third quarter. At any rate, the official gold and foreign currency reserves of the Member States have only risen slightly (indeed, in October they fell a little). At the same time the net foreign currency position of the banks seems to have deteriorated.

Capital movements showed a deficit for the Community, mainly owing to the drawings of Member States' currencies in connection with the credit granted to Great Britain by the International Monetary Fund. Also most of the short-term capital which had flowed into the Community because of lack of confidence in sterling has probably been drained off again; this must have occurred partly through a further worsening in the terms of payment in foreign trade. The action to support sterling, the measures announced by the government, and the improvement observed until spring in the United Kingdom's balance of trade have evidently removed for the present the fear that the pound might be devalued. Finally a certain amount of invested capital—especially foreign capital—has been withdrawn from the Federal Republic of Germany as a result of the Berlin crisis.

Nevertheless some of the capital exported was not drawn from domestic circulation, but was financed by the Central Banks. This means that on balance internal liquidity has probably been further increased owing to balance of payments developments. However, the inflow into the Community as a whole was much weaker than before, although it varied from one country to another. The result was that business demand for credit continued and may even have increased owing to a reduction in profit rates, leading to credit being less readily available in the money and capital markets of certain Member States. In the third quarter interest rates showed a tendency to rise, particularly on the Netherlands and Italian money markets and on both money and capital markets in the Federal Republic of Germany, where the cash surpluses of the public authorities continued to restrict domestic liquidity, though less than previously. The Central Banks of the countries concerned had to parry this tightness by such measures as reduction of the minimum reserve rates and open market operations in Germany and the Netherlands, or by purchasing foreign currency from the banks in Italy. In fact it seems as if the strain has recently been reduced and, in some cases, eliminated. No such tightness occurred in France and Belgium, largely because the payments position of these countries shows a surplus.

In public finance the rate of expansion in receipts—though still high—is tending to decline in certain Member States. On the other hand expenditure seems to be rising, if anything, rather more rapidly, but this increase includes payments to non-member countries. The damping anti-cyclical influences seem to have become a little less marked. In the Federal Republic of Germany cash surpluses have fallen, and in Italy they disappeared in the third quarter.

D. The results for 1961

Production in the remaining months of 1961, on which of course only incomplete information was available when this report was being prepared, may have regained a little momentum. The incomplete figures available for October, such as the index of industrial production in the Federal Republic of Germany, point that way. Exports to non-member countries will probably have risen a little less quickly than in the third quarter, whereas imports are not likely to have declined any further but may even have picked up a little. The balance of trade may well have remained very favourable.

Taking into account these forecasts for the closing months of the year, a rough outline of economic developments in the Community for the full year 1961 can be drawn. For the Community as a whole it has again been a year of boom—in which this time each Member State participated. Nevertheless, growth by volume was a little less marked than in the period of rapid advance from the middle of 1959 to the middle of 1960—largely because of shortages of labour and, in some cases, of capital. The probable increase in the Community's real gross national product in 1961 is about 5.3 % (compared with 6.9 % in 1960). This means that over the four years since the entry into force of the Treaty, that is to say from 1958 to 1961 inclusive, the real national product of the Community has increased by more than a fifth (approximately 21 %).

Industrial production alone will probably grow by 6 % in 1961, after an increase of 13 % in 1960. This would mean that industrial production in the Community has risen by some 32 % in the past four years.

Throughout 1961 the demand has been expanding rapidly. There has been an appreciable upward movement in investment by firms, although this is unlikely to have been faster than in 1960. There has, however, been a distinct acceleration in private consumer spending. During this phase of the boom, which is marked by increasing labour shortages in some Member States, there have been considerable wage increases; these together with the expansion of employment have resulted in a sharp increase in the total wage bill. Although wage increases generally—but not in Belgium—exceeded the rise of productivity, the rise in prices did not correspond to this divergence. This applies in particular to export prices, which have remained remarkably stable, having risen slightly in terms of foreign currency only in the Federal Republic of Germany and in the Netherlands; since this rise, however, merely reflected the revaluation of the Mark and the Guilder, prices expressed in national currencies have not risen at all. Demand, and in particular forecasts of its future trend, evidently made any sharper increase in prices inadvisable, so that most of the increase in costs was borne out of profits, which had previously grown relatively rapidly. The overall competitiveness of the Community's exports should therefore have deteriorated only slightly, particularly if it is remembered that some non-member countries have experienced a more or less similar development of costs.

In the course of 1961 exports recovered after overcoming certain reverses caused in the main by the recession in the USA. According to a preliminary and in the nature of things very uncertain estimate, they may prove to have been some 5 % higher in value (on a dollar basis) and 3 % greater in volume than in 1960. The latter year was, however, remarkable for an increase (in terms of value) of 19.5 %.

Community imports from non-member countries also increased more slowly in 1961 than in 1960, largely owing to certain repercussions of the slower expansion in production and to the efforts made by firms to limit their stocks. The dollar value of imports in 1961 may prove to have been 3.5 %, and their volume 4 %, greater than in 1960.

The Community's balance of trade, which had clearly deteriorated in 1960 with a surplus of 59 million dollars as against 829 million dollars for 1959, recovered noticeably in the second half of 1961 and may well show a surplus of some 300 million dollars for the whole of this year.

In most countries of the Community, especially in France and the Federal Republic of Germany, consumer prices rose. Prices for services mounted everywhere as a result of wage increases, but in some countries also as a consequence of higher controlled rents and higher rates for public services. In France more than elsewhere the effects were felt of measures to improve farm incomes via increased prices for agricultural products. Except in the Federal Republic of Germany, economic factors such as trends of demand or price increases based on the relation between wages and productivity were less instrumental in raising the level of consumer prices.

E. Outlook

There seem to be good grounds for supposing that the economic expansion in the Community as a whole will continue in the first half of 1962. This is especially the case for Italy and France; in the Federal Republic of Germany and the Netherlands the growth of production may pick up, as the pressure of the physical handicaps on supply are expected to lessen. In Belgium and Luxembourg on the contrary it will hardly be possible, in view of the way demand is shaping, to count on any substantial increase in output.

Demand is likely to rise further. In view of the world economic outlook this applies also to Community exports to non-member countries. However, these are hardly likely to register as great an expansion as during the last surge forward in the American economy. The slower booking of new export orders noted in the Federal Republic of Germany for some time past is a further indication that the pace will be moderate.

Above all, it seems that the business upturn in the United States is this time progressing rather more slowly than during the last recovery in 1959. In any case, the most recent figures on business investment plans for 1962 indicate that outlay will be very little above the level probably already reached in the fourth quarter of 1961. The same will probably apply to housing. The growth of private consumption could in turn be limited by the fact that, in the light of the trend forecast for investment, no specially rapid rise in employment or fall in unemployment is to be expected. Public spending, however, should rise sharply, and it would be quite usual if firms revised their investment schemes upward on an improvement in business conditions. On balance, the expansion of the United States economy should in any case permit a further recovery of Community exports to that area. Such a rapid rise as in 1959 is, however, hardly to be expected, if only because certain special factors then affecting the American steel and automobile markets will not this time recur.

Since the growth of home demand in the USA and the relatively quiet economic climate in Europe will probably lead the United States to import more, with a consequent further deterioration in the trade balance, the impact of the situation in that country on business in the rest of the world will be appreciable and will affect not only the Community but also other industrialized countries and—not least—the developing countries.

For this reason, but also in view of the upward trends which it is expected will be produced by domestic factors, the economic outlook in the industrialized non-member countries in Europe is not unpromising. At the same time the possibility of exporting to the Community affects the position of these countries, and at present there seem to be rather fewer opportunities to expand in this direction. On balance, however, a steady—even if no longer so rapid—expansion of the Community's exports to these countries may be expected.

Here Great Britain is an important exception, although this country, too, will benefit indirectly from American prosperity and continue to profit from the high level of the European economy. Its exports could therefore increase, although probably not

to any great extent in view of the limited competitiveness of the goods it offers and of the more leisurely pace of expansion in Europe. Such an increase is, however, hampered by the measures taken by the British Government and the Bank of England to curb home demand; in some circumstances these may have to be intensified, as Great Britain's balance of current payments does not yet seem to be showing any really significant turn for the better. It may become necessary to apply an even stricter deflationary policy if, in particular, wages cannot be kept stable. Any substantial increase in total demand is therefore unlikely. The recent reductions in bank rate make no difference here. Nor are they intended to act as a stimulus to the home economy; their purpose is to lessen somewhat the strong attraction of the high interest rates to hot money. True, imports might again rise, but this would be due in the main to the resumption of purchases of raw materials and semi-finished goods which fell off substantially under the influence of the stock cycle. A large increase in imports from the Community is, therefore, hardly to be expected.

The indications are that for Community products there will be no great expansion in demand from the developing countries, since we must expect that in the second half of 1961—and even earlier in Great Britain—the downward phase of the stock cycle, with European industrial countries, in particular the Community countries, importing less raw materials, and the further sagging of prices on raw materials markets, will have reduced the foreign exchange available to the developing countries. Against this must be set growing purchases from the USA and rising aid from the industrialized countries.

The growth of internal demand should in any case continue in the first half of 1962, but its rate might fall off. This lower rate of expansion would in the main affect investment by private enterprises. Here the forecasts for all member countries indicate some slowing of growth, which in France alone might be offset by a likely increase in investment spending by State industry. The tendency for investment to slow down will be particularly marked in the Federal Republic of Germany, as new foreign orders to the investment goods industry have been coming in only hesitantly for several months and have sometimes been lower than foreign sales. In Belgium, too, the rate of investment might fall off somewhat, particularly in iron and steel and textiles. A slower expansion of investments is expected in the Netherlands. In Italy the growth of investment should be relatively little affected.

The reasons for this slower growth are partly cyclical. In fact, businessmen in a number of sectors seem to be realising more clearly how much capacity is being expanded by the investment boom, and are obviously not expecting demand to expand enough to warrant a further increase of capacity on a similar scale. This weakening of the rate of growth of investment is also partly explained by certain after-effects of the slowing down of exports which followed the deterioration of the world economic situation in 1960 and early 1961. It may be a considerable time before the new stimulus being given to exports is reflected in a further wave of investment. Finally, the narrowing of profit margins observable for some time now is certainly having a cramping effect on investments.

On the other hand, effective incentives to investment still exist, including, in some member countries, manpower shortages which will probably continue, and rising labour costs per unit of output. On balance it seems, as already stated, that investment should continue to increase but that the pace will be appreciably slower than a year earlier.

In view of the rising number of building permits in the Community as a whole, increased activity can still be expected in construction; housing is likely to advance again, although here the expansion of demand seems in general less lively. But this weakening of demand affects those countries where the physical limits of building activity have in any case almost been reached and where there was a great volume of unsatisfied demand. On the whole, therefore, a continuing slight expansion of housebuilding is to be expected in the first half of 1962.

There is likely to be a further perceptible increase in private consumers' expenditure in the first half of 1962, but here too a certain deceleration in expansion must be expected, although it may be less marked than in case of investments. It is true that wages will go on rising—in the Netherlands substantially—but elsewhere the increase in total earnings per head might be somewhat smaller than hitherto. The fact that the number of hours worked per employed person throughout the Community is unlikely to rise further, and in the Federal Republic of Germany will probably again decline, also affects the position. In addition, the increase in the total numbers in employment will probably be smaller than hitherto.

Finally, if we are to judge by the budgets, total public investment and consumer expenditure will increase appreciably in all Community countries, heavier armament burdens being among the contributory factors.

In view of the quieter trend registered by certain components of overall demand and of the likelihood that there will still be bottlenecks, such as manpower in certain sectors, domestic supply, particularly the supply of industrial goods, will show only a limited rise.

A considerable acceleration in imports is hardly to be expected. Restraint in stocking imported raw materials and semi-finished goods might continue for a time, but even an end to efforts to run down stocks would not necessarily mean an immediate change over to re-stocking. Meanwhile, as the expansion of production is still very slow, the growth of current consumption of primary materials has fallen considerably. The change in the general economic climate can have the effect that future estimates of consumption of such materials in the future will not be such as to make any considerable increase in stocks held by enterprises appear warranted. Failing unforeseen political developments or any sharp rise in world market prices (for which no grounds are to be found in the statistical returns or demand estimates) the Community's imports of raw materials and semi-finished goods, representing almost two-thirds of its purchases from non-member countries, will indeed again increase, but the increase is likely to be modest. On the other hand, imports of manufactures, particularly consumer goods, might show a further perceptible upward turn, while imports of investment goods will probably expand considerably less.

The growth of trade between the member countries will probably slacken somewhat, given the probable general economic situation. However, the measures for the further implementation of the Common Market will tend to counteract this slow-down.

Prices will probably again rise particularly those for consumer goods, but the increase will be limited. For investment goods they are more likely to remain stable, while for certain basic materials they might even fall. Higher prices will result less and less from the pressure of demand on supply and more and more from the rising wagecosts.

The tendency for the trade balance to recover should continue, but the surplus will probably not be as high as in 1959. How the balance of payments between the Community and non-member countries will shape is likely to depend mainly on capital movements. In this connection further inflows of capital in 1962 are not to be completely ruled out.

The economic and financial policy of the Community ought to assist in preventing any further aggravation of imbalances in the payments account. The recovery in the Community's balance of current payments—and also reasons of internal economic and price policy—continue to call for an expansionary import policy.

Moreover exports of long-term capital, in particular help for developing countries, ought certainly to be further increased. In view of the continuing strong competitive position of the Community's export industries compared with those of other important industrial countries, the Community's surplus on trade could indeed be still further increased, but certainly not to the full extent needed to cover the additional capital exports. Any such additional exports of goods in 1962 could, moreover, have a thoroughly beneficial effect on the internal situation in the Community.

Finally, for reasons of international balance-of-payments policy, in particular to counter any inflows of short-term capital, short-term credit policy in the member countries should, in the coming months, again aim at a high degree of liquidity and low interest rates. Considerations of internal policy give increasing justification for such a policy, since it makes it easier to take certain measures of adaptation and creates favourable conditions for continuing economic growth, which in turn is to be welcomed for reasons connected with balance-of-payments policy.

In view of the way the economy is shaping it seems a basically sound or at least acceptable policy that the budgets of the public authorities in certain member countries should be stabilizing the economy through influences in part automatic and in part the result of financial decisions : they should encourage the long-term growth of demand by ensuring that their cash reserves have a less inhibiting or more expansionary effect than has been the case in the past. Certainly the situation and the requirements still differ from one country to another, and there are some in which a considerably more expansionary public finance policy than in the previous year might be dangerous, as it could seriously aggravate existing pressures on prices. But should trends towards a slowdown in the business situation also become visible in these countries, there would be an excellent case for timely action of this sort by the public authorities through their budgetary policy.

Furthermore, both sides of industry should be more conscious of the importance for the economy of moderation in wage demands at this particular time or, where necessary, Governments should take more active steps to ensure that it is observed. For it is fairly certain that, given present business prospects, further considerable rises in wage costs per unit of output might not only push prices up again but could also have a depressive effect. The situation differs from country to country, in some wages are relatively low and profits high while in others wages are high and profits moderate; but this need for restraint should nevertheless be borne in mind in most member countries and for most branches. At the same time the policy of encouraging competition should be more vigorously pursued in order to avoid "agreed" and excessive price rises cramping consumer demand and thereby the growth of production, and even to secure cuts in prices, wherever possible.

Precisely in view of the business outlook hinted at above, the need to consolidate the economic situation seems to call for further and rapid measures to implement the Common Market. Experience with the measures so far taken leads to the assumption that the better internal equilibrium which they made possible in the Community—this can be completely effective at sector level and need not always be fully reflected in balance of trade figures—leads in general to a stronger expansion of demand which at the same time is more closely followed by supply. The expansion of demand is also promoted by the incentives to investment arising from the implementation of the Common Market.

The extent to which the Common Market, as it develops the characteristics of an internal market, succeeds in smoothing out fluctuations and reducing sensitivity to economic conditions in the non-member countries can also be of importance for the way in which the economic situation develops in the second half of 1962 and early 1963.

The prospects for this period—i.e. after the middle of 1962—are at present very difficult to estimate in view of the latest changes in trends; in any case they cannot be predicted with any certainty.

If it is supposed that the business upswing in the USA will last throughout 1962 and have an appreciable stimulating effect on the world situation, that de-stocking will come to an end with a consequent increase in the capacity of the developing countries to import, and if the expected upward trend in private consumption and State expenditure for the first half of the year is taken into consideration, the rate of industrial investment in the Community might again increase. This would mean a fresh acceleration in the expansion of demand after the slower growth from mid-1961 to mid-1962.

The rise in the working population, the increase in capacity and the effects produced by some re-organization of production could by then increase appreciably the flexibility of supply, so that a further fairly rapid growth of the economy in the second half of 1962 and beyond is quite conceivable.

However, another possibility must at least be mentioned. This is that the driving forces provided by the other elements of demand might not prove strong enough to prevent a further slackening of the rate of industrial investment. Should this happen we would

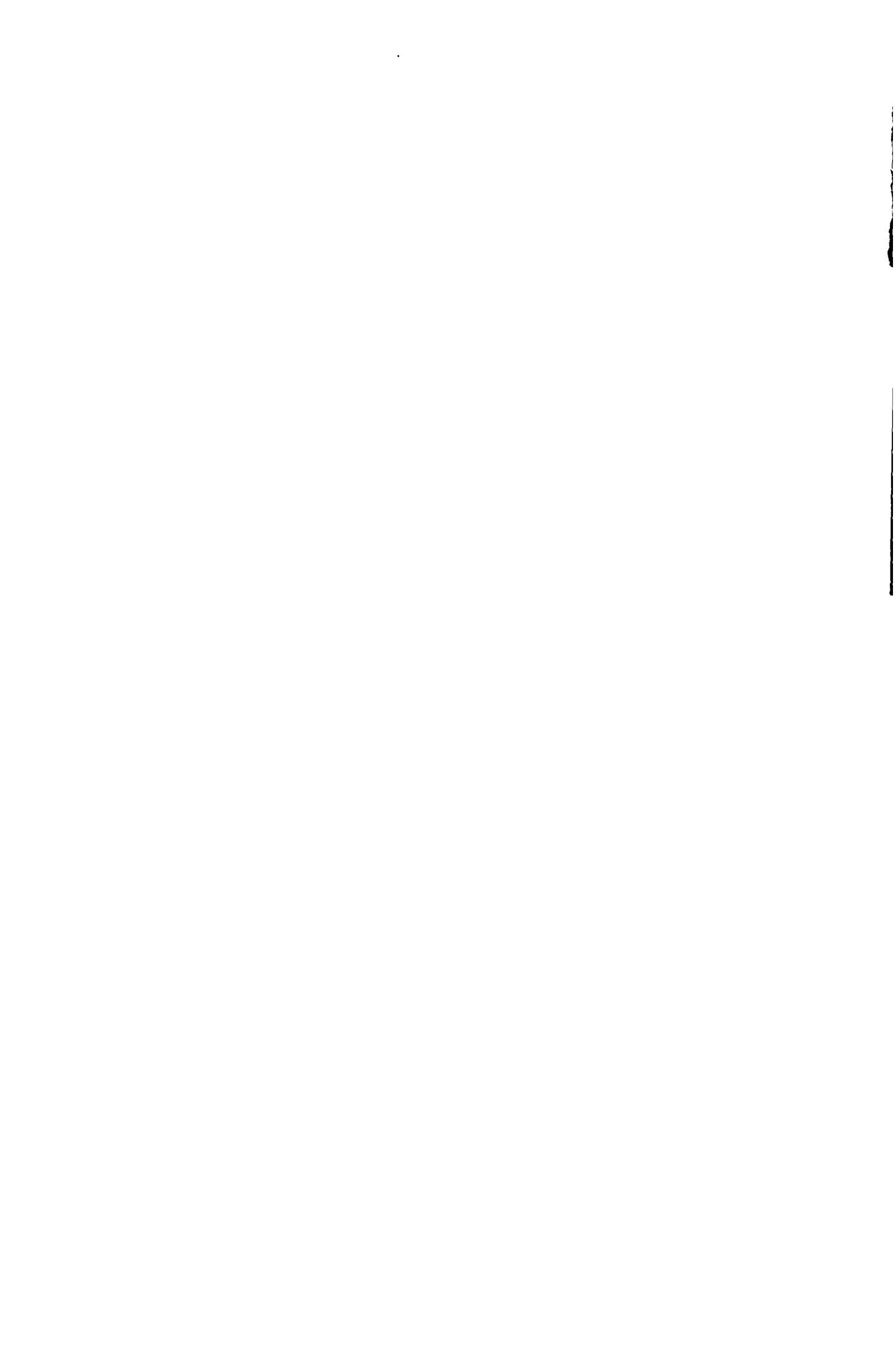
have to expect a tendency for overall demand to stagnate, if only because of the effects of such a development on income and consumption.

Whether this danger will materialize depends largely on how the world business situation shapes—for instance on how strong the upsurge of American business becomes and how soon it passes its peak—and also on the financial policy followed by Member States.

In any case it is proper and important that member countries should now jointly inspect their armoury for combating recession and where necessary supplement and refurbish it, so that expansion can be kept moving sufficiently should the need arise. Even the remote possibility of such a need—should, for instance, a loss of momentum in the Community coincide with a repetition of similar trends in the USA—demands that we hold ourselves in readiness.

All things considered, the gross product of the Community could again rise appreciably in 1962, the more so as in any case the rate of growth will probably reflect a part of the expansion achieved in 1961. A real increase of 4 to 5 % would be quite within the bounds of possibility.

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



A. Federal Republic of Germany

Expansion has continued in recent months, although in certain branches of industry the seasonal downturn during the summer was unusually marked. In the third quarter exports, seasonally adjusted, were only a little up on the second, though their value was 9 % higher than a year earlier. Investment continued to rise, and the rate of growth in consumption appears to have accelerated slightly under the impact of sharp wage increases and of a slight decline in the rate of saving, resulting from special factors.

Despite a sharp increase in imports of manufactures, there was a marked rise in prices. Largely as a result of the labour shortage, output grew slowly. Industrial production in the third quarter was only about 3 % higher than a year earlier.

Though there may have been some improvement in recent months, it appears from this trend that industrial production for the whole year will be about 6 % up on 1960. The gross national product will probably rise by around 5.5 to 6 %.

There are a number of signs which suggest that in future output may grow appreciably more slowly than in the last three years, not only because supply will be less flexible, but also because the rate of growth in demand may slacken. It is true that public consumption should stimulate economic growth if anything rather more and that relatively high rates of growth should again be recorded in private consumption; exports, however, could well decline in their importance as an expansionary factor, and in particular the rate of growth in fixed investment by enterprises may be less in 1962 than it was in 1961.

In addition, if the attitude toward the level of stocks continues to act as a serious brake on economic expansion, policy makers may later in 1962 have to face up to the following problem: should they accept a temporary slackening in the growth of demand—a solution which, desirable as it certainly is from the point of view of domestic price stability, could again lead to heavy surpluses on current account—or would it be better to allow demand to continue to grow, while at the same time encouraging imports?

The second alternative seems more likely to maintain economic growth, reduce the persistent surpluses on the balance of payments, and help to stabilize prices on a more lasting basis.

1. Recent developments

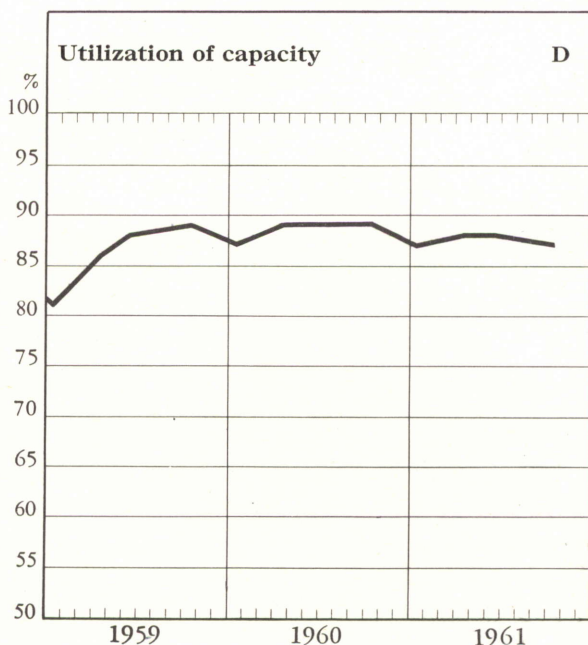
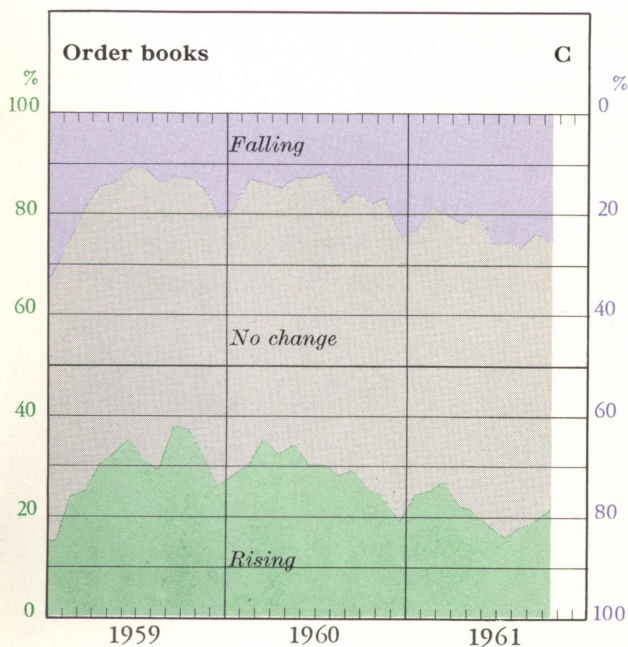
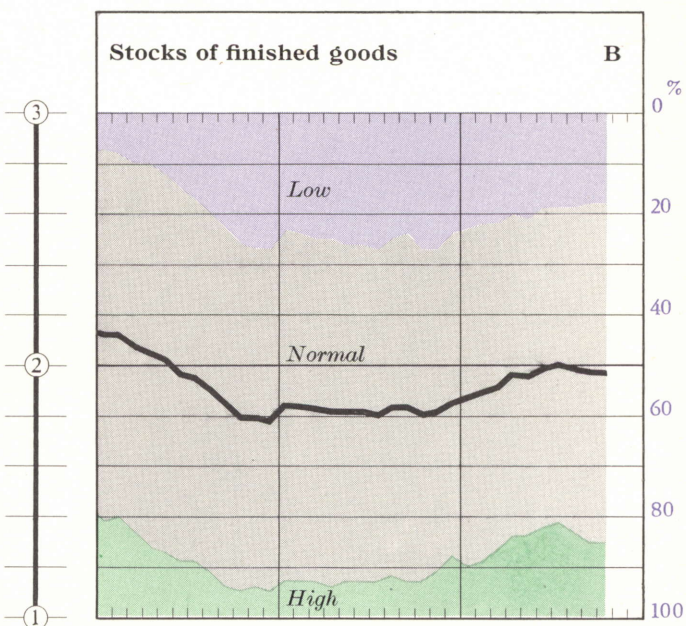
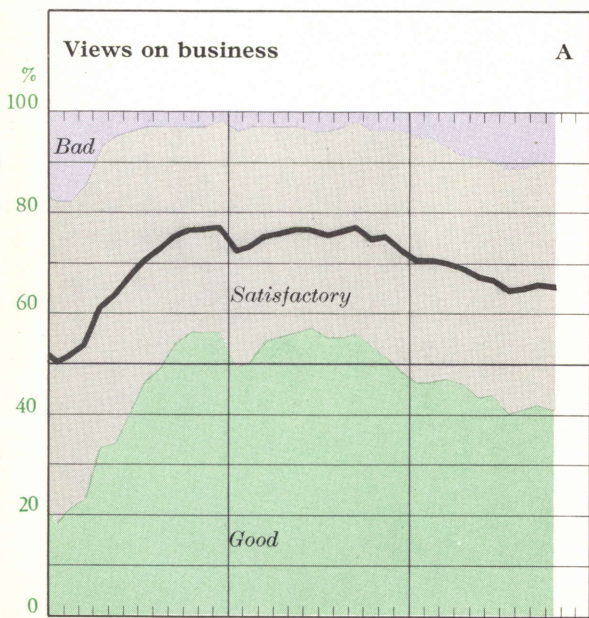
Although the trend in foreign orders has been more hesitant than in 1960, exports have in recent months continued to be appreciably higher—over 9 % up in the third quarter—than a year earlier; this is partly because of the exceptionally heavy backlog of orders. However, the growth in exports has been considerably less buoyant than in the second quarter—a loss of vigour which continued in October, when they were only 4 % higher than a year earlier.

The expansion in home demand may also have slowed down somewhat when compared with the previous periods. On the other hand, investment both in equipment and in building by private firms again grew considerably. Recently, the less satisfactory ratio of costs to returns, like the persistent manpower shortage, has been an incentive to spend money on cutting down overheads. On the other hand, capital expenditure on expansion seems to have dropped slightly. The level of demand for housing continued to move up, though the number of completions was slightly down on the figure for the third quarter of 1960. It is reckoned that the total for 1960—550 000 dwellings completed—will again be reached in 1961.

The trend in stocks, a feature of which in some sectors has been an effort to cut down on total holdings, has acted as a brake on demand; this affects in particular the processing of, and trade in, steel, together with certain sectors of retail trade. By and large, however, stocks appear to have been maintained well above the level of a year earlier.

The rate of expansion in private consumption may even have accelerated. The trend towards higher wages also persisted in the third quarter. The increases in hourly rates made under collective bargaining agreements were, however, at an average of 6.5 %, slightly below the figure for the previous quarter (9.6 %), being in many cases only the second stage increase of 5 % in a wage rise agreed some time ago. On the other hand, the increase under recent agreements averaged 10.5 %. The general level of wages in the third quarter was therefore about 8 % up on the corresponding figure for 1960. As the demand for manpower has continued to exceed the supply, actual earnings have once again advanced somewhat more rapidly than the agreed wage rates. Despite the slight slowdown in the rates of growth in disposable incomes, private consumption may have been growing slightly more quickly than before as a result of some faltering in the rate of saving : the special factors which had encouraged saving in the second quarter (such as the issue of Volkswagen shares) ceased to operate, and the rate of saving fell off more than is usual at this time of year. Retail turnover in the third quarter was almost 10 % up in value and 7 % up by volume on the corresponding figures for 1960; in October, the figures were 9.5 % and 6 % respectively. It should be recalled that it was during these summer months that the portion of consumer expenditure which is of no direct benefit to the retail trader—for example, money spent on travel and holidays—registered a disproportionate rise.

SURVEY OF BUSINESS OPINIONS



Source : IFO trend survey.

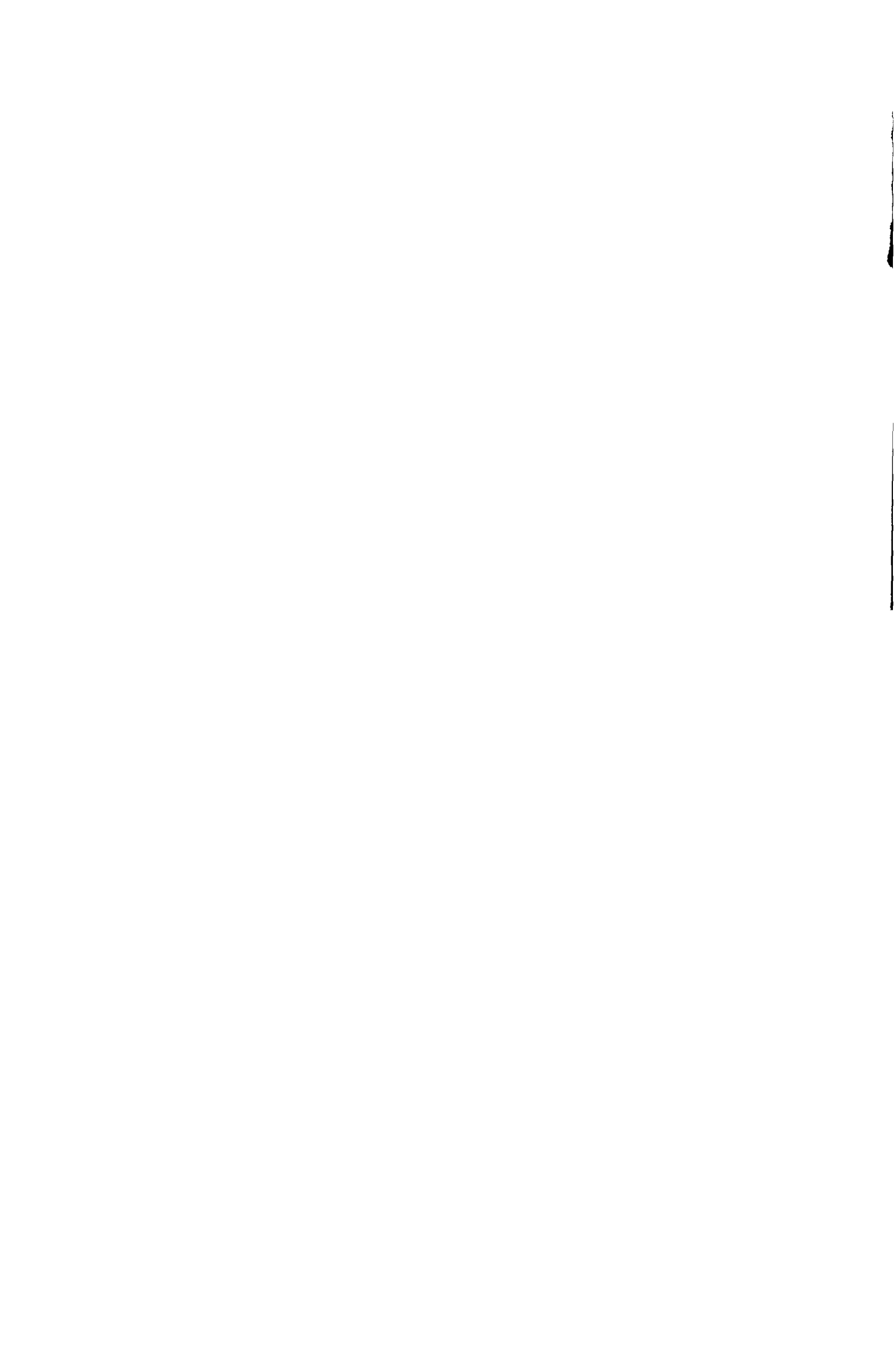
Note : Certain branches of industry are not covered by the survey, in particular : energy, iron and steel, foodstuffs.

GRAPHS A, B, and C : the grey, green and violet areas in these graphs indicate the changing proportions between the three possible replies to the question put.

GRAPH D : the curve shows the development in the utilization of capacity, given as a percentage of maximum technical capacity, as shown by replies.

GRAPHS A and B : the black curves, for which the scale is given between the graphs, show the trend obtained by adding up the percentage of answers in each group after weighting them as follows :

- 0.03 for answers "good" or "high"
- 0.02 for answers "satisfactory" or "normal"
- 0.01 for answers "bad" or "low"



The slowdown in the growth of demand was never marked, and has not yet led to a balance between supply and potential demand, since there has been practically no advance in output. Although the trend in demand has in certain sectors tended to restrain production—this, of course, has meant easier conditions on the market—it is still the shortage of manpower which has been mainly responsible for the stagnation in industrial production.

The situation on the labour market has certainly not eased appreciably. At the end of November the number of unemployed, despite a slight seasonal increase since October, was only 113 100, or 0.5 % of all wage-earners, an unusually low figure for the time of year. After an August peak, the number of unfilled vacancies had fallen at the end of November by 100 000, but was still 487 000 or more than four vacancies to each unemployed worker. The persistently tight labour market is all the more remarkable in view of the fact that in the third quarter the increase in the number of employed was unexpectedly large. On 30 September, the number of workers and employees was almost 560 000 above the corresponding figure for 1960. This big jump is largely accounted for by the influx of foreign workers and refugees from the Soviet occupation zone. The number of foreign workers has swollen in the space of year from more than 220 000 to about 550 000.

Despite this marked increase in employment, from which industry—in contrast with certain earlier periods—drew a smaller share than did other sectors, domestic supply made little real progress. The annual growth rate in industrial production fell from 8.3 % in the first six months to 3.5 % in the third quarter. After seasonal adjustment the figures seem to suggest that there has been a slight decline in production; here again, unusually wide seasonal variations and certain statistical abnormalities should be noted. During this third quarter output both in iron and steel and in textiles fell some 5 % below the level of the corresponding period of 1960.

Employment and output figures show that in the third quarter productivity in industry was little above the level reached in the corresponding period of 1960. The rate of growth in productivity per man-hour also declined perceptibly. The number of hours worked was rather lower than a year earlier, despite the increase in the labour force—this development was due to longer holidays, to the growing practice of closing down for the annual break, and to further cuts in the working week.

Agricultural production also made little contribution to the growth in domestic supply. The grain grown this year was almost 20 % down on last year's bumper harvest. Similarly, potatoes, vegetable and fruit crops were less successful than in 1960, in some cases markedly so. By contrast, livestock products made further progress. In comparison with the corresponding periods of 1960, the rate of growth in imports was slightly faster in the third than in the second quarter; they were 4.6 % up in value and about 10 % up in volume, against 4.4 % and 9 % respectively. In October this tendency persisted : the rate of growth was 6 % in value and 10.4 % in volume compared with October 1960. Imports of manufactures rose more rapidly than did the total. Imports

of agricultural produce have also picked up again in recent months, while the downward trend in purchases of raw materials and semi-finished products has become more pronounced owing to the running-down of stocks.

Prices have again been rising somewhat more rapidly since July. After yielding slightly in the previous months, industrial producer prices moved up by 0.4 % from July to October, investment goods rising by as much as 1 %. Prices in the construction sector rose very steeply; the housing index was in November just about 9 % up on a year before. Consumer prices also moved up in the third quarter, except for foodstuffs, which benefited a little from the seasonal fall in agricultural prices; other consumer prices were 1.1 % higher in October than in July. This rate of increase was higher than in preceding months and raised the cost-of-living index in October to 2.9 % above the corresponding 1960 figure.

In the third quarter the favourable trade balance, at DM 1 700 million, was as high as in the second quarter and about DM 570 million higher than in the third quarter of 1960. The figure for October, however, was only DM 355 million. Gold and foreign exchange reserves (Bundesbank and other banks) fell by DM 2 000 million from June to September. In the second and third quarters of 1961 special factors played an important role in this decline, which, since April, has totalled some DM 3 300 million. The deficit on the payments position—DM 1 900 million in the second quarter, mainly on account of exceptional payments made by the Bund—was about DM 2 000 million in the third quarter. This was the result of a heavier deficit on movements of capital, itself due in part to official capital transactions (DM drawings on the IMF), to certain outflows of capital in connection with the Berlin crisis, and to changes in the terms of payment, in part to a smaller surplus on current account in the third quarter (DM 400 million) than in the second (DM 1 050 million), largely owing to the deficit on services and an increase in unrequited payments.

This trend in the balance of payments, coupled with the effect on the domestic economy of the budget surpluses of the public authorities (still appreciable despite some decline since the first half of the year) and with an exceptional increase in the volume of notes and coins in circulation, has been a powerful contractive influence on bank liquidity. To combat the strains that these factors have placed on the money market, the Deutsche Bundesbank has continued to keep up the liquidity of the banks by repeated cuts in the minimum reserves rate, by open market operations and by freeing, for investment in the normal banking system, public balances held by the Central Bank.

At the same time as liquidity has been cut down by the financial position of the authorities, the supply of credit to business and industry has been increasing appreciably. It is true that progress in short-term bank loans to undertakings and to private persons has lost a little momentum, but long-term credits rose faster than in the first half of the year or in the corresponding period of 1960. It would seem that part of this trend stems not merely from narrowing profit margins but also from the widespread expectation that there will be no reduction in long-term interest rates in the near future.

In the last months of 1961, for which adequate information is not yet available, economic trends in Western Germany are unlikely to have changed appreciably, though the rate of growth of industrial production would seem to have picked up slightly. In October it was 4.9 % higher than a year earlier.

In these circumstances, an increase of about 6 % in industrial production may be expected for the full year 1961. The gross national product might well advance in volume by 5.5 to 6 %, as compared with 8.3 % in 1960.

2. Outlook

The expansion of total demand will probably continue in the first half of 1962. In various fields, however, the quieter trend already discernible in the flow of new orders will probably be confirmed and will help to bring about a better balance between supply and potential demand. It even seems possible that in some sectors demand may fail to grow as fast as the spare capacity created by the heavy investment of recent years.

Export prospects in various branches of industry have deteriorated in recent months. In industry as a whole new orders from abroad have been lower since the spring of 1961 than in the corresponding months of 1960, and in August and September they were 4.5 % smaller than foreign sales. However, the total backlog of these orders is still very high, and as both the reduction in tariffs between the EEC Member States planned for 1 January 1962 and the payments in respect of development aid will favour a further rise in exports, the slowdown in the growth of sales abroad in the first half of 1962 should not on the whole turn out to be very marked.

The rate of business investment seems to be falling off a little. Domestic orders received by the mechanical engineering branch in the third quarter were 13 % below the corresponding level of 1960 and 1 % less than deliveries. However, it should in no way be concluded from this that investment will be lower in absolute figures in the first half of 1962; order books are particularly full and delivery dates very long in the industries concerned. However, the narrower profit margins, the consequently greater need for finance from outside and, in addition, the slackening in the growth of demand might lead individual enterprises to review the profitability of their investment plans and, where necessary, to spread over a longer period some of the plans already decided on. In any case it is more likely than not that rationalization will be stepped up in order to counter the increased wage costs per unit of output, as these can only be partly offset by increased prices.

Further expansion is also to be expected in building investment. In the third quarter housing permits on a space basis were 5 % up on the level of the previous year, and it is expected that at the beginning of 1962 the building backlog will be even larger than in January 1961. Public building activity should also continue to show an upward trend. New orders for building were in any case 9 % higher than in the third quarter of 1960, and budget estimates for 1962 point to a vigorous increase in the building of roads, canals, etc.

A very perceptible rise in public consumer expenditure—in particular on defence—is also to be expected.

Although the peak of the wages rise may well have been passed, private consumer expenditure in the first half of 1962 will very probably again increase considerably. In any case, further rises in agreed wages—likely in some cases to be quite large—are to be expected, particularly in the metal industries. In addition, a 5 % increase in old-age pensions is planned.

All in all, the influence of consumer expenditure as a factor of expansion should grow. This is also apparent from the IFO Institute's economic surveys. While the opinions on the economic situation expressed by industrialists since the beginning of the year have remained roughly the same—as may be seen from the diagram on page 31—their assessment of prospects in the consumer goods sector is definitely more favourable. This view is held despite the fact that, for reasons connected with the stock cycle, traders have been hesitant to place orders, while imports of consumer goods have grown considerably.

In particular branches, such as basic materials and investment goods, the slower growth in demand than in capacity could result in a slowing in the rate of growth of production. However, shortage of manpower will probably continue to be the greatest handicap on growth. An important factor in this connection is that no further increase in labour potential is to be expected from the natural development of the working population. In addition, immigration of labour from the Soviet occupied zone of Germany will cease as a result of recent political events. It will probably become increasingly difficult to recruit foreign workers and the increase in the period of military service from 12 to 18 months, which will probably become effective in the spring of 1962, will most likely claim manpower which would otherwise be employed elsewhere. In addition, the pressure to shorten the normal working week is likely, in part because of agreements made some time ago, to become stronger rather than weaker in 1962, and it is unlikely that this trend can be offset by overtime.

In these circumstances the appreciable fillip to imports which should follow the reduction in duties between the Member States of the Community at the beginning of 1962 will be of great importance in easing pressures on the internal markets and restraining the upward pressure of prices. Businessmen will certainly endeavour to offset any reduction in profits due to higher wage costs per unit of output by increasing prices wherever the state of demand still permits.

While developments in the first six months of 1962 should probably be quite satisfactory on the whole, prospects for the second half of the year are at present less clear. It is true that by then the retarding effect of industry's present stock policy may have weakened somewhat, but the rate of business investment might fall off rather more, so that in any case the available capacity of the investment goods branches will not be fully employed. Now that the Bundesbank has already gone a long way in its policy of widening the margin of liquidity, it would be advisable to ensure that the financial measures

taken by the authorities shall encourage domestic demand. Otherwise it must be assumed that in the long run exports will rise and there will be very large surpluses on current account—at least as long as the present expansionary phase of the world economic situation continues. The experience of the last few years has shown that such surpluses are a threat to price stability. Within reasonable limits, therefore, support for the expansion in home demand cannot have an inflationary effect, especially if this policy, for which there are still considerable openings, is coupled with increased facilities for imports from abroad and measures to increase price competition at home.

B. France

The expansion of demand continued during the summer and autumn. The growth of exports even gathered a little further momentum, especially now that the downturn in exports to countries of the franc area, which had been depressing the general figures, seems to be over. All in all, exports in the third quarter were almost 10 % up in terms of value on the level reached a year before.

Investment activity continued to grow, mainly on account of an increasingly severe shortage of manpower. Private consumer expenditure was carried forward by the sharp rise in incomes—wages in particular moved up rapidly—coupled with an apparent decline in the rate of saving.

The expansion of supply, seems temporarily to have lost some momentum. Industrial production grew by only 1.1 % between the second and the third quarter; the average in the third quarter was down to about 4 % above the corresponding figure for 1960. Total imports hardly increased at all, a further advance in purchases of finished goods being offset by a fall in imports of foodstuffs and the levelling out of raw material purchases.

In recent months there has been a clear rise in the general level of prices: between June and October consumer prices increased by 3 %. These increases affected not only foodstuffs but also industrial products, in which there seems to be an increasing tendency for prices to rise.

There were further substantial surpluses on current account. However, official gold and foreign exchange reserves increased by only 52 million dollars between the end of June and the end of October on account of heavy debt repayments and as a result of measures to support sterling taken through the International Monetary Fund.

For the full year 1961 the rate of growth of industrial production should, on the basis of the INSEE index, be around 6 %, and the increase in the real gross national product about 5 %.

The tendencies likely to be most marked in the development of the economic situation during 1962 are an increase in exports, a very slight reduction in the rate of business investment, a vigorous expansion in investment by public enterprises, more wage increases and about the same increase in consumer spending as in 1961. By contrast, the real gross national product is unlikely to go up by much more than 5 %: this may prove to be the limit of growth in output, not so much because of the

lack of production capacity, as through manpower shortages. In 1962 it must therefore be the main aim of economic policy to increase supply by every means, particularly by encouraging immigration and boosting imports. The expansion of the French economy could well continue without major strain if the very heavy surpluses on current account were reduced, especially if, at the same time, the Government's financial policy could avoid stimulating demand too much.

1. Recent developments

Demand from abroad, which in the first six months had already made a big contribution to the increase in overall demand, was also an important factor in expansion during the summer and autumn months : exports advanced rapidly between the second quarter and the third, the seasonally adjusted figures showing an increase of 4 % in terms of value. The year-to-year growth rate rose from 8 % to almost 10 %.

This slight speed-up in exports suggests that certain negative factors have disappeared. For example, the pronounced downward trend in deliveries to countries of the franc area seems to have come almost to a halt—at a level, however, 7 % below the figure recorded a year previously. It would seem also that for the first time for several months there are greater sales opportunities in the developing countries outside the franc area. The very rapid recovery in exports to the United States is also noteworthy : the returns for the third quarter of 1961 were some 40 % up on the rather poor figure registered in the same quarter of 1960. In contrast, the rate of increase of sales to other industrial countries may well have fallen off slightly. Though in the third quarter the growth rate of sales by France to other EEC member countries, particularly the Federal Republic of Germany and Italy, was much the same as before, the seasonally adjusted figure for exports to the EFTA countries, on the other hand, barely exceeded that for the previous quarter.

A number of changes are also apparent in the export figures when broken down by product. Whereas sales of motor cars abroad have made a good recovery from their earlier setback, sales of other consumer goods again made little progress. Exports of investment goods, hitherto expanding vigorously, also seem to have been lower in the third quarter. On the other hand there was a substantial rise in the sales of raw materials and semi-finished products. The increase in sales of agricultural produce was particularly marked. This accounted for fully a third of the increase in total exports over the figure for the third quarter of 1960, i.e. almost exactly as much as that accounted for by industrial goods.

The expansion of internal demand has also continued in recent months. In particular, fixed investment by enterprises has continued to grow. Even though in certain cases profits have been under pressure from rising wages and social contributions, it seems that the reduction in profits available for ploughing back did not restrain actual investment: businessmen seem to be financing again without too much difficulty the building and equipment programmes, revised upwards this summer, even if at times greater recourse to outside capital is entailed. The shortage of manpower, stiffer competition from abroad and the expansion prospects opened up by the Fourth Plan, are still decisive incentives to investment.

Whereas direct investment by public authorities has still clearly been moving upwards and the placing of public contracts has had a considerable stimulating effect, State-owned enterprises have not so far stepped up their investment activity to any noteworthy extent.

As expected, housing picked up again in the third quarter, after a temporary slackening in the second due to unfavourable weather conditions. The estimate of 350 000 starts for 1961 should therefore prove correct. Moreover, expenditure on maintenance and repairs, which is an important part of investment in construction, has grown under the impact of the new regulations on rents: these permit higher rents for well-maintained flats and houses.

Private consumption was again encouraged by the sharp rise in incomes. The level of wages and salaries, the factor which in the main determines the demand for consumer goods, again moved upward fairly rapidly in the third quarter, rising about 2 % in comparison with the second quarter. Transfer incomes also increased: family allowances were raised again on 1 August by 3 %. The increase in personal incomes of the self-employed does not, however, seem to have been quite so sharp as that in wages.

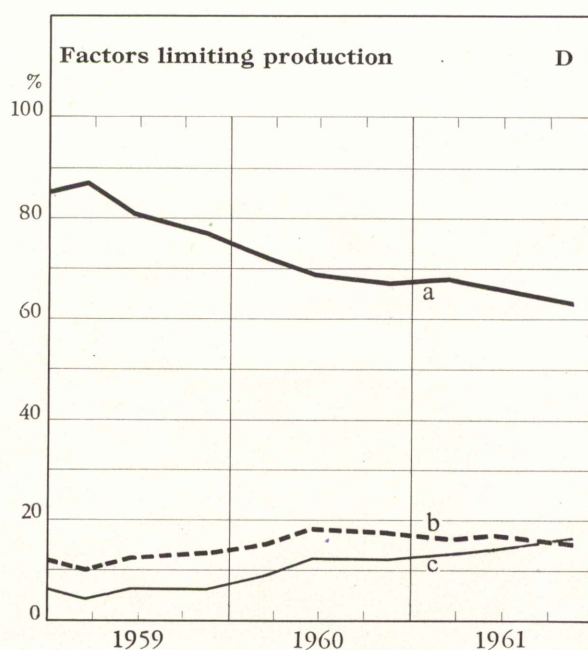
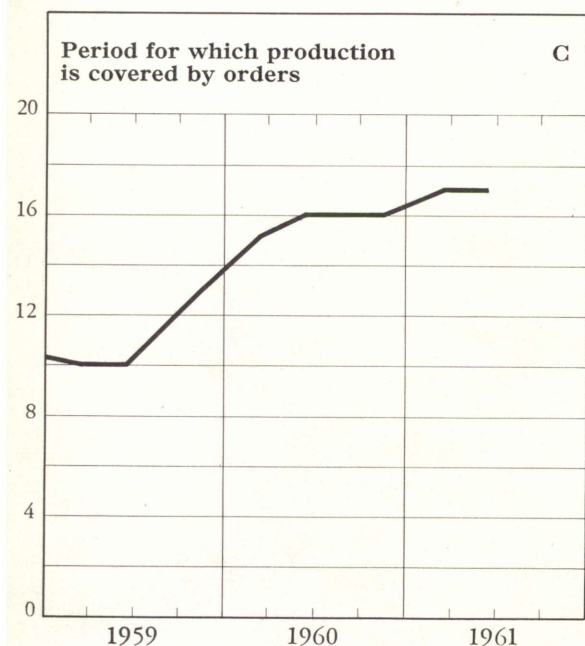
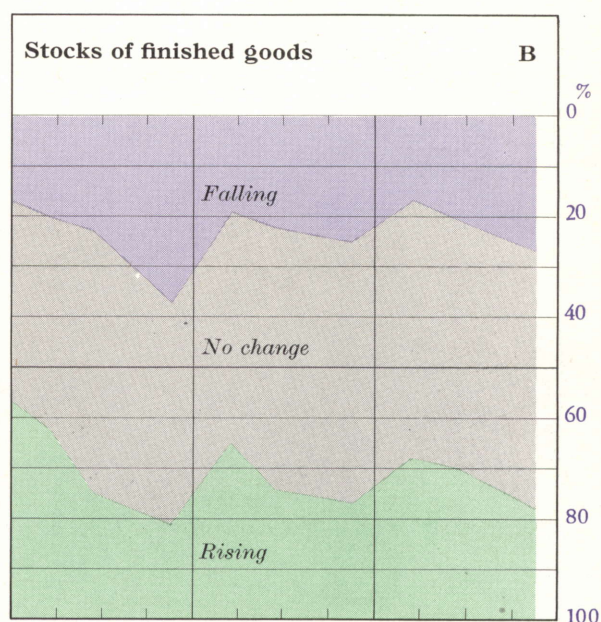
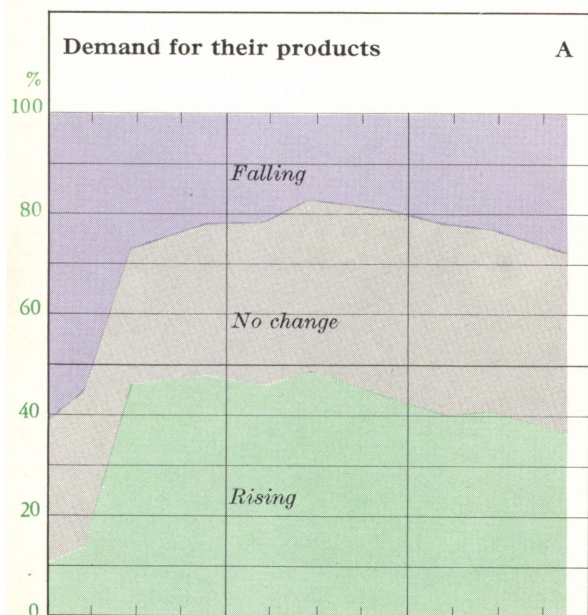
The consumer spending of households in the third quarter increased at least as much as did their incomes: the rate of saving seems to have fallen off a little. However, with this slightly more rapid advance in consumer spending there may have been a shift in the pattern of consumption. Partly because of higher prices, spending on food and beverages, and on services seems to have risen faster than did spending on industrial goods.

The seasonally adjusted turnover figures of the big Paris stores again moved up in the third quarter; they were about 5.5 % above the already high level of the corresponding period of 1960.

While, then, the growth of total demand has remained buoyant the expansion in supply may temporarily have lost some momentum.

Agricultural production was again ample for home needs, as overall results were from 1 % to 2 % up on the exceptionally good harvests of 1960. Though grain crops, and

SURVEY OF BUSINESS OPINIONS



Source : INSEE survey on economic trends

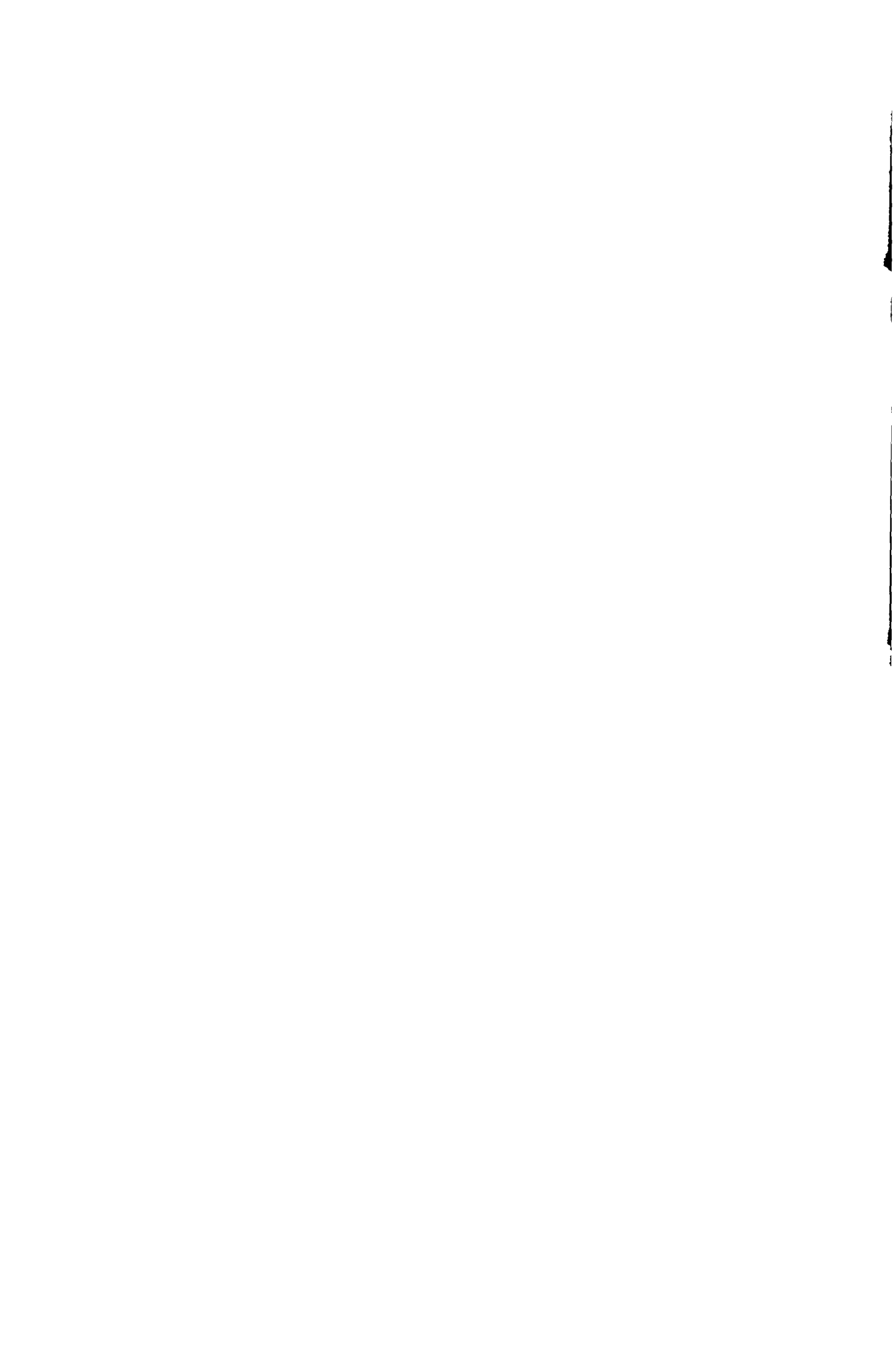
N.B. : the survey did not cover energy.

GRAPHS A and B : the grey, green and violet areas in these graphs indicate the changing proportions between the three possible replies to the question put.

GRAPH C : the curve shows the average trend of the answers received (in weeks).

GRAPH D :

- a) Percentage of enterprises which consider that they could produce more with their present resources;
- b) Percentage of enterprises whose output is limited by a shortage of capital equipment;
- c) Percentage of enterprises whose output is limited by a shortage of labour.



in particular wheat, were smaller than in 1960, livestock products, by contrast, rose by about 7 %. Despite a distinct increase in exports, stocks of meat and of dairy produce grew steadily. The growth in industrial production appears to have slowed down slightly in the third quarter; in any case the seasonally adjusted INSEE index shows an advance of 1.1 %, rather less than that in the previous quarter. The improvement on the figure for the third quarter of 1960 was a bare 4 %. Various factors explain this slowing down of expansion; the seasonal adjustment of figures in the summer is particularly liable to be distorted by shifts in the holiday periods, and the autumn pick-up of business in 1960 came relatively early : nevertheless business activity varied more widely between the branches. For example, the output of coal was reduced appreciably in the third quarter to allow some running down of pit-head stocks, which were still large. Iron and steel output was geared to the lower level of orders from dealers and manufacturers inside France, who were also making efforts to reduce their stocks. The resumption of activity by the motor industry in September was less marked than usual as new orders were sparse in anticipation of the launching of new models. Lastly, the expansion of production in certain industries may well have been hampered to some extent by difficulties on the labour market : only a slight increase in the numbers employed was possible, and the average number of hours worked remained at the very high level already reached since workers are increasingly unwilling to do further overtime.

There are in fact only small manpower reserves left in most industrial areas; recruiting difficulties are particularly severe in the north and in the east. Seasonally adjusted figures show that from the second to the third quarter unfilled vacancies increased by 4 %; in the third quarter they exceeded by nearly 50 % the figure recorded a year earlier, and the number seeking jobs was down by 14 %. There were again more immigrants from Algeria and from abroad, though not enough to ease the strain on the labour market to any appreciable extent.

The expansion in imports was very modest in the third quarter : in fact, after adjustment for seasonal variations, there was no increase at all over the second quarter. The figure for the corresponding period of 1960 was exceeded by only 1.5 %; however, since import prices were 5.5 % down on those for the third quarter of 1960, the increase in terms of volume was about 7 %.

This faltering trend in imports is partly attributable to the continuing decline in purchases of food, but it is due mainly to a temporary tendency to run down stocks of raw materials and semi-finished products. For example, purchases of steel and non-ferrous metals have been cut, though on the other hand, imports of investment and consumer goods have tended to rise sharply. The breakdown by countries of origin confirms the analysis by product : purchases from countries of the franc area, from other developing countries and from North America have tended to level off if not actually to fall; imports from industrial countries of Western Europe, and in particular from EFTA, have, on the other hand, developed vigorously.

The general level of prices, which had remained stable in the first two quarters, has been rising appreciably. From June to October the index of wholesale prices was 3.9 % up, that of retail prices 3 %. In October the year-to-year increases were 3.5 % and 3.1 % respectively. Particularly sharp increases have been recorded for foodstuffs and wine; these can be attributed mainly to the effects of Government measures to improve farm incomes by increasing prices to the producer. The slight rise in the prices of industrial goods, generally connected with higher costs, has also continued. In particular, a slight increase in the prices of durable consumer goods has been noted in recent months. Lastly, the prices of various services have been marked up, notably rail passenger fares. The rise in the cost of living led to an increase of almost 3 % on 1 December in the guaranteed minimum wage in industry.

The expansion of exports, coupled with the levelling off of imports, has resulted in a noteworthy growth in the trade surplus for the third quarter, particularly in trade with countries outside the franc area. Customs returns under this heading showed a surplus of only 3 million dollars in the first six months : from July to October the corresponding figure was 144 million dollars. The effects of the return—probably in September and October after the end of the sterling crisis—to normal terms of payment conditions may well have been more than offset. Net revenue from services, particularly in connection with tourism, also slightly increased. There were heavier surpluses on current account. However, official gold and foreign exchange reserves increased between the end of June and the end of October by only about 50 million dollars to about 2 830 million dollars. But advance repayments of debts and franc drawings on the International Monetary Fund ran to 365 million dollars during this period. Without these capital transactions, the increase in reserves attributable to payments on current account and to movements of private capital in the ten months since the beginning of the year has been more than 1 100 million dollars.

Surpluses on the balance of payments and a cash deficit on public transactions again increased the liquidity of the money and capital markets. This enabled not only the banks to further increase credits to business, but also to make fewer calls on the Central Bank. However, dealings in Treasury bills have been cut down substantially after the lowering of the ceiling on the banks' obligation to buy them. To cover its cash deficit, the Treasury has therefore been obliged to draw on the Banque de France on a fairly large scale.

More or less the same main trends as those of the late summer and early autumn should continue till the end of the year, at least with respect to the growth of demand and particularly of fixed investment, private consumption and net external demand. It is therefore likely that the slight slackening in the progress of industrial production noted in the third quarter has not continued and that for the full year a growth rate of about 6 % ⁽¹⁾ will be attained. In view of the increase in agricultural production and the expan-

⁽¹⁾ INSEE Index.

sion of activity in building and services, the real gross national product for 1961 should, as expected, be about 5 % above the 1960 figure.

2. Outlook

Continued economic expansion in France throughout 1962, or at least for the first six months, seems certain.

Exports are again likely to be an important factor in expansion. Partly as the result of efforts to find fresh outlets in the Common Market, sales of agricultural produce will probably continue to grow, even if supplies are limited in view of the poor grain harvests in 1961. Exports of industrial goods should still benefit from continuing lively business conditions in most of the countries to which France sells and from the apparently strong competitive position of French products. Moreover, sales of certain consumer and investment goods will undoubtedly be further stimulated by the total abolition on 1 January 1962 of the remaining quotas in some member countries and from the further tariff cuts.

On the investment side, the increase in expenditure by public undertakings will be particularly marked; in 1962 actual outlay will increase by 7 % and approvals of new programmes, which are of crucial importance for the placing of orders with the capital goods industries and the building trade will be up by 24 % on the 1961 figures. Investment by private enterprises will continue to expand at a fairly high rate, at least in the first six months, although the pressure on profits in busy branches with high wage bills is likely to increase as a result of the changes to be made in the system of social security contributions, and of the continuing rise in wages, so that the availability of funds may become an increasingly important factor in carrying out investment projects.

Personal incomes will hardly increase more slowly than they have done so far. In any case, further and considerable pay rises may be expected, because of the strain which will persist on the labour market in 1962. These increases will be granted fairly readily by private employers in the hope that they can be passed on, at least in part, to the consumer.

Public undertakings and the administrative authorities might also be obliged to grant fresh wage and salary increases. Rises in social security benefits, particularly family allowances (by 4 % on 1 January and by a further 4 % on 1 August 1962), have already been approved. Even if the growth in the incomes of self-employed persons were to be a little less sharp, all the conditions would be present for a further and relatively rapid expansion in consumer demand.

Lastly, a salient feature of the fairly optimistic outlook for 1962 will be that Government demand should be a more substantial expansionary factor than in the last two financial years. In fact, the cash deficit on the 1960 budget was appreciably smaller than had been forecast, and it is likely that the deficit for 1961 will also turn out to be less than the NF 7 000 million budgeted for. These results are not only because revenue from taxes was higher than expected but also to the failure to use funds made available for investment. At the end of 1960 these amounted to more than NF 2 000 million, and will probably be even higher at the end of 1961. As it was assumed that these appropriations would be used when planning to keep the deficit on the 1962 budget down to NF 7 000 million, it is probable that the rise in real terms in the Treasury's outlay for investment will exceed the 3 % increase actually budgeted for. Moreover, the rise in other forms of expenditure, about 8.7 % in comparison with 1961, already seems to be an underestimate. In particular, the recent pay increases in the civil service and in social security benefits have already led to additional expenditure.

Domestic supply may find it less easy than hitherto to meet this probable expansion of overall demand, though it is true that there is still reserve productive capacity in a number of industrial sectors, as is shown by INSEE's November survey of businessmen's intentions. The increase in productive capacity as a result of heavy investment in 1961 must also be borne in mind.

How far this capacity is used will depend in no small degree on the increase that can be made in the number of industrial wage-earners. There is in fact some danger that the manpower shortage may slow down the rate of real expansion in 1962. It therefore seems unlikely that a rate of growth in the real gross national product appreciably above 5 % can be achieved without at the same time releasing certain inflationary tendencies.

The main problem before those in charge of economic policy may therefore once again be the rising trend in prices already apparent in the last half of 1961. There is certainly no need to use drastic monetary measures to curb demand—and in any case the present easiness of the money market makes the banks relatively independent of the Banque de France. The main problem is to step up supply by all means available.

Some rebuilding of stocks and the growth of demand for foreign manufactured goods should certainly cause imports to increase more rapidly in 1962 than in 1961; this factor will contribute towards a reduction in the exceptionally high surplus on current account. It would none the less be well to take additional measures, for example with respect to customs duties, intended specifically to give a further fillip to imports. The large foreign exchange reserves, the modest scale of foreign debts and the continued favourable outlook for exports mean that this can be done without risk to the external stability of the economy.

In order to ease the strain on the labour market, measures have recently been taken by the Government to encourage immigration and to speed up the occupational training or re-training of unemployed or under-employed workers.

Lastly, efforts to modernize the whole system of distribution must be encouraged. In this respect the rapid implementation of plans under discussion, particularly in the foodstuffs sector, might be a valuable contribution to stabilizing the cost of living.

C. Italy

The rapid economic expansion continued almost unchanged in the third quarter, and probably also until the end of 1961. External demand and private consumption were the chief motors of progress.

There was a clear rise in exports. In value they were up 17.9 % in the third quarter over the corresponding period of 1960. In the second quarter the increase had been 7.3 %. But domestic demand also continued to advance, in particular private consumption, which was influenced by a sharp rise in employment and wages. On the other hand, investment, although still brisk, may have grown a little more slowly.

Production had no difficulty in keeping up with the expansion of demand. In the third quarter industrial output was 8.3 % higher than a year earlier, following a 7.2 % year-to-year growth rate in the second quarter. Meanwhile, the pace at which imports are expanding has fallen off: the year-to-year growth rate declined from 12.4 % in the second quarter to 8.1 % in the third.

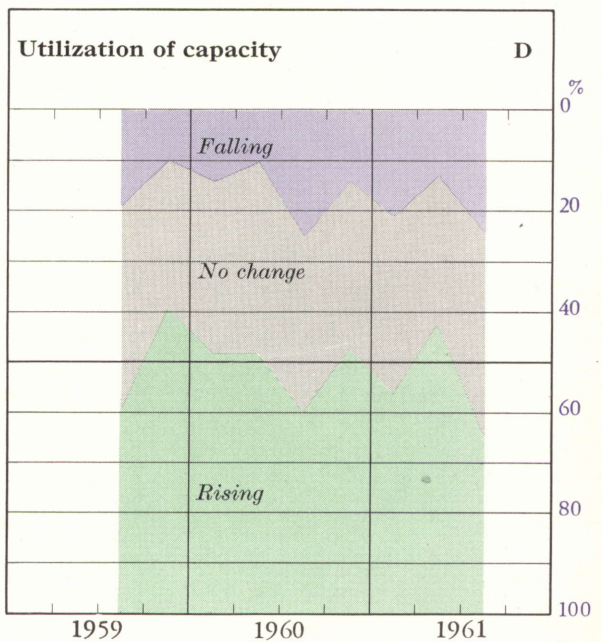
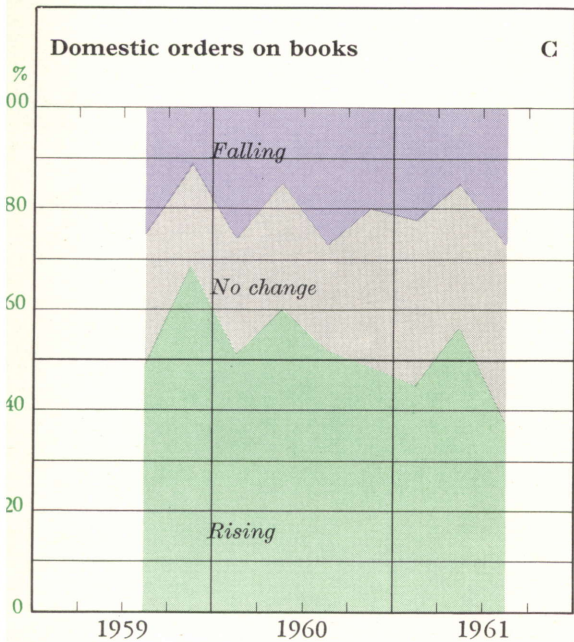
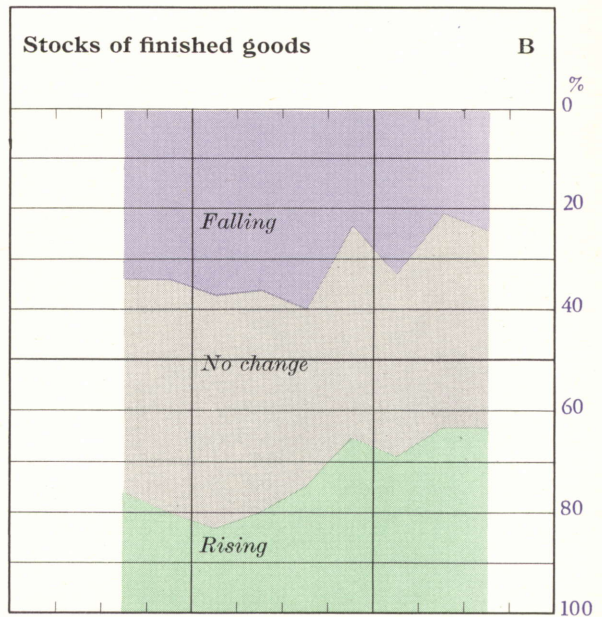
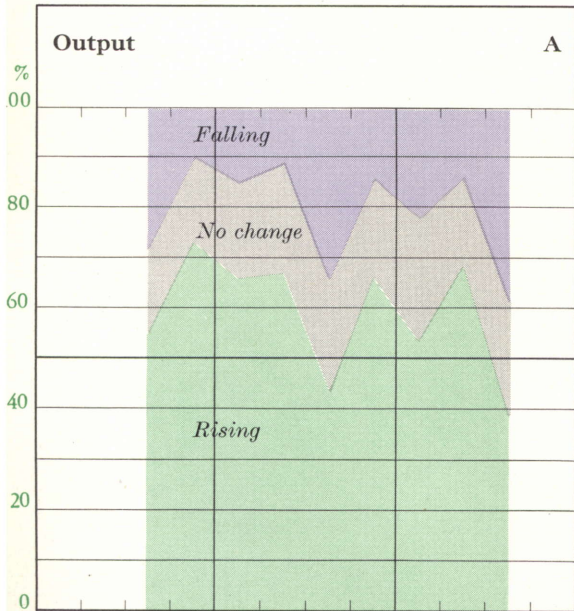
Prices remained practically stable. Wholesale prices weakened, but against this must be set a further slight rise in the cost of living.

As a result of the more speedy growth of exports coupled with only modest expansion of imports, the trade deficit fell considerably. Since there was at the same time a strong increase in net income from services, the balance on current account improved considerably. Although the net inflow of capital was somewhat smaller, official gold and foreign exchange reserves went up by 262 million dollars in the third quarter.

Despite the consequent tendency for internal liquidity to increase, certain signs of strain became apparent, chiefly as a result of the heavy demand for credit on the money and capital markets. As the aim is to maintain the growth of investment at the optimum level, this strain is bound to raise policy problems, and the Central Bank has already taken action to counter it.

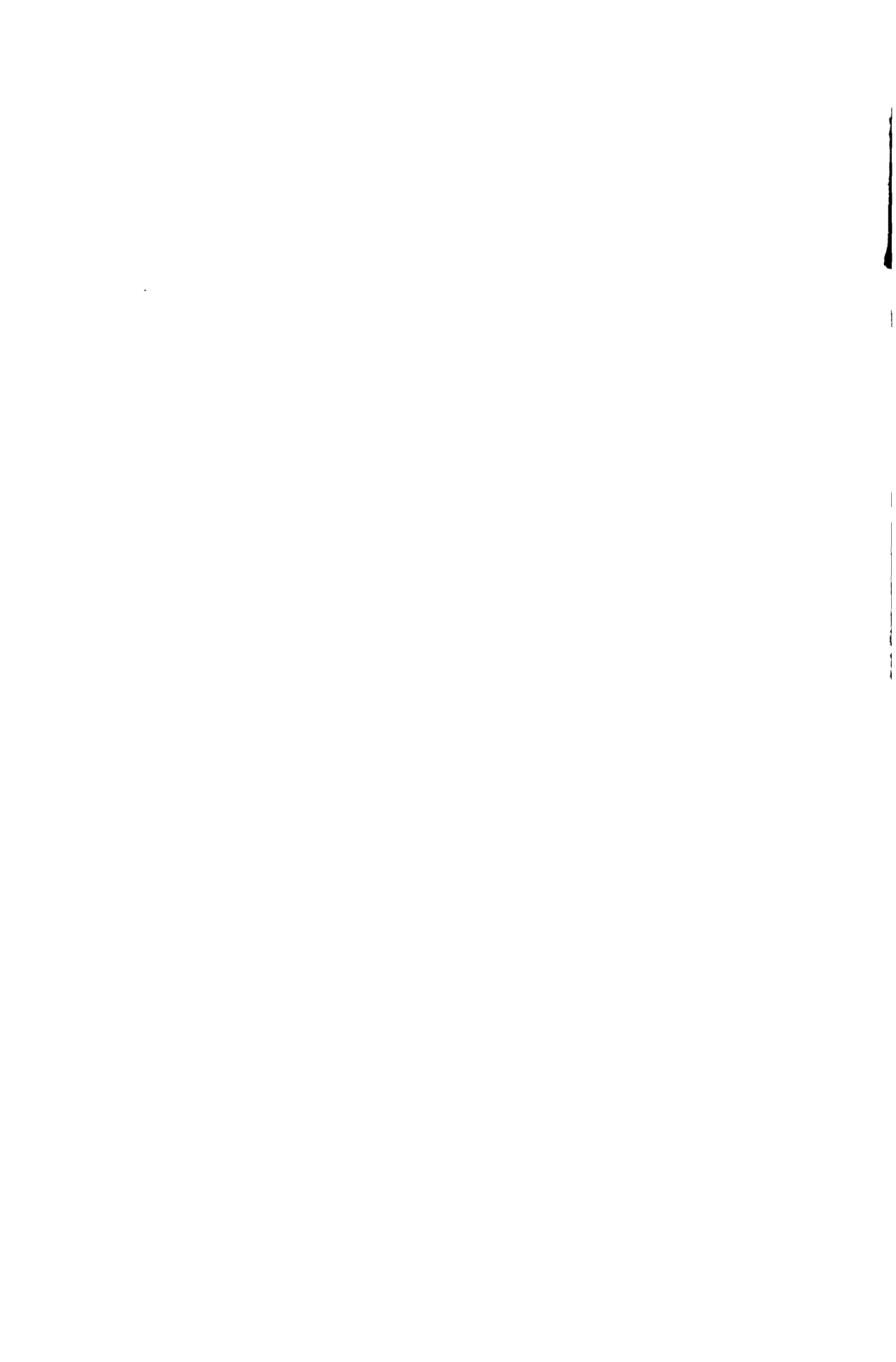
The real gross national product should probably again increase in 1961 by fully 6.5 % and industrial output by about 8.5 %. The prospects for further growth in the early months of 1962 are decidedly favourable. In this connection, as experience with the steps so far taken has shown, the customs and quota measures to be introduced at the end of 1961 as part of the Common Market should give a fresh boost to the economy, particularly to exports and investment. In view of the present somewhat more leisurely expansion of private investment, these measures are bound to have a favourable effect.

SURVEY OF BUSINESS OPINIONS



Source : Quarterly trend survey of ISCO — Mondo Economico

For each graph the grey, green and violet areas indicate the changing proportions between the three possible replies to the question put.



1. Recent developments

In contrast to the second quarter, expansion of exports was probably faster in recent months. The year-to-year growth rate in the value of exports rose from 7.3 % in the second quarter to 17.9 % in the third. The increase in volume was, however, somewhat less marked, since prices also rose.

Not only did exports of investment goods, semi-finished products and industrial basic materials rise appreciably, but so did those of agricultural products, Italy, unlike other Community countries, having had better harvests than in 1960.

The exports with highest growth rates were those to non-member countries in Europe; exports to other areas grew more slowly. The trend for exports to pick up continued to be particularly apparent in trade with the United States, but sales to Great Britain also were once more above the level for the corresponding period of the previous year. This had not been the case in the second quarter.

Internal demand also expanded further in the third quarter. However, the slight slowdown of growth in fixed investment since the second quarter has been confirmed. True, the year-to-year growth rate both in the number of dwellings completed and in the volume of commercial and industrial building was slightly higher in the third than in the second quarter. However, the value of public construction work in July and August, the last months for which figures are available, fell below that for the corresponding period of 1960. Above all, business expenditure on capital equipment seems to have grown rather more slowly than hitherto, although it is still running at a very high level. One sign of this is that the year-to-year growth rate of internal trade in important investment goods fell from 22 % in the second quarter to 18 % in the third. Nevertheless, the rate of business investment remained very high, as shown by the most recent ISCO—Mondo Economico business inquiry, and by the upturn in new orders for the steel industry made in the autumn by domestic concerns.

Once again investment in stocks did not prove a significant stimulant to the economy. In contrast with the previous year, stocks of manufactured goods nevertheless rose slightly in the first nine months. Industrialists consider that this trend will continue in the fourth quarter of 1961.

Although the growth of private consumption was already rapid in the first half of the year, it probably continued to accelerate somewhat in the third quarter. The number of hours worked in industry did fall slightly, but incomes again rose substantially as a result of the very sharp increase of employment (except in agriculture), further appreciable wage rises (particularly in the services sector) and the considerably higher level of incomes in farming compared with 1960. The increase in consumption was again accompanied by a noticeable improvement in quality. It is estimated that purchases of non-essentials were almost 20 % higher in the third quarter than in the same period of 1960. In the first six months the average rate of increase had remained below 10 %.

The continuing rapid growth of demand was clearly reflected in the development of industrial output. Its year-to-year growth rate, which had fallen to 7.2 % in the second quarter, rose in the third to 8.3 %. The seasonally corrected ISCO index also showed a somewhat higher rate of growth : about 1.5 % between the second and the third quarter, as against a little under 1 % between the first and the second. The braking effect of seasonal factors is becoming more marked each year and when this is taken into account the production increase in the third quarter is even more striking.

The chief result of the speedier growth of private consumption has been an appreciable expansion in output of consumer goods. Production of investment goods as defined in Italian statistics, particularly transport equipment and cement, has also risen. The growth of steel production is particularly noteworthy, and in contrast with the experience of other countries; the rise compared with the corresponding period of the previous year was 12.2 % in the third quarter and may have been of a similar size in the fourth quarter.

The expansionary trend in industry—and undoubtedly in services too—was accompanied by a further considerable increase in the number employed. According to ISTAT figures these two sectors were employing 4 % more manpower in July than a year earlier. The ISCO—Mondo Economico inquiry also indicates that there has been a considerable increase of employment in industry during the second half of 1961. So, increases in employment and in productivity appear to have contributed in roughly equal proportions to the expansion of industrial output.

The growth of imports, unlike that of production, has slackened. In the second quarter these were more than 12.4 % up in value over the same period of the preceding year, but the year-to-year growth rate was down to 8.1 % in the third quarter. The fall in volume was even more marked. Part of the decline in the rate of growth is however attributable to the trend in 1960 when the third quarter was definitely livelier than the second.

The slackening of the pace of growth was most pronounced in imports of industrial base products, investment goods and—presumably as a result of the good harvest—of farm produce. The slowdown affected imports from non-European countries, particularly the USA. Purchases of consumer goods, on the other hand, increased more strongly than in the second quarter.

In general, prices probably remained fairly stable in the third quarter. Though wholesale prices yielded further ground, the cost of living moved up again because of rising prices for services (a result of very appreciable wages rises in that sector), new statutory increases in rents, and slightly higher food prices, especially for wine. The cost-of-living index was 3.2 % higher at the end of the third quarter than a year earlier.

As the growth of exports exceeded that of imports for the first time in a long period, the balance of trade improved considerably. The deficit was 136 million dollars in the

third quarter against 250 million dollars in the same months of 1960. Since net income from services was also definitely higher—the inflow of foreign exchange from tourist traffic alone rose by 12 %—the surplus on current account almost doubled, reaching 371 million dollars in the third quarter. Finally, there were further inflows of capital—somewhat smaller, however, than in the corresponding period of the previous year—and the balance of payments therefore again showed a large surplus. In the third quarter the official gold and foreign exchange reserves went up by 262 million dollars, compared with an increase of 172 million dollars in the previous three months. In the same period total gold and foreign exchange reserves (including holdings by the banks) rose by 426 million dollars. The sharply rising trend of official reserves seems, however, to have weakened somewhat since September; in that month the rise was only 5 million and in October only 24 million dollars.

This trend in the balance of payments has had the effect of greatly increasing internal liquidity, the more so as the Banca d'Italia abandoned the policy which it had followed during the preceding eighteen months and encouraged the expansion of liquidity by special purchases of foreign currency from the banks. Cash operations by the State ceased to exercise a restrictive influence, as they had done in the second quarter. Nevertheless, the lively expansion of credit led to a further decrease in the liquidity of banks. The money and capital market became rather tight and in September the net yield on State securities rose to 5 %.

There can hardly have been any important changes in the economic position in the last months of 1961, for which no statistics are yet available. Thus the ISCO—Mondo Economico business inquiry in October showed that industrialists, particularly in chemicals and mechanical engineering, were counting on a further expansion of external demand during the remainder of the year. In general, industry expects another considerable increase in output for this period. The result could be an increase in industrial production of about 8.5 % for the full year. This is admittedly less than the increase between 1959 and 1960. In view of livelier construction activity and especially of greater agricultural output, the growth in the real gross national product should again be at least 6.5 % as in the previous year.

2. Outlook

Continuing economic expansion is to be expected in the first half of 1962 with private consumption and public investment as important factors.

But there are also many reasons to expect that exports will continue to advance vigorously. As the ISCO—Mondo Economico inquiry shows, management itself is counting on a very appreciable increase in the volume of foreign orders in the fourth quarter of 1961. It may be assumed that Italy's competitive strength on the international market

has considerably improved in recent years through the more rapid increase in productivity than in wages. The new regulations improving State export guarantees should further strengthen this position. The reduction in tariffs and the elimination of import quotas for industrial goods in the EEC countries on 1 January 1962 as part of the next stage in the Common Market will doubtless give a boost to exports. The not unfavourable business prospects in the other Community countries, the obvious recovery of the American economy and the probable increase in aid to developing countries also point to a further expansion of exports. Finally, Italy's still relatively large reserves of production guarantee that the country will be able to meet demand.

These prospects of external demand will in themselves encourage industrialists to invest. Past experience shows that a further strong incentive to investment should be provided by the above-mentioned reduction of internal tariffs in the Community on 1 January 1962. This will be the greater because customs duties in Italy are particularly high, and stronger foreign competition is therefore to be expected on the home market. The simultaneous abolition of Italian quotas for industrial products will tend to have the same effect but, in view of the high degree of liberalization already reached in Italy, it will probably be of much less significance.

In fact, the statistics on commercial and industrial building projects at present available and orders in hand in the main capital goods industries justify the expectation that there will be a further growth of industrial fixed investment, at least, in the next few months. Fixed investment by the public sector should also again expand to cover a series of programmes entailing considerably higher expenditure.

Private consumption will certainly rise in the first half of 1962. On the one hand, a further increase in employment is to be expected, and on the other, income will rise because of the renewal of wage agreements now coming to an end, the re-organization over a period of wage areas, and further and more substantial measures to bring women's pay into line with that of men. Higher social security pensions could also prove a stimulant.

All this indicates a further appreciable expansion of industrial production in the first six months of 1962. This development is unlikely to be greatly hampered by shortages of capacity or manpower. Nevertheless, it will be necessary to continue and step up measures for improving occupational training and mobility.

Although perhaps wage costs per unit of production must be expected to rise to some extent, even in Italy, the economy will doubtless continue to expand, while prices will remain relatively stable, and rising imports (which will also be cheaper because of the tariff reductions referred to above) will increase the volume of supply.

Despite rising imports, the lively growth of exports and net income from services will probably bring an improvement in the current account in the first half of 1962 com-

pared with the corresponding period of 1961. Coupled with further—even if perhaps somewhat smaller—net inflows of capital, this development could lead to a fresh increase in official gold and foreign currency reserves.

Even if the balance of payments should thus again have an expansionary effect on internal liquidity in the first half of 1962, the slight signs of strain on the money and capital markets might nevertheless become more marked. This possibility is chiefly because in the future the State will finance its structural programme more from loans than in 1961. In addition, enterprises whose profits are expanding less fast, largely as a result of increased wages, will probably have greater recourse to outside finance.

Official credit and financial policy will have to be very adaptable if such strains are not to affect the growth of business investment, in particular long-term schemes. The Banca d'Italia in any case has always shown that it is prepared to maintain sufficient liquidity at home. To prevent greater strains, it would be well advised to continue or even intensify this policy. The State might also make use of other forms of finance legally available to it for its investment programmes before approaching the capital market with large new issues. If this policy were supplemented by further measures to stimulate imports, the danger of price strains—which is slight, in view of the considerable reserves of factors of production—would certainly not become any greater.

D. Netherlands

The level of economic activity in the Netherlands has remained high in recent months despite the fact that the shorter working week has meant that industrial output has been somewhat below the figures for the early part of the year.

Demand continued to expand, with fixed investment still in the van. The increase in private consumption was slight, but exports showed some signs of recovery.

Now that the effects of the shorter working week have worked themselves out, industrial production may well show a slow recovery by the end of the year. However, the increase in production in 1961 as a whole will not be much above 2 %. The real gross national product is likely to increase by about 2.5 %.

Manpower shortages continued to be severe and labour reserves are now completely exhausted. The increase in imports was only slight, but this temporary development was probably due in the main to the run-down of stocks of raw materials and of semi-finished products.

The domestic price level went up somewhat under the pressure of demand and increased production costs, which in the case of the latter were mainly the result of the rapid reduction in the working week.

When seasonal factors have been allowed for, the balance of trade again improved; the downward trend seems to have ceased, at least temporarily.

It is expected that business will continue much on these lines in the first half of 1962, although the pace of the expansion of demand might be somewhat slower than hitherto. Investment demand is being constantly stimulated, primarily by the shortage of manpower. The review being made of most collective wage agreements is likely to lead to higher demand from private households.

It is still not certain whether supply can keep pace with demand without strains appearing.

There are indeed several lines of action open to the Government if it wishes to place direct restraints on any price increases resulting from this development. The recently published ordinance on the fixing of profit margins for imported products should be mentioned in this connection.

It remains, however, important to keep the rise in wages within the limits of productivity increases and to counter the dangers of rising prices by increasing supply still more through measures which could improve productivity and ease the shortage of manpower.

1. Recent developments

After a loss of pace in the first half of 1961, exports picked up somewhat in the third quarter. This change is doubtless largely seasonal, but it cannot be exclusively due to seasonal or random factors. Capacity to deliver seems to have improved a little further. In fact, slackness of demand was probably only a minor factor in the slow-down noted in the preceding months, the trend of orders from abroad would rather suggest that in industry the chief handicap on the growth of exports has been insufficient elasticity of supply, except in some sectors like shipbuilding.

Although, as the trend of production shows, these factors certainly continued to play a part, they did not prevent exports from increasing again slightly in the third quarter: according to customs statistics the increase was 3.4 % in value and 7.5 % by volume over the same period of 1960. In the second quarter there had still hardly been any increase at all (+ 0.7 % in value and + 2.6 % by volume). In terms of national accounting the third quarter shows a growth rate of 5.5 % (in volume) compared with 1 % in the second quarter.

The figures for October do not show whether an upward trend in exports has begun; sales abroad were even 5 % less in value than in October 1960. These figures, based on value, were probably however depressed by certain special statistical factors.

The slight recovery of exports in the third quarter mainly affected deliveries to other Community countries, in particular the Federal Republic of Germany. Exports to EFTA countries on the contrary fell off. Exports of agricultural products—meat and dairy produce—were considerably below the corresponding period of the previous year when, however, they were very high.

Real fixed investment continued to rise rapidly. The fall in the year-to-year growth rate from 12.1 % in the first quarter of 1961 to 5.6 % in the second quarter can be attributed to the fact that in the second quarter of 1960 the figure for investment had been greatly swollen by purchases of aircraft and ships. It is unlikely that there was any perceptible slackening of investment demand in the third quarter; the growth of investment is more likely to have been hampered by physical limitations on capacity which have been making it impossible to meet all the increased demand for equipment goods. The strong propensity to invest was again maintained by the high level of demand at home and from abroad, by manpower shortages and by the consequent rationalization measures.

All branches of the economy probably contributed to the expansion of investment demand, but it was probably fixed investment in industry which rose most sharply. The rates of growth shown by investments in plant and machinery, particularly in road transport equipment, were very high. The imports of investment goods in the third quarter also suggest that the tendency to expand was maintained.

Activity in the construction sector was again very lively, although the measures introduced in April to curb the housing boom were made more severe in July. Building permits, which in the second quarter had risen 74 %, were still 25 % up in the third quarter. As a considerable part of the subsidized housing programme had still to be completed, an easing of the strain can hardly be expected. The number of dwellings under construction at the end of September reached the record figure of nearly 110 000 units and the result of this situation is a continual rise in building costs. In order to avoid excessive strain, the Government is still doing all it can to curb expansion in other branches of the industry.

For some months now manufacturers appear to have been running down stocks, one result of which has been a slackening in the imports of raw materials.

Wages in most branches of the economy have remained almost stable, the main aim of the workers having been to hasten the reduction of the working week. In any case most collective wage agreements will be reviewed at the beginning of the coming year.

In the second quarter the wages bill, which in January-March had shown a year-to-year growth rate of 13 %, was only 6.5 % higher than in the corresponding period of 1960, when the stability of the first quarter had been followed by wage rises in the second. The Central Planning Office estimates the increase in the wages bill of 1961 at 7.5 %, of which 2 % was due to the rise in wages paid under collective agreements, 3 % to other rises and 2.5 % to the increase in numbers employed.

Private consumption seems to have stabilized at the high level already reached. That consumption in the third quarter was up by as much as 5 % in value and 3.5 % in volume on the same period a year earlier is due to the fact that it was only towards the end of 1960 that the increase in consumption gathered speed. The stabilization observed in recent months can be attributed to the smaller increase in the total wages bill and the greater increase in savings.

At the beginning of August certain measures, among them stricter hire purchase regulations, were introduced in an endeavour to hold down demand for consumer durables. Purchases of these goods appear to have slackened somewhat in comparison with the trend noted in earlier months.

There has been no easing of the strain on the labour market, which is still suffering from an acute shortage of manpower. As school leavers very rapidly find work, the unemployed represent only 0.8 % of the paid labour force. The total of unfilled vacancies is still high, but it seems impossible to reduce the number of workless further, as most of them are more or less unemployable.

Industrial output has not expanded further in the period under review. It even appears to have fallen off in May, when the severest reductions were made in hours of

work, for the reductions were offset to only a slight extent by an immediate rise in productivity and in increase in overtime. In the months that followed production still failed to rise. In the third quarter, as in the second, it was no higher than in the corresponding months of 1960. True, the fall in hours actually worked was more rapid and more drastic than had been intended. It is estimated that the hours being worked in industry (including cuts which, although not mandatory, are nevertheless generally applied) are 4.5 % less than those worked at the beginning of the year. Some slackening of demand may also have contributed to the levelling off of production in particular sectors.

In agriculture, harvests have been somewhat smaller on the whole than in 1960, despite the better quality of some products and an increase in output of animal products. Thus the value of production probably fell off only slightly.

The seasonally adjusted figures for imports show an appreciable slowing down. Whereas in the second quarter their value was still almost 9 % higher than in the corresponding period of 1960, the third quarter could show a year-to-year growth rate of only 4.7 %. As however, import prices were lower, the increase by volume was 7.7 %. In terms of national accounting, the third quarter shows a growth rate of 7.5 % compared with 12.3 % in the second quarter. In October, the value of imports was even 5.6 % below the corresponding figure of the previous year; this fall may have been due in part to statistical factors similar to those which affected exports.

The main cause of the drop in imports was, however, the sharp fall in purchases of raw materials, while for manufacturers—with investment goods again in the lead—considerable increases continued to be registered. Imports from Community countries increased further, but those from EFTA also made good progress.

Consumer prices, which had for some time been fairly stable, edged up a little in the third quarter. Prices for services in particular were subject to considerable strain. This development was reflected in the cost-of-living index, which in the third quarter was 1.5 % above the corresponding period of 1960.

The balance of trade in the third quarter was definitely more favourable than in the first two quarters of 1961. The deficit, which until then had averaged 850 million guilders, fell to 500 million. Seasonal factors certainly contributed to this development, but in any case the rapid deterioration in the balance of trade which had begun in the first half of the year seems to have been halted.

Despite the fact that the balance on current account was more favourable than in the previous quarters, the overall balance of payments in the third quarter was probably to all intents and purposes in equilibrium—at least if conclusions may be drawn from the

way in which the gold and foreign exchange reserves developed. Between the end of June and the end of September the official reserves went up only slightly—by 100 million guilders. At the same time the foreign exchange position of the banks probably deteriorated by a somewhat larger amount. The surplus on current account has been offset by further considerable public and private exports of capital. This is in part the result of the measures in support of sterling taken by the International Monetary Fund and of opening the capital market for the issue of further foreign loans.

In recent months, especially from the end of August to the end of October, the money and capital markets sometimes showed signs of strain. This was mainly due to the heavy payments falling due as corporation tax and, probably, to the various capital export transactions and the issues floated by public and private bodies at home. At the beginning of August the State floated a loan of 300 million guilders.

The strain was also reflected in the interest rates for call money. The Central Bank, which had already reduced the minimum reserve rate from 10 to 8 % to facilitate bank transfers in connection with the issue of the State loan, further reduced this rate to 6 % for the end of October and November. The Central Bank also used open market operations to increase the liquidity of the banks, with the result that the position has been easier since the beginning of November.

When this report was being prepared, statistical data were not yet available on the economic situation in the Netherlands during the last weeks of 1961, but it may be assumed that exports have made further progress. Imports may have grown somewhat faster, although growth rates have probably not been much higher than a year earlier. It is doubtful whether the industry has again reached the very high output attained in the early of the year. This being so, industrial production for the whole of 1961 will show a growth rate of only 2 %. If the creation of wealth in other spheres is taken into account, the real increase in the gross national product in 1961 compared with 1960 will probably be 2.5 %. On current account there is likely to be a surplus of 600 to 700 million guilders, as against 1 200 million in 1960.

2. Outlook

In the first half of 1962 the level of economic activity reached in recent months may well be exceeded.

Exports might again rise slightly, but their growth will continue to be held back by the factors which are hampering a rapid rise in production and by the expected increase in demand at home.

Home demand, in particular private consumption, will be boosted by wage rises following the renewal and revision of numerous collective agreements in the new year.

The rationalization of enterprises will maintain at a high level demand in the shape of fixed investment. These rationalization programmes are being stepped up because of the need to offset the persistent shortage of manpower and the rise in production costs caused by higher wages. The tax reduction due to come into force in the middle of 1962 and the keener competition which will result from the expected increase in imports may also stimulate investment. However, the narrowing of profit margins and the consequent need to call on the capital market may militate somewhat against this development. The new arrangements concerning depreciation and deductions for investment will undoubtedly inhibit the investment schemes of enterprises. However, they are in any case unlikely to exert any influence on actual expenditure before the middle of 1962 or even, probably, before 1963.

In construction, demand will continue high because of the maintenance of intense activity in housing and the large-scale projects planned in the other building spheres.

The trend of industrial production will probably continue to be determined less by demand than by the situation on the labour market. It is, indeed, to be expected that the fluctuations which followed the reductions in working hours will gradually be eliminated and that industrial production will again increase, but the growth rate will be lower than in the first half of 1961.

Imports will probably rise further, for the increase in domestic supply will presumably continue to lag behind the growth of demand. There will also be some re-building of stocks. Finally, the further steps to implement the Common Market will not be without effect on imports; they should, however, be felt less in the Netherlands, where duties are already low, than in other Member States of the Community.

Prices are likely to come under increasing pressure. The rise in wage rates which will result from the review of collective agreements will probably influence not only consumption but also production costs.

The balance of trade might be somewhat more favourable than in the first half of 1961.

The trend in the second half of 1962 may be similar. Demand is likely to receive a further boost from the reduction in the taxes on wages and incomes and the growth of production may be somewhat more rapid as a result of an increase in the number of school-leavers who will be seeking work.

The tendency for surpluses on current account to fall might reappear if the growth of external demand should slow down.

For business cycle policy, the immediate need will still be to find means of dealing with the pressure on supply caused by the speed at which demand is increasing.

It is evident that the pressure on prices exerted by heavy demand and over-employment threatens to assume disquieting proportions, especially as output, despite the increase in productivity that should accrue from the high level of investment, is limited by serious difficulties.

Like the 1961 budget, the draft budget for 1962 reflects the new line in the financial policy of the Netherlands. This is no longer merely directed to ironing out the business cycle, it also takes certain longer-term aims into consideration. As a result the draft budget again takes up the principle of a reduction in the rates of taxation and in the ratio of public expenditure to the national income. The cumulative effect of increasing expenditure and reducing fiscal income is calculated at 3 % for 1962, whereas the nominal national income should increase by about 6 % in the same period. Thus the share of the State in total expenditure will be less than in 1961. On the other hand, allowing for the increasing impact of taxation, tax receipts should rise by about 8 %. It is this difference between the increase in revenue and the rise in expenditure which is the anti-cyclical element in the budget. In view of the strains which are to be expected at least in the first half of 1962, a policy conceived exclusively as a corrective would have to call for a sharper curb on spending. Because, however, of the other aims being pursued by the Netherlands' Government, such policy is not feasible, and the Government finance measures taken so far will need to be supplemented by further measures in other fields.

In the sphere of wages policy in particular a more prudent attitude would therefore seem to be called for. In practice workers' and employers' organizations have agreed on a basic line of approach to the coming revision of collective wage agreements which takes into account both the expansion of productivity in the particular branch concerned and of productivity in general. This will avoid excessive disparities in the pattern of wages from branch to branch : the rate of increase for three quarters of the wage is to be calculated according to the productivity of the branch and for the remaining quarter according to the productivity of the economy at large. The Government has agreed to this formula as the basic line for the coming negotiations on collective agreements. It would perhaps have been well if the importance attached to overall economic productivity had been greater. Nevertheless, the solution reached is probably a considerable step in the right direction, that of a wages policy which will prevent labour costs rising faster than productivity.

It seems obvious that policy on wages will present fewer difficulties if the labour force and its productivity can be increased more rapidly. Thus, the immigration of foreign manpower which is already actively encouraged could be further intensified, and now that a great number of collective agreements are due for review, arrangements could perhaps be made to include stronger incentives to increased productivity. For instance,

a system of bonuses could be planned or a margin for further increases allowed in the agreed tariffs, with the proviso that this margin was only to be used if appreciable further increases in productivity were achieved.

In its price policy the Government has already taken preventive measures against unwelcome developments. After the Price Law had come into force on 1 June 1961, an ordinance of 1 November fixed the profit margin for imported consumer goods, which may not be higher than in 1959. In this way it is hoped that the reduction in import prices produced by the revaluation of the guilder and the lowering of tariffs will be passed on to the consumer in full.

E. B.L.E.U.

Belgium

The expansion of demand has continued in recent months. In the third quarter exports in particular moved ahead and were in terms of value 9 % higher than a year earlier; investment has also advanced, though perhaps a little more slowly; and consumption has benefited from the development of employment, from rising wages and also, it would seem, from an increase in the number of hours worked.

This trend in demand led to a marked improvement in output. The year-to-year rate of growth of industrial production has, however, slowed down slightly: after touching 7 % in the second quarter it was down to 5.5 % in the third. Imports, too, grew less rapidly in the third quarter: they were only 3.3 % in value above the corresponding figure in 1961, whereas the increase had still been 8.5 % in the first quarter.

Prices have remained much the same. In the third quarter retail prices were only 1.7 % up on the corresponding figure for 1960.

From the second to the third quarter there was a further slight improvement in the balance of trade, though at Bfrs. 1 500 thousand million the deficit remains relatively heavy. After falling in previous months, net official gold and foreign exchange reserves improved appreciably in the third quarter, mainly on account of operations designed to consolidate the Government's short-term foreign debt.

Assuming that there has been no major change in the economic situation during the last few months, industrial production will probably have grown 4 % in the full year 1961, and the total real gross national product 3 to 4 %.

The outlook for the earlier part of 1962 suggests that growth will continue. If there were some slackening, it would be due in the main to the export situation. This makes it all the more important that Belgium, in the interests of continued economic expansion and a better competitive position, should go ahead with any action, whether already begun or only planned, which is intended to increase investment at home.

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The two outstanding features of overall demand in recent months have been the continued growth of investment and a substantial increase in exports. In the third quarter the value of exports was more than 9 % higher than a year before. The rate

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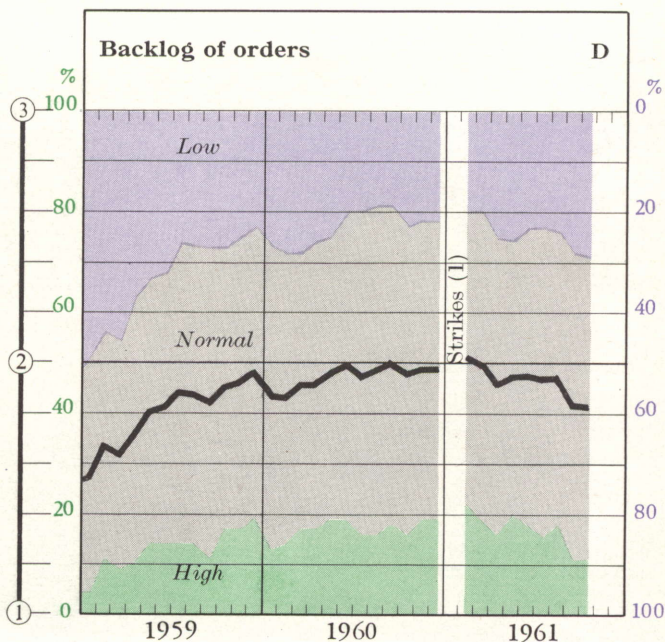
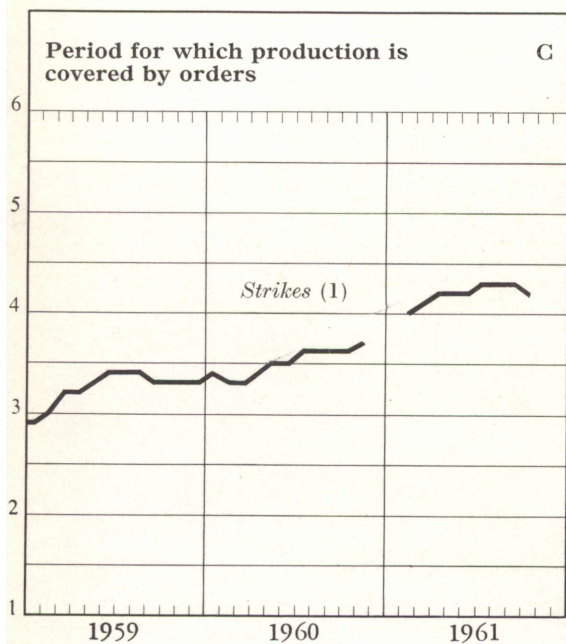
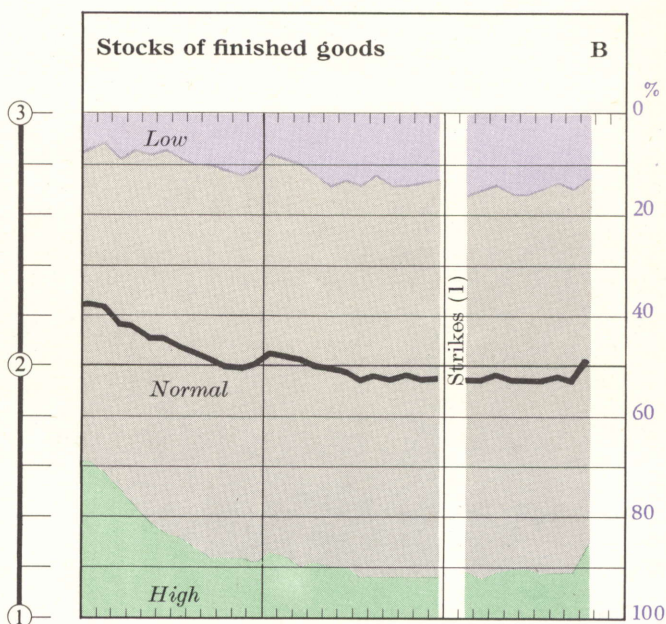
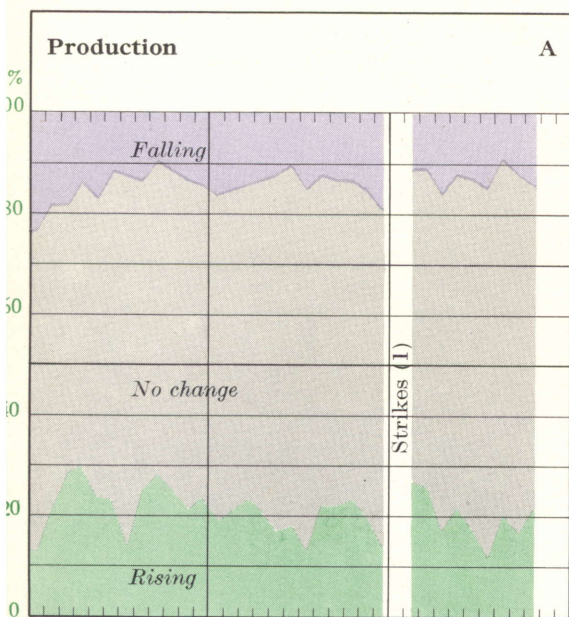
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SURVEY OF BUSINESS OPINIONS



(1) Interruption because of strikes.

Source : National Bank survey of trends.

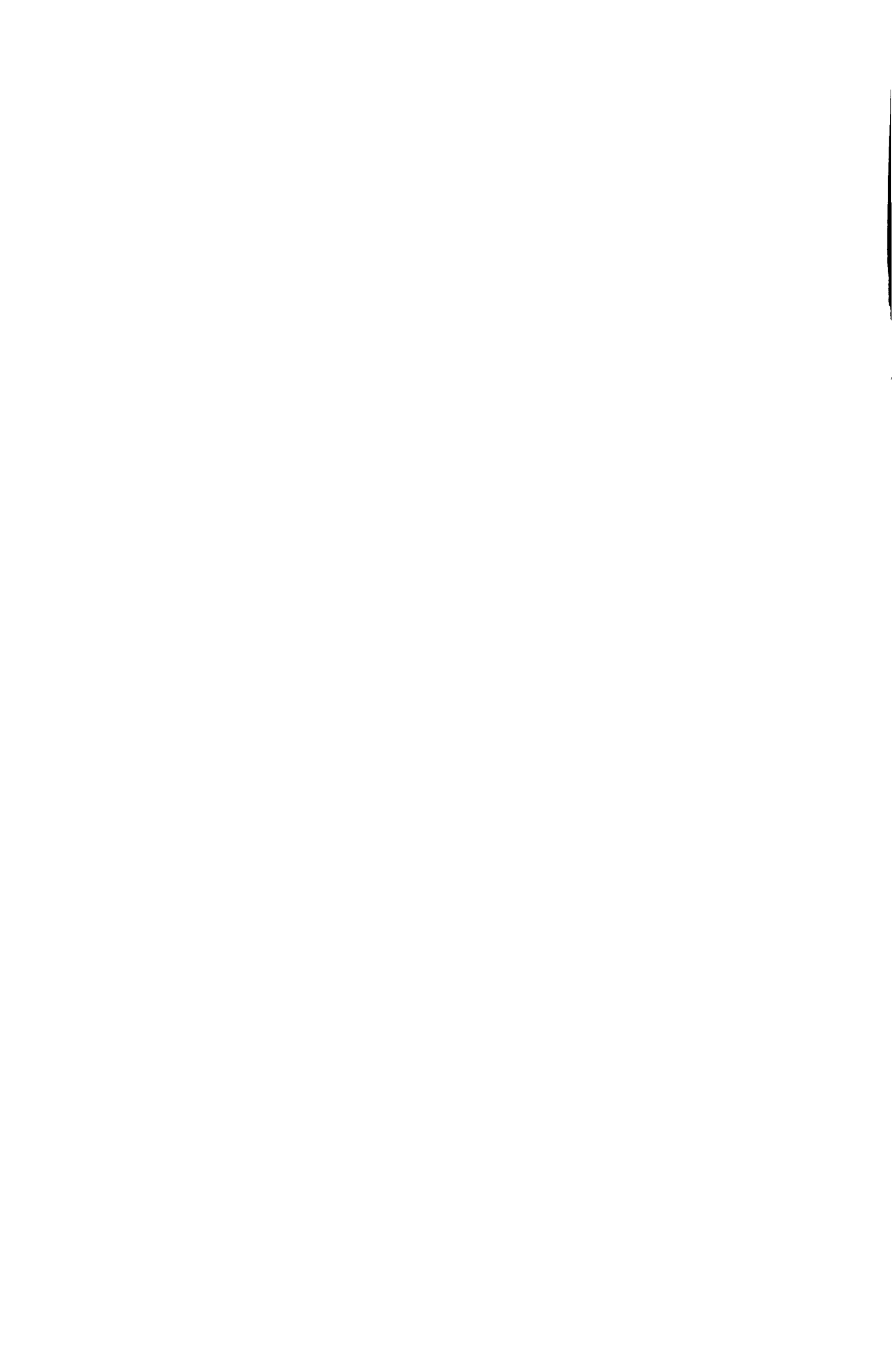
Note : Some sectors of industry are not covered by the survey, in particular : energy, chemicals, non-ferrous metals and foodstuffs.

GRAPHS A, B and D : the grey, green and violet areas in these graphs indicate the changing proportions between the three possible replies to the question put.

GRAPH C : the curve shows the average trend of the answers received (in months).

GRAPHS B and D : the black curves for which the scale is given between the graphs, show the trend obtained by adding up the percentage of answers in each group after weighting them as follows :

0.03 for answers "high"
0.02 for answers "normal"
0.01 for answers "low".



of advance had been 5.6 % in the second quarter, whereas the effects of the strike had brought it down to almost - 4 % in the first.

Fortuitous factors, such as the lively and unexpected advance in the exports of certain goods—in particular transport equipment—contributed to the overall improvement, but the crucial factor was the rapid growth in other and more important industrial sectors, such as machinery and textiles. Sales of iron and steel products, however, showed no increase over the corresponding period of 1960.

For the first time in many months exports to non-member countries began in the third quarter to improve more rapidly than to countries of the Community. It is true that the growth in sales to the Netherlands and to France was still substantial, but exports to the Federal Republic of Germany improved only slightly after a setback in the second quarter, so that the progress of exports to the other Community countries combined was only modest. On the other hand, the recovery in sales to non-member countries was exceptionally vigorous : deliveries to the United States and other OECD countries showed a definite advance.

Domestic demand has also continued to grow. As before, it has stemmed mainly from business investment and expenditure on housing.

Fixed investment by enterprises seems to have continued its growth : there has been a fresh increase in deliveries of industrial equipment at home and in the corresponding imports. Furthermore, starts in commercial and industrial building were in the third quarter 9 % up on the corresponding 1960 figure. After adjustment for seasonal variations, the figures none the less suggest that the increase in expenditure on industrial equipment may have lost something of its momentum. This would seem to be confirmed by the answers to an inquiry addressed to heads of firms, by a more modest increase in the flow of orders to the metal processing sector, and by some faltering in the growth rate of imports of equipment goods.

In the housing sector activity remained buoyant. The number of starts in the third quarter was about 10 % higher than a year earlier.

Public investment was again marked in the third quarter by a fall in actual expenditure compared with 1960, and by a perceptible growth in public works commitments.

Lastly, private consumption seems to have advanced a little further. The number of employed has again increased and the hours worked per week also seem to have increased a little. Wage adjustments in certain sectors have played their part in improving household incomes. Nevertheless these developments have led to only a very limited increase in outlay on private consumption. Purchases of motor cars, for example, were not greater in number in the third quarter than they had been a year previously. Again, turnover in the department stores has been falling off slightly, although experience has

shown that it is just the turnover of the department stores which serves as an early pointer to the general trend of retail trade sales. Lastly, there has been practically no further growth in the imports of many consumer goods. In the light of these factors, there are small grounds for believing that private consumption has recently been making any marked advance.

An increase in the number of persons employed led to a further improvement in the unemployment figures. The number of registered unemployed—an average of 90 000 in the third quarter—was down by 32 000 on the corresponding 1960 figure. It is true that the departure of foreign workers, particularly workers employed in coal-mining, has had some limited influence on these figures; coal-mining even experienced a slight shortage of manpower. But other sectors, too—for example, metal processing and construction—have also been encountering difficulties as the right skills and other qualifications are not readily available among those workers still seeking jobs.

The manpower problem is, however, far from being as serious for the Belgian economy as for certain other countries : expansion has not been hampered and, as can be seen from the latest figures ⁽¹⁾ industrial production has risen appreciably under the pressure of demand.

For the second quarter, the index shows a year-to-year growth of about 7 % and for the third quarter 5.5 %. The slight loss of pace was due to stagnation in the iron and steel industry, in coal mining and in a few branches of chemicals; on the other hand mechanical engineering, building materials and a few branches of textiles again made perceptible progress.

Agricultural production seems on the whole to have been satisfactory : a fresh increase in output of livestock products offset the poorer harvests of grain and root crops.

The growth of imports which had been substantial in the first half of the year, was considerably less in the third quarter : the rate of growth, which (in terms of value) had for the first six months been 8.5 % higher than a year earlier, fell to 3.3 %. This decline is largely due to a drop in purchases of food and certain other consumption goods.

Prices on the whole remained very stable, varying once more within only narrow limits. For example, wholesale prices have been tending downwards because of a fall in the prices of certain iron and steel and agricultural products. On the other hand, consumer prices increased slightly, having risen in the third quarter to 1.7 % above the corresponding 1960 figure. From August onward, however, a slight tendency for prices to yield ground was again apparent.

⁽¹⁾ The IRES index of production has been revised of late on two occasions. On the second many industrial sectors were included in which the growth of output had been appreciably more lively than the average of the other sectors.

The growth of exports and the hesitant trend of imports led in the third quarter to a further reduction of the deficit on trade though this, at Bfrs 1 500 million, was still relatively high. Thus, the first nine months of the year produced an overall trade deficit of more than Bfrs 10 000 million, while the comparable figure for 1960 was Bfrs 5 900 million. This situation reflects not only higher expenditure on investment but also such special factors as the strikes early in the year and the deterioration in the terms of trade. The latter is mainly the result of the fall in steel and textile prices on export markets. Because of the discouraging trend of other items in the current account, and of the increased exports of capital through official transactions, particularly debt repayments, there was a heavy deficit on the overall balance of payments, even though net exports of private capital fell. The deficit was Bfrs. 7 600 million in the first half of 1961, whereas a surplus of Bfrs. 5 100 million had been recorded in the same period of 1960. The situation seems, however, to have improved in the third quarter. Official gold and foreign exchange reserves rose from Bfrs. 53 800 millions at the end of June to Bfrs. 59 000 million at the end of September.

The Government's financial situation has improved appreciably in recent months; total indebtedness to foreign countries was reduced by Bfrs. 2 500 million between the end of May and the end of September, though it was not possible to eliminate entirely the heavy increase which had taken place early in 1961. Internal indebtedness hardly changed at all and borrowing from the Banque Nationale remained Bfrs. 1 000 to 2 000 million below the authorized ceiling. Loans issued on the internal market were taken up without difficulty. Lastly, revenue from taxation was appreciably higher because of the rising business trend and of higher taxes, so much so that the cash deficit for the full year should be appreciably less than in 1960.

Ample funds were once again available on the money and capital markets. The high level of interest rates certainly had something to do with this. The increase in business credits was fairly limited. The extreme liquidity of the money markets caused interest rates for call money to tend slightly downward and the indebtedness of other banks with the Banque Nationale to be reduced substantially.

There should be no pronounced change in the general economic trend in the fourth quarter, though the rate of growth in output may once more lose a little momentum under the influence of faltering world demand for steel. Thus, in the light of revised output statistics, the growth of industrial production for the full year 1961 may be calculated at about 4 %. Altogether, the real gross national product should advance by 3 to 4 % by volume. This is better than was forecast, and the difference is attributable, apart from the statistical factors already mentioned, to the delayed and incomplete implementation of the financial provisions contained in the "loi unique": there have been, in particular, practically no cuts so far in expenditure. Exports, moreover, particularly to the Netherlands, but also to the leading non-member countries, developed more favourably than was to be expected. Lastly, the growth of investment was, in part thanks to foreign investment in Belgium, more lively than had been forecast.

2. Outlook

It is not certain that the economic progress made so far will continue at the same pace in the first six months of 1962. Growth rates will, it is true, again be substantial by comparison with the corresponding period of the previous year, because of the great strides made in 1961. They might, however, tend to fall off, mainly as a result of a decline in exports of iron and steel—and perhaps of textiles—to Community countries, where some slowing of economic expansion has been observed, with special difficulties in the markets for these products. It is doubtful whether the expected growth of exports to other countries, particularly the United States, will offset this trend sufficiently to maintain a rapid rate of expansion in exports generally.

Excessive pessimism as to exports is, however, unwarranted. The outlook remains favourable, particularly in mechanical engineering. Moreover, although production costs in Belgium remain relatively high, the cost of wages per unit of output has eased slightly, as the substantial improvement that has occurred in productivity of recent years has been accompanied by only modest wage increases. Since wages in the other countries have increased, sometimes considerably, Belgium's competitive position has become stronger. In addition, the reduction of customs duties to be made between member countries at the end of 1961 will mean that Belgium too has greater opportunities to export, particularly to Germany, but also to France, though in the case of France some of the reductions have in fact already been made.

Investment at home should continue to be brisk. In certain branches, however, especially in iron and steel, there may be some weakening of the propensity to invest. This will increase the importance of current or future measures by which the authorities endeavour to encourage or guide investment. The Belgian authorities are well aware that the share of the gross national product devoted to investment at home is smaller than in other Community countries, and that so far the distribution of investment has not been in line with requirements of a modern economy. A public investment plan, to be co-ordinated with industrial investment programmes, will therefore be put forward at the beginning of 1962. Moreover, the establishment of a "National Investment Company" is planned. Aided by regional companies, the main task of this national company will be to encourage the development of new industrial enterprises whose establishment involves certain initial risks, or which on account of their modest scale have difficulty in obtaining capital. These investment companies will be able to take up part of the risk capital. The Government is also preparing to reorganize the money and capital markets, and to recast its credit policy in order to increase the liquidities available for productive investment and to achieve some reduction in the cost of borrowing. These measures would be completed by a tax reform to allow the proportion of savings invested within the country to be gradually increased. In this connection it appears advisable to increase little by little the ratio of direct taxes to total taxation, though in doing so every effort should be made to avoid reducing productively invested savings. Efforts might for instance be made in the course of time to achieve surpluses on current account which would make

it possible to cover some part of public investment without reducing the amount of private savings available for private investment.

Public investment will also continue to advance in the coming months, if only on account of the substantial increase in commitments undertaken this year. It is likely, too, that private consumption will also increase again, especially if the numbers in employment continue to grow and the tendency for wages to rise gathers strength—a development which, in view of the fact that full employment is in sight, is not improbable. In these circumstances there are grounds for believing that despite uncertainty in the business outlook in particular industries, such as textiles and steel, industrial production will continue to grow, although perhaps at a more moderate rate than in 1961.

Grand Duchy of Luxembourg

Economic expansion in Luxembourg continued in the third quarter. A further weakening of export demand was, however, reflected in the order books of the iron and steel industry. Although the situation improved slightly in October, the expansion of output will probably have slowed down in the last months of 1961.

The year-to-year growth rate of industrial production was 3.8 % in the third quarter, but was down to 2 % in October. For the full year the increase in industrial production may none the less be about 3.5 %, that of the gross national product probably much the same.

The outlook for investment in the Grand Duchy—particularly in the public sector—and for consumption suggests that the economy should continue to develop favourably. However, trends on the steel market are those on which the maintenance or temporary levelling out of growth in the national product will depend. In view of the high standard of living in Luxembourg the prospect of a pause would not be too worrying, especially as experience shows that fresh strides forward follow fairly soon on such periods of stagnation. If, however, economic activity were to slow down too sharply, the authorities would be well able to do some priming of the economy. The excellent cash situation of the Government and the existence of financial reserves would make it possible to put in hand a number of public investment plans that have already been drawn up.

1. Recent developments

Demand continued to move forward in the third quarter. True, the backlog of orders in iron and steel thinned out fairly rapidly during the summer because of a tendency for Community users to run down stocks and because of a slight weakening in demand from non-member countries; the price of steel, especially for export, fell perceptibly right up to October. The level of exports, however, was till October higher than a year earlier, thanks to the considerable backlog of orders received in previous months. It is not certain whether exports will have improved again in the full fourth quarter.

Investment continued to expand. The index of building and construction rose sharply, owing mainly to the speed-up in public works. Moreover, tax concessions offered on new investment under the Budget Law of 20 May 1961 have encouraged private investment—more especially in the small and medium-sized enterprises.

Private consumption was further increased by the rises in the incomes of private households as a result of the expansion of transfer incomes, by growing activity in industry and services and by higher wages in building and construction. The increase in consumption was reflected particularly by an increase in expenditure on services and consumer durables. The increase in new registrations of private motor cars slowed down appreciably during the summer, but there was, on the other hand, a further increase in sales of radio and television sets.

Industrial production in the third quarter was 3.8 % and in October 2 % higher than a year earlier. In the third quarter output per worker was 2.7 % up on the corresponding figure for 1960. Outstanding increases in output were recorded in iron mining (+ 13 %), in beverages and tobacco (+ 16 %), footwear and garments (+ 11 %) and building and construction (+ 14 %).

As a result of the drop in the backlog of orders during the summer, the iron and steel industry has not been working quite to capacity; whereas output at the beginning of the third quarter was still 4 % up on the corresponding 1960 figure, by September and October the year-to-year figures showed hardly any improvement. For certain special products, such as plate and sheet, delivery dates have been shortened by almost half since the beginning of the year; for rolled products, however, users must still wait from three to four months.

Substantial growth was again recorded in the services sector; tourism in particular increased considerably. For instance, nightly bookings in hotels rose 15 to 25 %, depending on the area; sales of petrol for cars rose by 15 %, and the output of beverages by 11 %. Taken as a whole, railway traffic picked up little; however, the number of wagons loaded inside the country continued to fall for structural reasons.

The index of consumer prices, which in November was only very slightly above the corresponding 1960 figure, was affected at the end of the year by higher prices for coal from Germany, and for macaroni and similar products made more expensive by higher rates for Canadian hard wheat. On the other hand, the control of profit margins on the distribution of pharmaceutical specialities has led to an appreciable fall in their prices, although these are not included in the index of consumer prices.

The ample funds available to the Government as a result of the rising revenue from taxation has made it possible to postpone the issue of the loan planned for early autumn and even to reduce public indebtedness. At the end of the third quarter the budget showed a surplus of about 500 million Luxembourg francs and, in October, the total of public indebtedness was about 350 million francs lower than at the beginning of the year.

As the tendency for the output of crude steel to slow down is likely to continue till the end of the year, the total figure for the whole year 1951 appears likely, in the light of the available statistics, to be 1.5 % higher than the 1960 figure. This rate of growth would be slightly less than was forecast at the beginning of the year. The rate of progress of industrial production as a whole should be about 3.5 %.

All in all, figures for agricultural production seem unlikely to be better than those for 1960; productivity, however, will have continued to improve since the number of persons working in agriculture is falling at a rate of nearly 3 % a year. In view of the expansion of activity in the services sector, the growth of the real gross domestic product will be about the same as the growth of industrial production.

2. Outlook

As the autumn brought little recovery in orders for steel, the rate of economic expansion in Luxembourg during the first half of 1962 is likely to be lower than in 1961. There may even be some degree of stagnation. This applies in particular to exports of steel—which are of the first importance— whereas exports of other goods, encouraged by the law of 25 November 1961 for the establishment of a Luxembourg credit insurance scheme, might develop a little more favourably after implementing regulations have been issued.

Investment ought also to develop fairly rapidly in the coming months, particularly in the public sector : the budget estimates for 1962 provide for a substantial increase (about 20 %) in extraordinary expenditure, much of it as part of the administrative, educational and health investment programme. In the private sector expenditure on conversion and modernization should continue. Thus, several projects for establishing new firms should be implemented shortly as a result of the continuation of the tax concessions on new investment under the terms of the draft budget. Adoption of the draft of an outline law for the introduction and co-ordination of measures to improve the regional structure and regional balance of the economy and to encourage expansion would also make a useful contribution to the realization of such projects.

Public consumption should increase by about 5 % in 1962. Private consumption, too, might advance again slightly in the early months of 1962—mainly as a result of a number of wage increases made during 1961, of higher transfer incomes, and of the maintenance of a high level of business activity.

As the growth of industrial production will depend to a great extent on the market for steel, it is impossible to forecast with any degree of accuracy the prospects for the coming months. The excellent financial position of the Government and the existence of many public investment plans should however enable the State to ward off depressive tendencies if activity in the private sector were to fall off.

Other fairly serious problems now face the authorities responsible for Luxembourg's economic policy. In particular, strains on the labour market are growing from year to year. The building industry is having increasing difficulty in recruiting seasonal Italian workers. If the labour shortage were to grow more serious, this would be enough

to compromise the prospects for economic expansion, and measures should therefore be taken to facilitate the permanent establishment of more foreign workers.

Price trends are also causing misgivings. Buildings costs will increase as a result of the wage rise provided for in this industry. The new law concerning conditions of work for employees in the private sector will lead to somewhat higher distribution costs, which are likely to be reflected in the shops; the prices of certain foods and services will be raised and this means that the point above which the sliding-scale comes into play may well be reached early in 1962.

