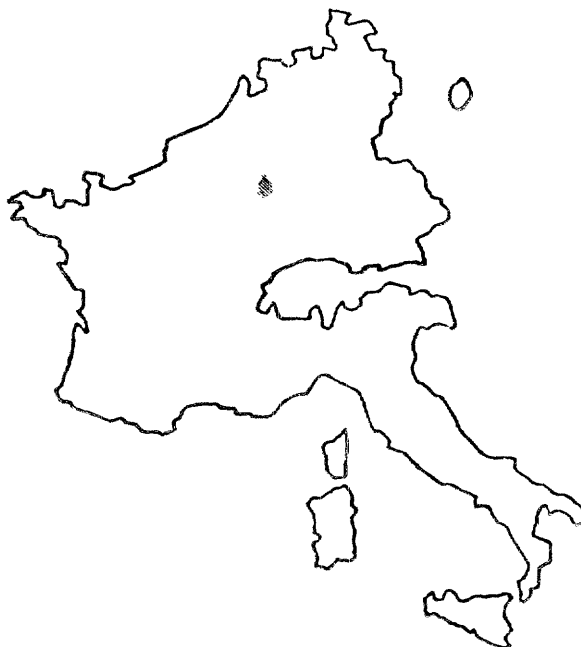


EUROPEAN
ECONOMIC
COMMUNITY
COMMISSION



DIRECTORATE-
GENERAL
FOR ECONOMIC
AND FINANCIAL
AFFAIRS

**THE ECONOMIC SITUATION
IN THE COMMUNITY**

3

SEPTEMBER

QUARTERLY SURVEY

1964

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

COMMISSION

The Economic Situation in the Community

SEPTEMBER 1964

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I. THE OVERALL SITUATION

The upward trend of economic activity in the Community continued in the second quarter and the summer months, but the expansion of demand probably slackened somewhat. At the same time signs of an incipient return to economic balance became more clearly visible.

External demand did not increase quite as rapidly as in the first quarter. On the basis of foreign trade statistics, however, the value of goods exported to non-member countries during the second quarter was 9 % above the corresponding figure for the previous year. This reflects not only the expansion of the world economy, which continues in general to be quite vigorous, but also certain effects produced by the easing in the expansion of internal demand.

On the whole, the expansion of internal demand in money terms lost something of its momentum.

Although investment picked up considerably in the Federal Republic of Germany, investment expenditure in the Community increased less quickly than in the first quarter, owing to a clear decline in Italy. In most member countries expenditure on building and construction, which had risen very rapidly in the first quarter as a result of the relatively good weather, could not maintain the same high rate of growth.

Investment in stocks again increased considerably in almost all Community countries, mainly because of a greater tendency to stock raw materials and semi-manufactures.

Expenditure on consumption rose markedly, but here too the pace was lower than in the first quarter. Particularly in Italy there was a distinct slowing in the rate of expansion, but this was also true of France; in the Netherlands there was an unmistakable drop in the rate of expansion of private consumers' expenditure after the very sharp rise experienced in the first quarter. There was, it is true, some quickening of the pace in Germany, but this was not sufficient to offset the effects at Community level of these developments in other member countries.

Apart from agricultural production (harvests should as a rule be well above last year's), internal supply also tended to grow less rapidly. This applies to industrial production in particular, partly because of increasing inelasticity in some industries and some countries—here manpower shortages played an important role—and partly because of falling demand in others. However, the index of industrial production published by the Statistical Office of the European Communities shows a 6 % rise in production on the second quarter of 1963.

Strains on the labour market increased, except in France, where certain signs of relief could be seen in some areas and sectors, and Italy, where there may even have been a certain decline in the total number of hours worked.

The upward trend of Community imports from non-member countries lost something of its momentum, though imports of goods into Germany increased more rapidly, while imports to Italy fell sharply. According to customs returns, the aggregate value of Community imports of goods during the second quarter was 10 % higher than in the corresponding period of 1963.

The signs of an incipient return to economic equilibrium were most clearly visible in trade between the member countries, where expansion was rather slower. Italy's balance in particular improved considerably, and there was an appreciable decline in Germany's surplus. On the basis of imports as shown in customs returns, the total value of intra-Community trade in the second quarter was 17 % higher than in the second quarter of 1963.

Price increases, however, continued. The consumer price indices show that in Italy they were for a time even more rapid than before, and in Belgium too prices rose faster than hitherto. In the other member countries prices did indeed go up, but the increase was relatively moderate—especially in France. In part the tendency for prices in the Community to be pushed up was due to special factors such as dry weather and storms in some areas and higher charges by public undertakings.

The Community's balance of trade with the rest of the world did not deteriorate in the second quarter (largely owing to a notable improvement in Italy's balance), but the deficit was still \$146 million bigger than a year earlier. Member countries' official gold and foreign exchange reserves rose \$320 million between the end of the first and second quarters, but at the same time the net foreign exchange holdings of the commercial banks probably fell even more.

Everything points to continuing expansion in the Community as a whole up to the end of the year, but the increases in external demand, internal demand and production may again slow down somewhat. Particularly in Italy, the expansion of domestic demand will still be decidedly weak. However, the Commission currently forecasts that for 1964 as a whole the increase in the real gross product of the Community may well be 5.5 %.

Preliminary forecasts for 1965 indicate that economic expansion in the Community will continue. The growth rate during the year may be rather slower than in 1964—particularly the first half of 1964. Nevertheless, the growth rate of GNP for the full year should be at least 4 %.

The world economic situation will probably not favour expansion quite as much as it did in 1964. Internal demand in money terms may also be slowed down not a little in the Community by the effects of stabilization measures. This is likely to have favourable effect on foreign trade balances and, perhaps to an increasing extent, on prices, and at the same time it will doubtless contribute to a certain moderation of the pace of real economic growth.

The situation will, however, still tend to vary from country to country: a further vigorous rise of domestic demand together with reduced elasticity of domestic supply in Germany, entailing the possibility of increased prices; persistence of the strains being felt in Belgium—though possibly in milder form; relatively slow growth of demand in France and the Netherlands, with some repercussions on the growth of production; possibly some increase in business activity in Italy, relatively slight at first; and in general, persistence of the upward pressures on prices, though in most member countries less marked than in 1963 and 1964.

Such tendencies may still be altered considerably, however, through economic measures. It is important that these should be directed more than has hitherto been the case towards the stabilization of prices and costs and that pressure should not be put on investment alone, as has sometimes happened in the past—especially in Italy.

On the whole, then, a continuation of anti-inflationary action, strictly in line with the Council's recommendations of 14 April 1964, seems to be called for if complete equilibrium is not only to be achieved in the first six months of 1965, but to be made safe for the future. Only in Italy does it seem that a policy whose general effect is to slow down internal demand in money terms is no longer suitable: the prescription there should be no longer the "mixture as before", but a brake should be placed on the increase in costs, and investment should be encouraged.

A. Recent developments

1. Demand

In the second quarter and the summer months the expansion of total demand in the Community as a whole continued. But the pace of expansion probably slackened off a little—chiefly as a result of a certain decline in private consumers' expenditure and in exports.

However, external demand—defined as actual exports of goods and services to non-member countries—seems to have grown considerably once more; at any rate visible exports were on the basis of customs returns, and after seasonal adjustment were 3 % in value higher than in the first quarter—after rising 5.5 % from the fourth quarter of 1963 to the first of 1964. The figure for the second quarter was almost 9 % up on that for the second quarter of 1963. Preliminary export figures for the summer, however, point to more moderate expansion.

The continuing growth of exports reflects the favourable economic development in other industrial countries as a whole and the increased availability of foreign currency in the developing countries. Moreover, the Community's stabilization policy had already brought about a perceptible increase in the availability of goods for export and spurred businessmen on to greater efforts.

The most significant factor as regards the industrial countries is that economic progress has been maintained in the United States. Seasonally adjusted, gross national product in real terms rose 1.2 %, after a 1.1 % increase from the last quarter of 1963 to the first of 1964. The second-quarter increase from 1963 to 1964 was 5.2 %. Unemployment, which in January had still been 5.6 % of the working population, dropped to 5.1 % by August (seasonally adjusted figures).

All components of internal demand contributed to the expansion of the United States economy in the second quarter. The increase in demand by public authorities was particularly marked, whereas the March tax cut played only a limited role in raising private consumers' demand: the proportion of disposable income saved by households seems to have risen considerably.

This expansion of total demand was reflected in further increases in imports. Community exports to the USA consequently increased, though perhaps at a rather slower pace than in the preceding months; for the quarter their value was 8 % in value higher than in the corresponding quarter of 1963.

Community exports to EFTA countries also expanded considerably, being as much as 10 % in value up on the second quarter of 1963. Exports to the United Kingdom showed a year-to-year growth rate of 12.5 %. However, a tendency for expansion to slow down developed in the course of the period under review. It is not certain how far this is due to a reduction in the expansion of demand in Britain. In any case, real economic growth there recently slowed down distinctly.

The trend of Community exports to the developing countries was not uniform. On the one hand, sales in Latin America went up again, and deliveries to the Middle and Far East continued to expand. On the other hand, the growth of exports—particularly French exports—to some of the African countries associated with the Community was decidedly sluggish. The overall growth rate of Community exports to the developing countries was thus only 4.5 % higher, in terms of value, than a year earlier.

Community exports of goods to non-member countries ⁽¹⁾

(% variation in value on preceding year)

Exports to	1963	1963				1964	
		1st quarter	2nd quarter	3rd quarter	4th quarter	1st quarter	2nd quarter
United States	+ 4.5	- 6	+ 8	+ 7.5	+ 7.5	+ 17.5	+ 8
EFTA	+ 6	+ 1	+ 9	+ 4.5	+ 9	+ 14	+ 10
including :							
United Kingdom	+ 8.5	+ 3	+ 9	+ 5	+ 18	+ 25	+ 12.5
Developing countries	+ 2.5	- 6.5	+ 6	+ 6.5	+ 4.5	+ 12	+ 4.5
including :							
Associated overseas countries and territories	+ 8	- 7.5	+ 20.5	+ 21.5	+ 3	+ 9	+ 1.5
Total non-member countries	+ 5	- 2.5	+ 7	+ 6.5	+ 7	+ 15	+ 9

⁽¹⁾ In comparing the year-to-year growth rates for the first and second quarters of 1964, the reader should note that the rates for the first quarter reflect the fact that the export trend in the first quarter of 1963 was largely a consequence of the freeze-up.

As regards the development of internal demand, the expansion of expenditure on gross fixed asset formation continued. Although investment in Germany increased its pace and in the Benelux countries maintained a high rate of increase, a slight reduction in the growth rate for the Community as a whole is possible, chiefly because expenditure on building and construction did not go up as quickly as in the previous quarter (which benefited greatly from the weather), but also because investment in plant and equipment in Italy showed a very considerable decline.

Total investment in stocks presumably increased vigorously—not only in agricultural products as a result of the harvests, but above all in raw materials and semi-manufactures because of the continued high level of stockbuilding. Only in Italy, where production was stagnant, economic prospects unfavourable and financing difficult, were stocks of raw materials and semi-manufactures run down, while stocks of a number of manufactured goods seem on the other hand to have built up involuntarily as a result of slackening demand.

The rise in public current expenditure on goods and services continued fairly rapidly from the first to the second quarter, even though there was in the course of the second quarter a certain fall in the rate of growth.

Private consumers' expenditure rose less steeply than in the first quarter. Particularly in Italy there was a definite easing in the pace at which consumption expanded. The level of private consumption in the Netherlands halfway through the year was considerably higher than a year previously, but after the first quarter there seems to have been hardly any perceptible increase. For some time the rate of expansion of private consumers' expenditure has been slowing down somewhat in France too. In Belgium and Germany, on the other hand, there was a continuing vigorous—and in Germany even slightly faster—expansion.

The rather less lively expansion of private consumption can be explained mainly by the slight deceleration in the growth of disposable incomes. There was a further overall rise in agreed wages, it is true, and the rise in real earnings also gathered speed a little in Germany. But the total number of hours worked in the Community hardly increased at all, partly because it was already very high as a result of the good weather, but partly because in Italy numbers employed and hours worked tended to go down slightly.

As far as the structure of consumption expenditure is concerned, signs began to appear in some countries—partly because of stabilization measures—that sales of consumer durables, particularly private cars, were tending to fall off. For the Community as a whole the number of private vehicles registered in the second quarter was only 2 % higher than in the second quarter of 1963, whereas the growth rate for the first quarter had been 15 %.

2. Production

Internal supply in the Community expanded significantly once again in the second quarter and the summer.

Early figures on this year's harvest show that in some cases agricultural production distinctly exceeded output for the corresponding period of 1963. Grain crops in particular were very good: preliminary estimates indicate a 10 % increase on last year's figures. Wine output also seems to have been considerably better than last year. The potato harvest, however, will probably be less than in 1963 owing to the reduction in area planted and the dry weather in some parts of the Community. Output of livestock products increased less sharply in the second quarter than it had earlier in the year.

The growth of industrial production continued, but at a reduced pace. The adjusted index of the Statistical Office of the European Communities (without building and food, beverages and tobacco) rose only 0.5 % from the first to the second quarter, as against almost 2 % from the fourth quarter of 1963 to the first of 1964. However, the figures for the second quarter were still 6 % higher than for the corresponding period of 1963.

There seems to have been a slowdown in the growth of industrial production during the third quarter too. This can be explained partly by a decline in elasticity of production resulting from full utilization of the factors of production (the labour shortage in particular is acting as a brake in some countries and industries) and from the levelling-off (as in France) or even (as in Italy) the decline of demand in a number of sectors. During the summer another contributing factor was the tendency, observed for some years now, for seasonal recessions to gain in strength as a result of longer holidays and the practice of factories closing down completely over the holiday period. Nevertheless, growth of production in Germany was hardly any slower than in the early months of the year; in Luxembourg it even speeded up distinctly.

A breakdown by branch of industry shows that the slower expansion of industrial production in the Community can be ascribed to a slackening in activity in some consumer-goods industries, particularly those manufacturing consumer durables in Italy and France. Private car production actually decreased in both these countries during the second quarter, so that for the Community as a whole the year-to-year growth rate in this branch was only 2 %. In the investment goods industries the growth of output was weak in France, and production in Italy even declined appreciably, but there was considerable further expansion in the other member countries, especially Germany. In most sections of the basic materials industries there was no substantial rise after the considerable growth of production in the first quarter. The chemical industry again showed a very marked rise in production in all member countries.

In the building industry there was a fair degree of expansion throughout the Community except in Italy, where production fell off during the period under review. In comparison with the first quarter, when building activity was extraordinarily lively because of the mild weather, only slight progress was made.

The expansionary trend in the services sector continued in all member countries, though here too there was a slight tendency for expansion to slow down in services supplied direct to consumers.

The labour market was under continuing strain in Germany and the Netherlands and suffered from serious shortages in Belgium and Luxembourg, but there were further signs of an easing in the situation in Italy and of a tendency for a better balance to emerge in France. In most member countries unemployment was again reduced or at least kept at a very low level. In Italy, on the other hand, the total of hours worked in industry and in building and construction began to decline; here, however, some of the workers released probably found new jobs in agriculture.

3. The balance of the markets

Community imports of goods and services from non-member countries probably continued their advance, though rather more slowly after the particularly vigorous expansion of the first quarter. The value of goods imported rose about 2 % from the first to the second quarter, as against some 4 % from the fourth quarter of 1963 to the first quarter of 1964 (seasonally adjusted figures based on customs returns); compared with the second quarter of 1963 the rise was 10 %.

In contrast to the situation throughout 1963 and in early 1964, the expansion of Community imports was no longer due chiefly to a sharp increase in demand from France and Italy. In fact, the forces working for a reduction of imports in these two countries—resulting from internal tendencies towards and measures to achieve stabilization—came more strongly to the fore. In Italy, where the fall in demand was particularly marked, the trend of imports from outside the Community in the second quarter was distinctly downwards; import figures barely exceeded the 1963 average. The growth of imports continued in France, but the pace was much slower than in 1963. On the other hand, in Germany and the Belgo-Luxembourg Economic Union, where the expansion of demand speeded up or remained vigorous, imports from non-member countries rose rather more rapidly than before. In the Netherlands, the strong expansion of domestic demand even brought about a particularly marked increase in purchases from outside the Community; in the second quarter their value was no less than 25 % higher than in the corresponding period of 1963.

Figures so far available indicate that the expansion of imports was again made up largely of industrial consumer goods. However, it is notable that there was also a tendency for imports of raw materials and semi-manufactures to rise more rapidly. Imports of agricultural products also tended to be brisk.

Community imports of goods from non-member countries ⁽¹⁾

(% variation in value on preceding year)

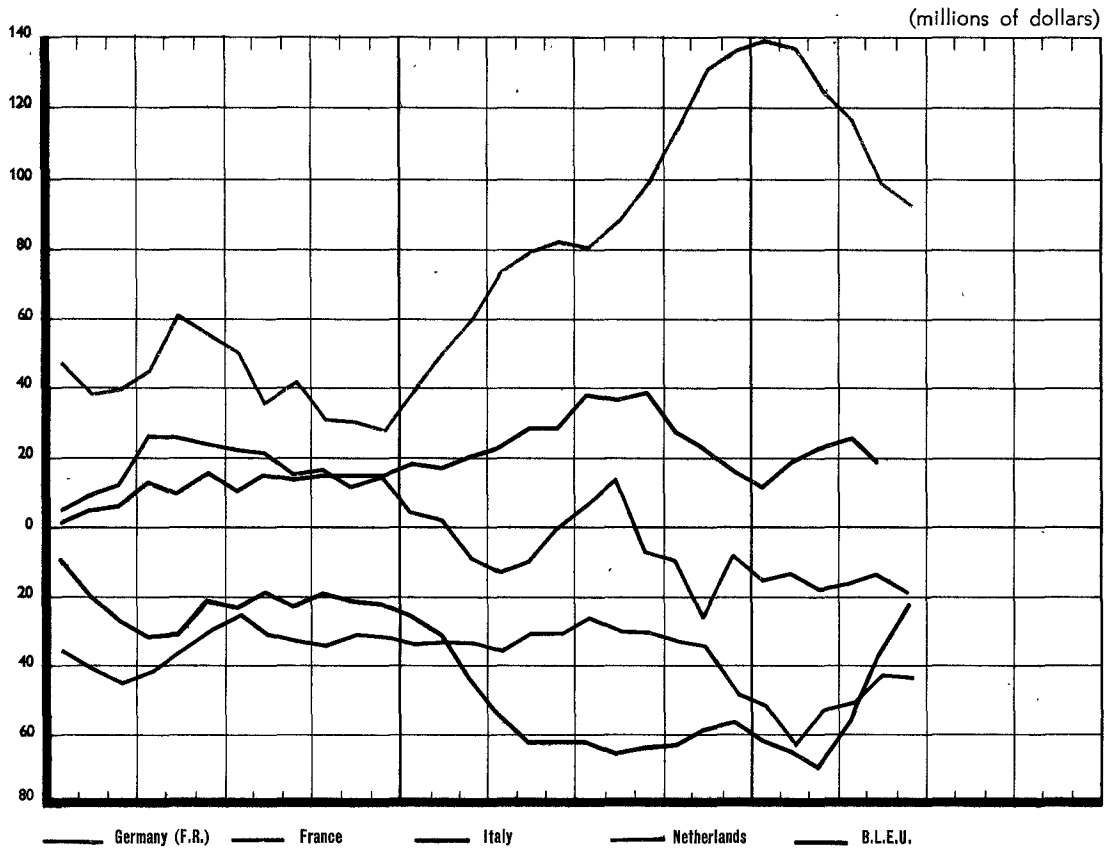
Imports from	1963	1963				1964	
		1st quarter	2nd quarter	3rd quarter	4th quarter	1st quarter	2nd quarter
United States	+ 13	+ 9	+ 16	+ 14	+ 15	+ 14	+ 5
EFTA	+ 12	+ 9	+ 16	+ 14	+ 11	+ 14	+ 8
including :							
United Kingdom	+ 17	+ 15	+ 24	+ 21	+ 12	+ 14	+ 9
Developing countries	+ 8	+ 9	+ 6.5	+ 8	+ 10	+ 16	+ 16
including :							
Associated overseas countries and territories	+ 3	+ 3	0	0	+ 9	+ 6	+ 18
Total non-member countries	+ 10.5	+ 7.5	+ 11	+ 12.5	+ 11.5	+ 16	+ 10

⁽¹⁾ In comparing the year-to-year growth rates for the first and second quarters of 1964, the reader should note that the rates for the first quarter reflect the fact that the import trend for the first quarter of 1963 was largely a consequence of the freeze-up.

A breakdown of Community imports by geographical origin again shows a relatively sharp increase in purchases from the developing countries, particularly the associated countries and territories overseas and Latin America.

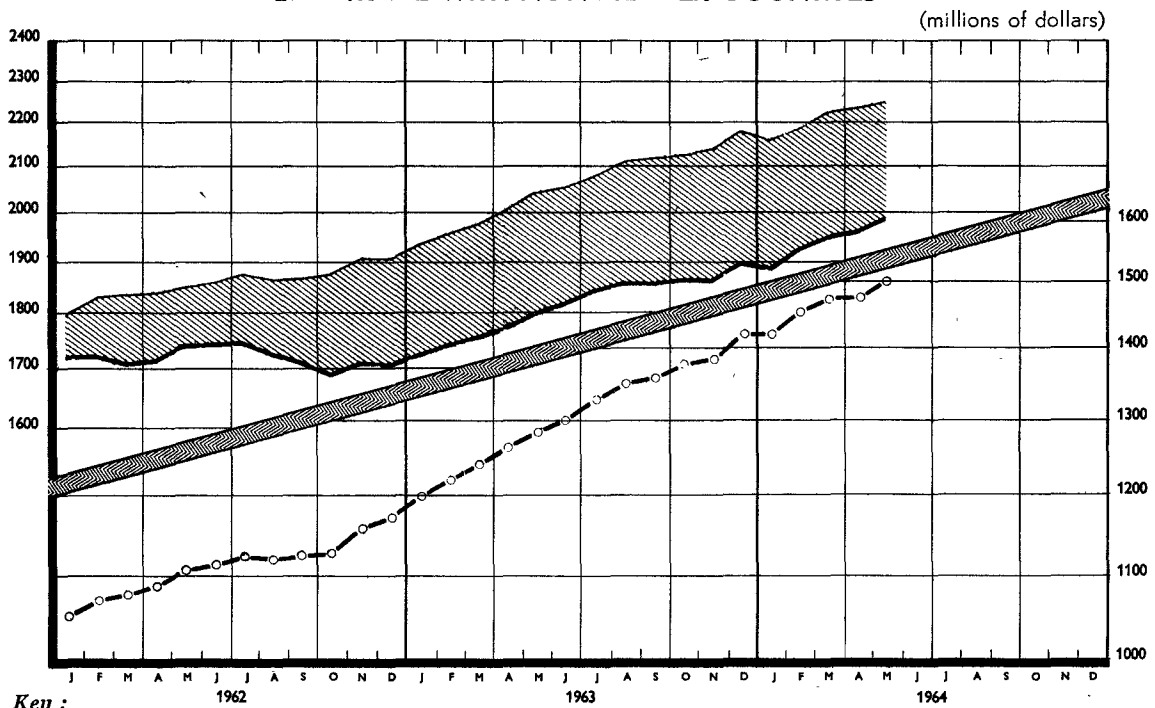
There were conspicuous changes during the second quarter in trade among the member countries; these reflect distinct signs of an incipient improvement in equilibrium.

1. — THE BALANCE OF TRADE BETWEEN EACH MEMBER COUNTRY AND ITS PARTNERS



Note: Based on the customs statistics for imports and exports of each member country. Three-month moving average based on figures seasonally adjusted by SOEC.

2. — TRADE WITH NON-MEMBER COUNTRIES



Note: Series adjusted by SOEC for seasonal and accidental variations. Exports fob, imports cif. Conversion at official exchange rates.

Source: Statistical Office of the European Communities (except as otherwise indicated).

The most important change was the considerable decrease in Italian imports, the value of which in the second quarter was roughly the same as in the corresponding period of 1963, after a 27 % rise in the first-quarter figures. In France the year-to-year growth rate of imports from the other member countries in the second quarter was still noteworthy at 21 %, but the rate of expansion was flattening out considerably. Even in B.L.E.U. there were signs that the rate of increase of imports was inclined to fall. Only the Netherlands increased its imports from the other member countries at a practically undiminished pace; they were no less than 23 % up on the second quarter of 1963.

On the export side too there were shifts that might well help to restore equilibrium in the Community. The most notable development was the perceptible slowdown in the expansion of exports by the German Federal Republic, while exports from Italy were in particular distinctly higher than in the preceding months.

The movement of imports and exports in intra-Community trade resulted in Italy's deficit falling sharply and that of France ceasing to rise. At the same time Germany's surplus of exports was perceptibly reduced, and in B.L.E.U. too there was a certain decline in the credit balance. The Netherlands almost offset the very rapid increase of imports from the other member countries by increasing its exports to them, particularly to Germany, so that the balance of trade did not deteriorate.

On the whole, the expansion of intra-Community trade slowed down somewhat, mainly because of the developments tending to improve equilibrium—just the opposite of developments up to the end of 1963, when the divergence of inflationary pressures from country to country helped to hasten expansion. The value of internal trade in the second quarter, on the basis of imports as shown in customs returns, was none the less 17 % higher than in the corresponding period of 1963, after a year-to-year growth rate of 25 % in the first quarter (when the figure was inflated because internal trade early in 1963 had been greatly hampered by the severe weather).

The trend towards a better balance in the economy did not have such marked effects on prices as it did on internal trade. As a rule, increases persisted—particularly in consumer prices—though pressure was perhaps less than in the first quarter. It is noteworthy, for instance, that in Italy consumer prices again went up more rapidly despite a tendency for parts of the economy to lose momentum, but here some bad weather had affected the price of certain foods. In Belgium too, the upward price trend accelerated distinctly. In the Netherlands, consumer prices rose very vigorously until April; since then, the indices have slowed down—apart from the increase in rents halfway through the year—but government price controls were in part responsible for this. Direct government intervention in the price mechanism was still an element of stabilization policy in France also—where the rise in the cost-of-living index remained within fairly narrow

limits. Nevertheless, the "free" price climate, too, reflecting price formation under normal market conditions seems in general to show a distinct improvement. In Germany the price increase remained relatively moderate despite the increased momentum of internal business activity.

In July the consumer price indices exceeded the figures for the corresponding month of 1963 by 7.2 % in the Netherlands (in April by 7 %), 6.8 % in Italy (4.7 %), 5.2 % in Belgium (3.3 %), 3.3 % in Germany (1.6 %), 2.9 % in France (3.9 %) and 2.4 % in Luxembourg (4.1 %).

Throughout the Community there was a fairly general rise in the prices of various fruit and vegetables as a result of drought in some areas. Otherwise, there were only few changes in ex-farm prices. The rise in industrial producer prices tended to slow down in Italy, where prices for some capital goods and consumer durables even weakened. In the Benelux countries, on the other hand, particularly Belgium, the advance of prices in this sector was quite pronounced, while in Germany the increase in prices of industrial manufactures remained weak. Prices for services generally went up sharply, though this was partly due to increased charges by public utility and transport undertakings.

Except in Germany, the price increases which occurred in all member countries were reinforced by the rise in production costs, or even caused by it. This latter possibility applies in particular to Italy, where the expansion of demand fell off sharply but unit costs kept on rising, particularly as the increase in productivity was extremely low because of the stagnation of production—at any rate in industry. In most other member countries the level of demand remained so high, and the strain on the labour market so severe, as to stimulate, or at least permit, rises in money incomes in excess of productivity increases over the same period.

After the tendency for the Community's balance of trade to deteriorate had been considerably reduced in the first quarter, the situation seems to have been stabilized in the second quarter, when exports continued to increase at a high rate and the growth of imports slowed down. However, customs returns still show a deterioration of \$146 million from the second quarter of 1963 to that of 1964, bringing the deficit on the Community's trade account for the first half of 1964 to about \$1 900 million—as against \$1 600 million for the first six months of 1963.

In view of the rather better balance of trade in the second quarter, the current account was possibly no longer in deficit. The balance of capital transactions on the other hand was distinctly reduced, despite an improvement in the capital transactions of Italy; this was mainly because of large outflows of capital from Germany.

Though the official gold and foreign exchange reserves of the member countries again rose \$320 million in the second quarter (after falling \$300 million in the first quarter), this may be counterbalanced by a greater deterioration in the net foreign exchange holdings of the commercial banks.

Foreign payments transactions contributed in many countries to some tightness of internal liquidity, particularly as public cash transactions in some cases tended to work in the same direction. In Germany, the previous very heavy inflow of funds from abroad declined considerably, chiefly because a considerable amount of capital left the country in the second quarter after the announcement that there would be a tax on the yield of fixed-interest securities owned by non-residents and because at the same time current transactions showed slight surpluses. However, the liquidity margin of the banks was so big that the expansion of lending continued at an increased pace. The Bundesbank consequently intensified its slightly restrictive policy (by increasing minimum reserve ratios and taking steps to curb too strong an influx of money from abroad). There were some signs of strain in the Netherlands too—mainly as a result of the deterioration in the balance-of-payments situation. With the expansion of credit continuing at a high rate, Bank rate was in June again increased, to 4 ½%. Further progress was made towards monetary stabilization in France: the formation of monetary capital rose considerably, and lending was kept within the prescribed limits in the second quarter. In Italy the bank liquidity improved to some extent because of the recent accumulation of a surplus on the balance of payments and the continuation of heavy deficit spending by the Treasury, particularly as the expansion of lending practically ceased. Belgium had no greater success in limiting credit expansion in the second quarter than in the first; at the beginning of July Bank rate was therefore further raised to 4 ¾%, and the policy of a minimum reserve was brought into operation for the first time, with a reserve rate of 1%; the rediscount policy of the National Bank was made more stringent.

The cash transactions of the public authorities in some member countries had a less expansionary effect in the second quarter than in the corresponding period of 1963. In certain of them, however, this may well have had more to do with the high yield of taxes in the current boom—partly the result of inflation—than with any reduction in the growth of expenditure. In Germany the Federal Government showed a slight cash deficit, but its extensive payments to abroad ensured that the overall effect of the cash transactions of the central authorities was to cut down liquidity. In France, as a result of the sharp rise in tax revenue and a distinct slowdown in the expansion of expenditure, there was even a cash surplus in the second quarter. In Italy, on the other hand, recourse was again had to the Central Bank to finance part of a Treasury deficit that remained sizeable. Similar developments took place in Belgium, where the State again (but to a much smaller extent than last year) took up short-term loans in foreign currency to finance some of its surplus expenditure. Official cash transactions in the Netherlands, too, were instrumental in increasing liquidity during the second quarter.

Supply and utilization of goods and services (1)

	1962	1962	1963	1964 (2)
	At current prices (in \$'000 million)	% variation by volume on preceding year		
Gross Community product	226.7	5.3	3.9	5.5
Private consumption	138.0	6.3	5.5	4.5
Public current expenditure	32.3	7.4	4.7	3.0
Gross fixed asset formation	51.8	6.4	3.8	5.5
Balance exports (3) less imports (3) (in \$'000 m., current prices)	+ 1.6	+ 1.6	+ 0.5	+ 1.0

(1) Community aggregate (excl. Luxembourg) based on official exchange parities.

(2) Commission estimates; figures rounded off.

(3) Goods, services and factor income.

B. Outlook

In the period up to the end of 1964 there may be a slight slackening in the expansion of overall demand in the Community. The pace of increase in production may also be reduced slightly.

External demand will continue to exert a considerable effect on the economic situation within the Community; exports of goods to non-member countries, however, may show rather lower growth rates in the rest of the year than those produced by the vigorous increase during the first six months.

In the world generally the forces making for expansion will again dominate the economic situation. Particularly in the United States, expansion is likely to continue at a rapid pace. The tax cut could have a greater influence on private consumers' expenditure in the second half of the year than in the second quarter. Moreover, the results of the latest surveys on businessmen's investment plans point to a more rapid increase in fixed asset formation, mainly because of the high level of capacity utilization and of the favourable trend of profits. Demand for housing, however, will presumably show little change. The vigorous overall expansion of demand will not only stimulate output but will also lead to further increases in purchases abroad. The purchases made in Community countries may even increase more rapidly during the coming months.

In the United Kingdom, on the other hand, a further slowing of economic expansion is not impossible. The economic indicators pointing to stagnation in the second quarter could have been affected by fortuitous factors (the last business survey still shows an upward trend, particularly in production prospects), but there are now some grounds for doubt about the possibility and probability of investment boom and the relatively rapid economic growth continuing, and this may have an effect on investment. These factors—apart from those deriving from internal politics, which are doubtless of only passing significance—are consequences of the considerable deterioration that occurred in the balance of current transactions during the first half of 1964 and of the expectation that for balance-of-payments reasons a brake will sooner or later have to be put on the expansion of domestic demand. To be on the safe side it should be reckoned that the Community's exports to Great Britain will not be as high as in the first six months of the year, towards the end of which the first signs of slowing down appeared—as has already been pointed out. By and large the economic outlook in other industrial non-member countries—and consequently the outlook for Community exports—remains buoyant.

Community exports to the developing countries will also increase further. The level of industrial raw material prices remained steady in the first half of the year. Export

prices in the associated overseas countries and territories, which benefited little from the general rise in world market prices for raw materials in 1963, rose significantly in the first half of 1964. World market prices—particularly for industrial raw materials—should not increase much in the coming months. This, together with the hitherto fairly sharp rise in purchases by the industrialized countries (including the Community), has made more foreign currency available to the developing countries (an estimated increase in currency reserves of \$2 000 million from the middle of 1963 to the middle of 1964), and this will certainly help these countries in the coming months to expand their imports considerably, including imports from Community countries.

As regards the probable development of internal demand in the Community, it must be assumed in the first place that expenditure on fixed assets will continue to expand appreciably. In Italy, however, it can be expected to decline for a while, though investment in building and construction may recover to some extent towards the end of the year. Expansion in the Community as a whole will depend chiefly on developments in the German Federal Republic, where an even more rapid advance is probable. In Belgium and Luxembourg the rate of increase of investment will remain decidedly high, though in Belgium it may perhaps be not quite as rapid as in the first half of the year. Expenditure on investment in France seems at the moment to be expanding rather more than before. Lastly, there may be some slackening of the investment boom in the Netherlands though not before the end of the year.

There is nothing to indicate any appreciable slackening in the expansion of public expenditure on investment by the end of the year in any member country.

There will doubtless be a certain decline in the growth rate of private consumers' expenditure, particularly in Italy, where the slowing of economic expansion is having more and more repercussions on private incomes and the propensity to spend may well have decreased. The stabilization policy has had a moderating influence on expenditure in France. In the Netherlands, after the sharp rise at the turn of the year, the upward movement is expected to be more gentle, though perhaps rather quicker than in the second quarter. In Germany the increase in incomes from wages and salaries—and consequently in private consumption—which has been moderate so far, may well accelerate, but not so much as to offset completely—for the Community as a whole—the factors tending to slow down the expansion in consumption in most other countries.

The reduction in the pressure of demand in some member countries and some sectors, together with reduced elasticity of production elsewhere (the continuing and to some extent worsening labour shortage has a constricting influence here), will presumably hamper the expansion of internal supply of goods and services. Industrial production in particular will probably show lower growth rates than before.

Imports from non-member countries will again tend to rise in the coming months. However, the reduction in the growth rate of visible imports already observed in the second quarter is likely to continue because domestic demand is falling off somewhat in several member countries (investment in stocks of imported raw materials and semi-manufactures may also have passed the peak of expansion). In view of the prospects for exports over the same period, the Community's balance of trade during the rest of the year may tend to improve again.

Prices in the Community as a whole will doubtless be rather more stable in the coming months than they have been so far this year. In spite of the increase in turnover tax this holds good for Italy too, where the factors favouring stabilization should come further to the fore—if only because reduced demand will hardly permit any major price increases without sharp repercussions on sales and hours worked. The success achieved in reducing the pace of price increases in France may continue to be a feature of the months ahead. In the Netherlands, too, price increases should—at least until the end of the year—be considerably more moderate than they were at the beginning of the second quarter. In Belgium, however, the prospects are less favourable in view of the relatively vigorous expansion of demand and wages; the level of consumer prices may well continue to rise. In Germany the increase in prices is likely to continue at least at its present and still moderate pace.

So much for current trends in prices. But prices will also go up as a result of the further increased charges by which public services seek to reduce their deficits, of higher rents and of other "autonomous" increases. Lastly, some foodstuffs may also become dearer—partly because of bad weather, partly because of the policy followed in the agricultural sector.

In view of developments so far and the outlook till the end of the year, there is no reason to make any essential alteration to the forecast changes in the volume of supply of goods and services in the Community and its utilization for the full year 1964 as against 1963; these forecasts are regularly published in the Quarterly Surveys, the most recent being in No 2/1964. Nevertheless, it would be as well to revise the change in real GNP from 5 % to 5.5 %. This is mainly because figures on achievements in the first half year—particularly the revised figures for the first quarter—now reveal a more vigorous expansion of building production, and thus of gross fixed asset formation, than was at first assumed, and because the earlier estimate of agricultural production will be very appreciably exceeded because of the good harvests.

As far as any picture can be gained at this stage of the further development of the Community's economy in 1965, the prospects are for continuing expansion—especially in the first six months. It is possible, however, that the economy will tend to slow down further.

External demand in 1965 could be rather less dynamic than in 1964, though in some member countries the elasticity of export supply and the export drive might increase as a result of a reduction in the excess pressure of domestic demand. In Germany, and perhaps in Belgium too, the elasticity of supply will if anything be reduced and so have the opposite effect.

The world business situation may remain buoyant, but the pace of expansion could slacken. In the case of the United States, for instance, some observers forecast that what has so far been the longest period of expansion in this century will come to an end in the course of 1965; they expect stagnation or even recession after the investment boom has passed its peak, presumably in the first half of the year. But this seems too pessimistic. It is true that public expenditure on investment—in fact, public expenditure as a whole, will add relatively little to domestic demand; but the Americans estimate that the 1964 tax cut will make a net contribution to the economy of \$3 500 million over the first half of the year, and this will probably stimulate investment by enterprises and private consumers' expenditure in the last two quarters also. Furthermore, the Administration has already announced that there may be other tax reductions—and this is known to stimulate the economy in advance. However, it may well be that in 1965 the rate of expansion in the American economy will be lower than in 1964.

The economic outlook for the United Kingdom in 1965 is perhaps less promising; despite the upswing in the world economy, United Kingdom exports in 1964—particularly those to the sterling area itself—expanded weakly. Among the other EFTA countries, a slowdown in the expansion of demand is to be expected in Switzerland especially, whereas in Sweden, Norway and Austria it could continue at much the current pace.

The slightly reduced rate of expansion in the industrialized countries means that the growth of demand for raw material from the developing countries will tend to slacken. However, as the availability of foreign exchange and credit to these countries has improved, they will certainly continue to buy appreciably more from the Community countries for some time yet.

Internal demand in the Community is also sure to rise further. In France and the Netherlands the expansion of demand may slow down somewhat, but in Germany it will speed up further and in Belgium will remain fairly rapid. In Italy economic activity may perhaps revive within certain limits in the course of the year, though it is starting out from a reduced level.

Just how sharply the economy slows down or speeds up depends a great deal, of course, on the economic policy pursued by the Member States individually and jointly.

This policy is not yet clear enough for precise forecasts; but as the stabilization of prices and costs is one of the main targets, a reduction in the rate of expansion of internal demand in money terms is to be expected for the Community as a whole—at all events in comparison with 1964.

This could apply to some extent to expenditure on gross fixed asset formation by enterprises, which in Italy is not showing much of a year-to-year growth rate at all, in spite of the support measures that have been introduced or announced. In the Netherlands expenditure under this head may slow down somewhat, and in Belgium too the very rapid expansion of investment may possibly give way in the course of 1965 to a more gentle upward trend. In France, some increase in the expansion of investment as a whole is quite possible, and in Germany the sharp rise that began in 1964 will continue throughout 1965 also.

The expansion of actual expenditure on public investment will be influenced more and more by decisions taken as part of the stabilization policy, but the increase should still be relatively large.

Overall expenditure on investment in building and construction will increase more slowly than in 1964, one of the reasons being that the unusually good weather in 1964 made an unexpectedly high level of expenditure possible and thus allowed more of the pent-up demand to be met.

However, it is chiefly in private consumption that expenditure is expected to rise less steeply than in 1964, since the factors tending to cause a slowdown in the rise of money incomes in Italy and—to a lesser degree—in France will also be felt in 1965, and because the Netherlands at any rate cannot be expected to repeat the “explosion” of wages and consumption which occurred at the end of 1963 and the beginning of 1964. However, the expansion of private consumers’ expenditure deriving from a spurt in wage increases will certainly be more powerful than in 1964, and in Belgium there is little to suggest that the rise in wages will slacken appreciably.

It is at this stage hardly possible to forecast just how far the decline in expenditure on consumption will go, but it is likely to be if anything too little rather than too much. In any case, the expansion of expenditure in Germany will probably be too high when judged against the needs of price stabilization, and there is also a danger that the rate at which incomes affecting costs—and consequently of consumers’ expenditure—are expanding will remain too fast in the Netherlands and Belgium. Even for France and Italy, this danger must still be reckoned with, at any rate as far as incomes affecting costs are concerned.

The situation on the labour market in the Community, except in Italy, seems to be still so strained that it could lead to the percentage increases in money incomes being higher than the expansion of real production.

As regards this last point, the Commission's staff considers that a good 4 % rise in G.N.P. from 1964 to 1965 is possible, though this is a first, very provisional estimate, which takes into account the probable decrease in the elasticity of production in most member countries. The increase could, of course, turn out to be greater, but this would only be possible if there were considerable further sacrifices of stability.

The declared aim of the Community's economic policy, however, is not the highest possible economic growth under any circumstances but balanced growth, restored price stability and a satisfactory but moderate surplus on current account. Examination of the economic outlook until the end of 1964 and for 1965 shows that it will be necessary to maintain a short-term economic policy which contributes to stabilization. In this connection the Council recommendations of 14 April 1964 on measures to be taken to restore the internal and external economic equilibrium of the Community have lost none of their value—the more so as in 1964 they have not been fully followed, especially in the expansion of public expenditure.

This is not to say that the member countries did not try to direct their economic policies along the lines suggested in the recommendations, for they did. It must be remembered, too, that the authorities in most member countries had already begun to take remedial action against inflation as advised, since the spring of 1963, by the Commission, the Short-term Economic Policy Committee and the Monetary Committee. For the most part such action was already on the lines of what the Council recommended on 14 April, even if the scope and intensity of the action taken was different.

On 22 July the Commission submitted its first report on action taken by Member States to implement the Council recommendation of 14 April 1964—for discussion at the Council session of 30 July. This report was drawn up on the basis of written information that the Member Governments had made available by the end of June—except Italy, where the government crisis made it impossible to submit a written document in time; in the case of Italy, therefore, this document was replaced by inquiries undertaken by officials of the Commission. The Commission's report gives the Commission's assessment of the position, though certain comments and amendments put forward by the representatives of the Member States in the Short-term Economic Policy Committee on 17 July were taken into account; it is given in the appendix to this Quarterly Survey.

Except in Italy, no further stabilization measures of importance have been taken since the report was submitted other than a certain tightening of credit policy (an increase

in the minimum reserve ratio in Germany and arrangements to curb the rise in banks' indebtedness abroad in the Netherlands). The rate of increase in public expenditure as a whole remained so high that it would seem that in 1964 no member country strictly observed the rules laid down by the Council for budget policy. In the Netherlands and Belgium there were even further rises in public expenditure on goods and services, in the Netherlands owing to a further rise in wages and salaries in the public service in September, backdated until the beginning of the year, and in Belgium thanks to the effects of the sliding wage scale on a large fraction of public expenditure.

Nevertheless, as was shown earlier, the balance of trade relations among the member countries has improved—mainly because of developments in Italy and France. This is already a great success, as it has put an end to the spread of inflationary pressures which had at times been passing from Italy and France to the other countries of the Community; in fact, by comparison with the situation in the second half of 1963 and the first quarter of 1964, the situation may now be reversed. The calming effect produced on the German economy, for instance, is evident; the prospects for an efficient stabilization policy in this country have been considerably improved—though this is also due to the considerable effect already exerted by the announcement of measures to curb the inflow of capital and to such further effect as they will still have if they come into force soon in the form proposed. What must now be kept within limits in Germany—and can presumably be curbed more easily than before because of the changed foreign trade situation—is the expansion of domestic demand in money terms; there is otherwise a danger that Germany will sooner or later exercise a strong expansionary influence on the other member countries—with particular danger to the Netherlands and Belgium.

The success to date of stabilization policy in the Community should, however, not be exaggerated. In Italy, the political situation at home has hampered the Government's efforts to take action in connection with the budget and on the question of incomes; together with correspondingly more vigorous action in the credit field—perhaps inevitable in the circumstances—this has helped bring to the fore the recessive tendencies affecting industrial output and the total number of hours worked.

Italy is the only member country where the situation no longer calls for a general deceleration of internal demand in money terms, but rather a change in the ingredients of policy, i.e. support for productive investment by enterprises coupled with limitation of expenditure on consumption and a brake on rising costs. At the end of August the Italian Government took a series of measures, and announced others, of which more detail is given in the chapter on Italy in this Survey. The aim of these measures seems to be broadly what, in view of the changed situation, is needed for stabilization of prices without too sharp a decline in activity. The incentives to investment that the Commission considers necessary should be realized mainly through a certain easing of the restrictions on credit and measures to encourage the capital market. Large-scale measures of a

general nature to promote the expansion of demand would, however, be premature in Italy as long as the stabilization of prices and unit costs is not assured.

Other member countries too would be wise to avoid more or less general measures that would tend to increase internal demand (such as broad tax cuts) or granting special aids (such as tax concessions for investors, increased subsidies) if there is any risk that they may over-compensate the braking effect that has been or will be achieved by limiting the expansion of public expenditure, increasing indirect taxes or introducing new ones, and raising public service charges. In budget policy in particular it is important to follow the Council's guidelines very closely—at least for 1965. It would seem that at the moment all Member Governments are endeavouring to meet these requirements.

In credit policy, too, restrictive lines will have to be maintained generally—except in Italy, as already mentioned—and perhaps reinforced in Belgium, the Netherlands, and even Germany, if the steps taken so far do not slow down credit expansion enough.

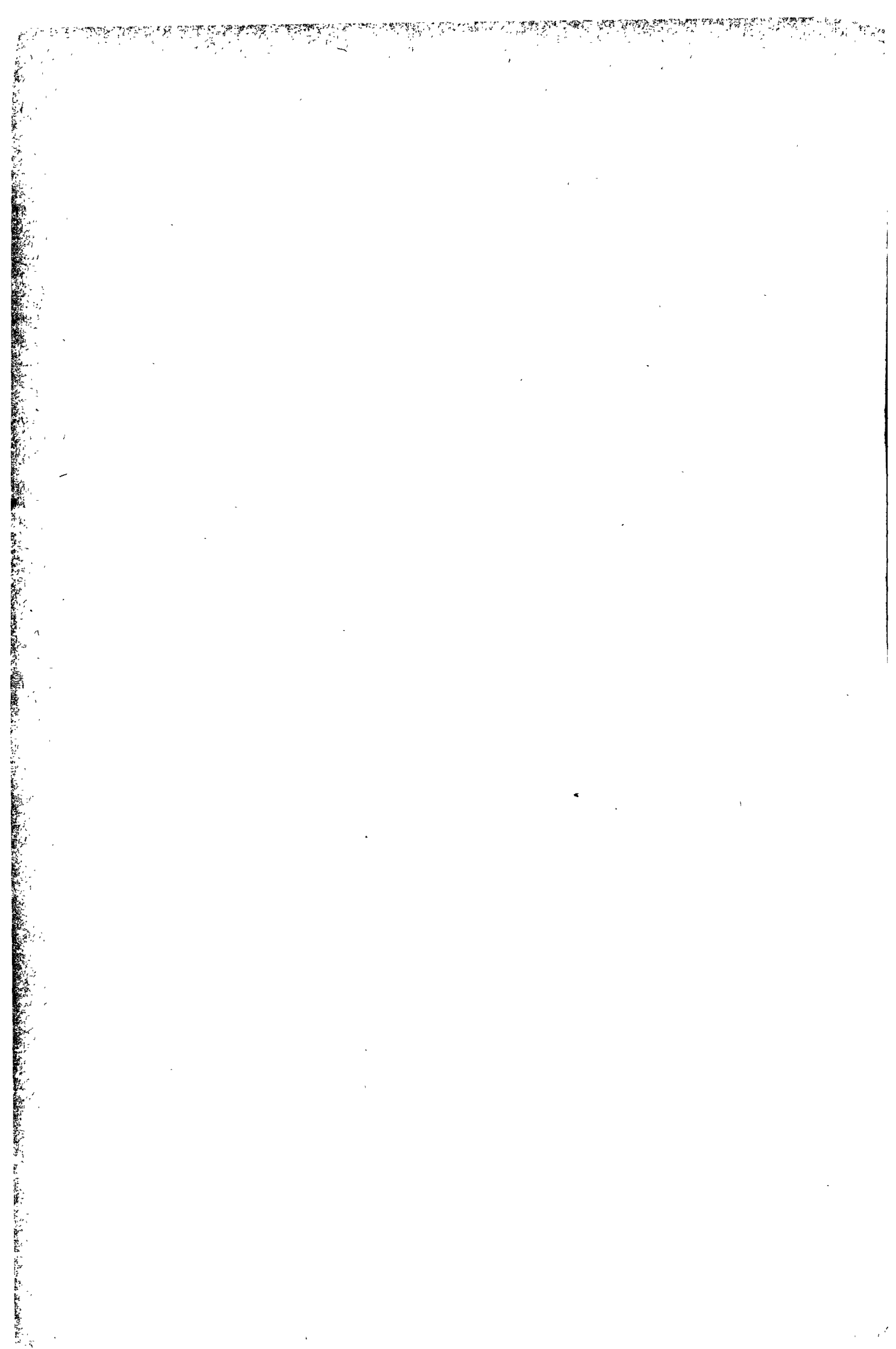
As interest rates in general are tending to move upward, in the non-member countries too, with little likelihood of a change for some time to come, and as a series of special measures to curb excessive inflows of capital have meanwhile been introduced, there is less reason than before to fear that a restrictive credit policy in Europe will immediately set in motion capital movements which would render the policy nugatory.

Only if the measures taken to curb the expansion of internal demand in money terms are maintained and intensified will it be possible to apply a successful incomes policy and so obtain by direct action the stabilization of unit costs—in other words, a proper relationship between expansion of income per head and expansion of output per head. It will still be impossible to pursue a successful incomes policy if, as a result of budget and credit policy being too expansionary or not restrictive enough, the labour market is exposed to a continuation of strains comparable with those experienced in the Netherlands, Germany and Belgium in 1964. On the other hand, workers and management could, if they were prepared to co-operate in achieving the short-term economic aims mentioned above, help to ensure that the overall measures to curb the expansion of demand are less severe than would otherwise be necessary.

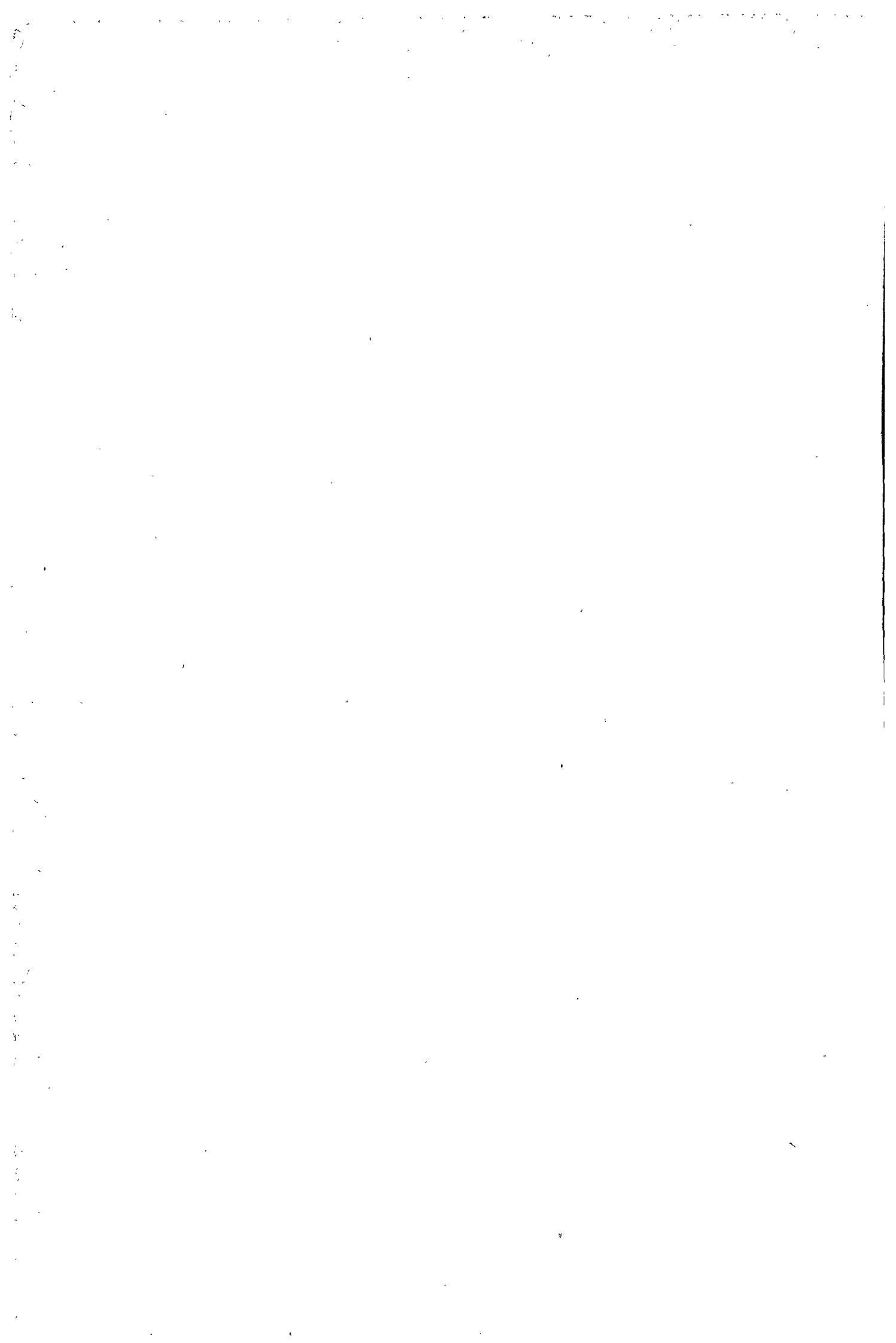
In some countries—particularly Italy and Belgium—consideration might be given to the possibility of recasting existing machinery where it obstructs an incomes policy along the lines recommended by the Council (price index clauses of various kinds).

To sum up, stabilization policy in the Community can be said to have made considerable headway (improved balance in internal trade, no further deterioration in the

balance of trade, some improvement in the price climate), but it has probably not yet reached the target put up by the Council on 14 April, i.e. restoration of stability of prices and costs of production by the end of 1964. This will not be achieved until next year—and even then only if during the year economic policy everywhere is conceived and implemented along the lines of the Council recommendations. The opinion issued by the Short-term Economic Policy Committee when it met on 24 and 25 June to discuss the preliminary economic budgets for 1965 also points to this necessity. This opinion is published in the appendix to the present Survey.



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



A. Federal Republic of Germany

In the second quarter and on into the summer the forces making for economic expansion gained further momentum.

Though exports again expanded vigorously, the pace of growth was somewhat slower. On the other hand the stimulus provided by domestic demand was noticeably stronger, thanks in particular to an appreciable rise in actual expenditure on investment by enterprises. Spending in the public sector maintained its distinct upward movement. With fairly vigorous increases occurring in wages, the expansion of private consumption became somewhat more lively.

Real domestic supply has so far shown considerable elasticity. The growth of industrial production continued; according to the Federal Statistical Office's index of production per working day, it was in the second quarter 7 % higher than a year earlier. There was also a distinct increase in imports. Prices continued to creep upward.

In the external balance the surpluses on current account fell, mainly because of a decline in the surplus on trade. The capital account showed a distinct reversal of trend connected with the measures — taken or foreshadowed — by which the inflow of capital was to be slowed down, and the gold and foreign exchange reserves of the banking system (Bundesbank and other banks) dropped by about DM 300 million in the second quarter, against the increase of DM 2 200 registered in the first quarter.

The economy will continue its advance for the rest of the year, and probably in 1965 too. True, the expansion of exports might lose some of its momentum, but the growth of domestic demand is if anything likely to become even stronger. The investment plans of enterprises, for instance, show a very marked upward trend, and private consumption should rise vigorously as a result of the speed at which incomes can be expected to grow. On the other hand it is not impossible that there may, in 1965 at least, be a slight fall in the expansion of public spending as a result of the measures aimed at stabilization.

Largely because of the severe shortage of labour, the reserves of production capacity are slight, and the growth of domestic supply is likely to slow down. To judge by the trend of production so far, however, a real rise of 6 to 6.5 % in gross national product—higher than was initially supposed—now appears likely for the full year 1964. The expectation that the pace will slacken in the course of the second

half-year and especially in 1965 makes it none the less seem advisable to give a maximum of 5 % as tentative forecast for the possible growth of the national product in 1965.

Despite the appreciable rise to be expected in imports and the fact that the surpluses on external account may only be small, prices may tend to rise more strongly; the expansion of domestic demand in the private investment and consumption sectors could then pose particular problems to those responsible for short-term economic policy.

1. Recent developments

When analysing the economic trend in the first half year it must be remembered that the comparison of year-to-year growth rates gives only a very imperfect picture of current trends, as growth rates in the first quarter had in some cases been greatly pushed up by the effects of the unusually severe 1962/63 winter.

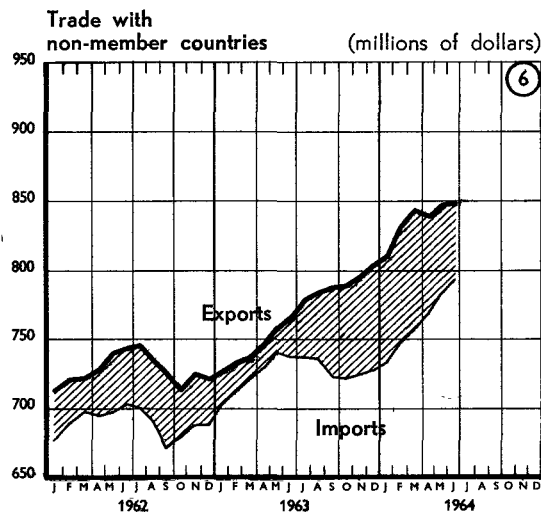
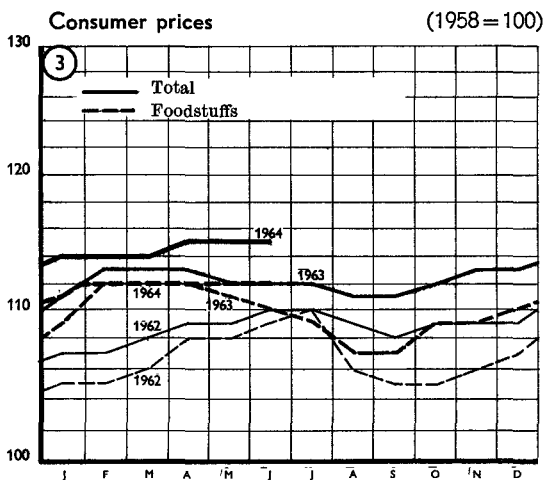
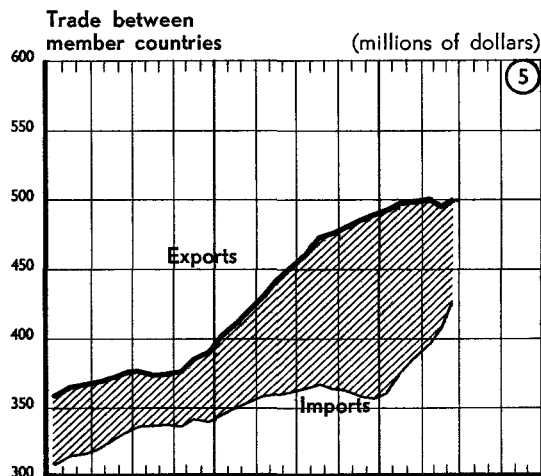
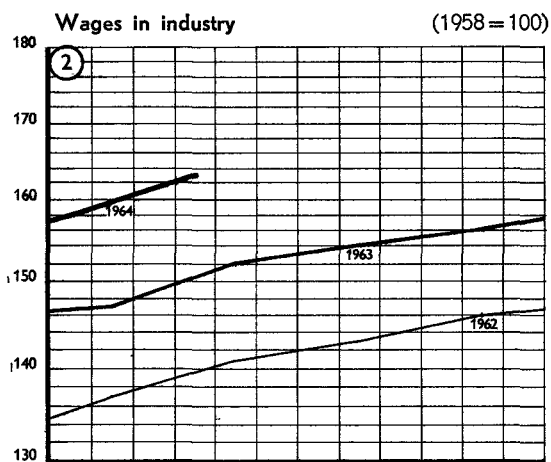
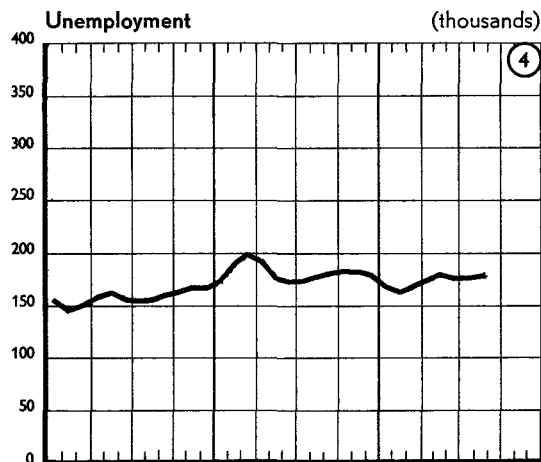
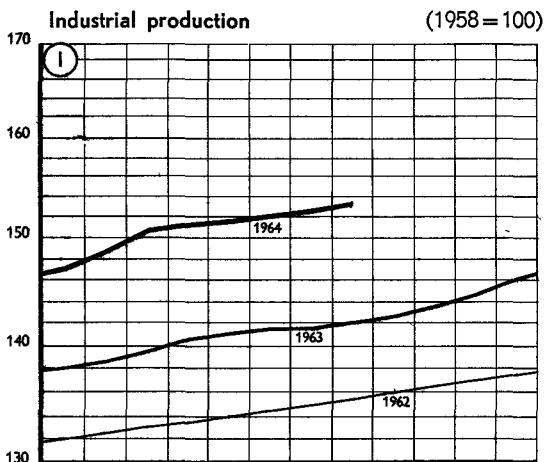
Exports of goods and services in the second quarter again rose considerably, although at a slower pace. Customs returns show that exports of goods in the second quarter were 11.7 % in value and 11 % by volume, and in July/August 4.2 % in value, higher than a year earlier. Growth rates by value had been 15 % in the fourth quarter of 1963 and 20.5 % in the first quarter of 1964. Whereas deliveries to non-member countries increased appreciably, the growth of exports to other EEC members slowed down distinctly; deliveries to Italy even declined sharply, falling to about 8 % below the level reached in the second quarter of 1963.

The expansion of domestic demand became more lively; the strongest contribution was made by gross fixed asset formation. Outlay on building again rose appreciably : in addition to those sectors which have been expanding vigorously for some considerable time (public building, transport, housing), there has for some time now been an appreciable increase in expenditure on industrial building. This clearly mirrors the much stronger propensity to investment of enterprises—a propensity which is, however, reflected even more strongly in increased spending on capital goods.

Stockbuilding by enterprises also helped to strengthen the forces making for increased economic activity. Not only did raw material imports increase much more rapidly than production, but the scale of domestic orders for basic goods also reflects

FEDERAL REPUBLIC OF GERMANY

ECONOMIC INDICATORS



NOTES :

Source : Statistical Office of the European Communities (except as otherwise indicated).

Graph 1 : Estimated trends based on SOEC seasonally adjusted data. Excluding construction, food, beverages and tobacco.

Graph 2 : Index of average hourly gross earnings.

Graph 3 : Cost-of-living index for consumers in medium income groups.

Graph 4 : End-of-month figures, seasonally adjusted by Commission.

Graphs 5 & 6 : Series adjusted by SOEC for seasonal and accidental variations. Exports fob, imports cif. Conversion at official exchange rates.

clearly the efforts being made by enterprises to increase their stocks. Traders, too, have stocked up further.

While the available indicators show that the increase in public consumer expenditure has if anything tended to slow down, private consumption has picked up a little. The turnover of retail traders in the second quarter was however only 5.5 % in value and 3.8 % by volume, and in July/August 4.6 % and 2.2 %, higher than a year earlier, after growth rates of 4.2 % and 1.8 % in the fourth quarter of 1963 and 7.6 % and 6.0 % in the first quarter of 1964. The determining factor in the increase of private consumers' expenditure was the more rapid rise in the incomes of households — with the proportion going to savings if anything slightly up. It is true that agreed wages are still showing no very strong upward trend—in the second quarter they were, on a weekly basis, up only 4.2 % on the same period of the previous year—but actual earnings have risen appreciably faster. After allowance is made for increased employment and higher transfer incomes on the one hand and the progressively heavier incidence of taxation on the other, mass incomes were about 9.7 % higher in the second quarter than in the same period last year, after growth rates of 6.6 % in the fourth quarter of 1963 and 10.3 % in the first quarter of 1964.

The labour market has again become tighter, although the manpower requirements of the building industry showed a distinct decline. Total vacancies at the end of August stood at 680 900, a new record and a good 6.5 times as high as the number of unemployed (102 800).

Although labour, then, has again become scarcer, real domestic supply showed considerable elasticity. In the industrial field this is probably attributable mainly to advances in productivity which have resulted in part from the utilization of spare capacity, in part from rationalization.

Industrial production again expanded strongly. According to the Federal Statistical Office's index of production per working day it was in the second quarter up 7 % on the comparable period of the previous year, and in July 8.6 %, after year-to-year growth rates of 5.3 % in the fourth quarter of 1963 and 11.8 % in the first quarter of 1964.

Agricultural production as a whole also contributed to the expansion of supply, albeit to a lesser extent. Although harvest prospects were adversely affected by the dry weather in July, initial estimates show that grain harvests will be even higher than last year. Crops of certain types of fruit and vegetables, however, will in some cases probably have fallen appreciably short of last year's results. As against this, output of livestock products has risen further.

Although imports by governments were below the level of the previous year, imports of goods and services as a whole again rose appreciably. Imports of goods in the second quarter were up 6.8 % in value and 5.9 % by volume, and in July/August

10.3 % in value, on the corresponding periods of 1963, after having recorded growth rates of 1.8 % in value in the fourth quarter of 1963 and 8.4 % in the first quarter of 1964.

The trend of supply, which was on the whole quite favourable, has so far prevented any further aggravation of the tendency for prices to rise. Nevertheless, prices of agricultural products in August were up 3.1 % on the same period of last year, and industrial producer prices 1.5 %. In some sections of the building industry, in particular, there is a certain tendency for prices to settle down. True, the price index for housebuilding in August was still running 5.4 % above the level of a year earlier, but there has been a distinct drop in prices for roadbuilding, where the backlog of orders has been considerably deflated, mainly as a result of the high level of activity at the beginning of the year. The cost-of-living index continued to rise at about the same pace as before. In August it was 3.1 % above the level of the comparable period for the previous year; some of this rise was due to unfreezing of rents and to higher food prices.

The surpluses on transactions in goods and services with abroad again contracted in the second quarter. The current account, which includes unrequited services, closed with a surplus of just on DM 500 million, against a surplus of DM 1 200 million in the first quarter.

The determining factors in this decline were a fall in the surplus on trade of DM 400 million (down to DM 2 000 million) and an increase of almost DM 300 million in the deficit on unrequited services. In addition, mainly as a result of the measures, already mentioned in the last Quarterly Survey, to damp down the inflow of capital, net exports of capital (including the residual items but excluding changes in the banks' foreign exchange position) are just on DM 800 million, compared with net capital imports of almost DM 1 100 million in the first quarter. Taken overall, therefore, the balance of payments in the second quarter showed a deficit of about DM 300 million. The gold and foreign exchange reserves of the banking system (Bundesbank and other banks) which had risen a further DM 2 200 million in the first quarter, consequently fell (official reserves up DM 120 million; the net foreign exchange position of the commercial banks down DM 420 million). In July the foreign exchange reserves of the banking system declined by a further DM 148 million.

The calls made by the banks on their liquid reserves abroad were primarily due to the tendency towards greater tightness on the money market. Not only did the inflow of liquidity from abroad decline appreciably because of the developments in the balance of payments, but the cash transactions of the central public authorities caused bank liquidity to shrink distinctly. True, the cash position of the Federal budget in the second quarter closed with a slight deficit, but this was appreciably smaller than in the two preceding years, and in addition the Federal Government again made large payments to abroad. Finally, the squeeze on bank liquidity was further increased by raising the minimum reserve requirements: in addition to the increased requirements that were a

direct consequence of growth, the reserve rates for external commitments were on 1 April raised to the statutory maximum. On 1 August the other reserve rates were also increased by 10 % above their previous level.

The rise in bank advances in the second quarter was in fact greater than in the first quarter or in the same period of 1963, industrial circles and even more the public authorities having considerably stepped up their demand for credits.

2. Outlook

The present trends will probably persist till the end of 1964 and become more marked. However, the conditions in which growth can occur freely could deteriorate. The expansion of supply (in real terms) will probably be less able than hitherto to keep pace with the expansion of demand.

True, the pace of expansion of demand from abroad (in terms of actual exports) will probably decline further, particularly because the demand pull from EEC countries will further abate, mainly as a result of their stabilization policies. There should however again be an appreciable rise in exports to non-member countries, and not least to the developing countries. Total exports of goods will therefore probably swell further. Orders received by industry from abroad in the second quarter were a bare 12 % above the level of the same period last year and deliveries in the period were 4 % up; in the fourth quarter of 1963 the corresponding figures had been 23 % and 7 %, and in the first quarter of 1964, 22 % and 9.5 %. In July the flow of orders from abroad eased still further.

The strongest upward push probably comes from spending on gross fixed asset formation. In the building and construction sector, however, there was a noticeable easing of the situation in roadbuilding, the high level of activity in the first half of the year having led, as already mentioned, to a rapid reduction in the backlog of orders. In some cases enterprises, which in recent years have considerably expanded their capacity by greater mechanization, have even been short of orders to keep them busy, as the budget funds for roadbuilding this year are largely spent. However, efforts are going on to provide supplementary finance in advance out of next year's budget. In the remaining branches of building and construction, on the other hand, demand has even become somewhat stronger still. Orders for public building in the second quarter, for instance, were 14 % higher in terms of space enclosed than a year earlier. In terms of volume, building permits for housing were 4.7 % above the corresponding figure for last year. The most vigorous expansion is to be seen in the projects for industrial build-

ing, and permits in this field were up in terms of space enclosed by almost 20 % on the level of the second quarter of 1963.

As capacity comes to be more fully used, enterprises in general seem to have been revising their investment programmes upwards. Whereas the December inquiry on investment made by the IFO Institute suggested that there would be a 5 % growth in investment expenditure by industry between 1963 and 1964, the April inquiry suggests that industry will invest almost 10 % more. Orders received by manufacturers of capital goods point to an even stronger demand for plant and equipment: domestic orders in the second quarter were 17 % above the level of the same period last year and 2 % above deliveries. In mechanical engineering alone the corresponding rises were 23.3 % and 1 %.

Mainly because of the 8 % rise in civil servants' pay, decided on 1 October, and of higher government imports, public consumption will probably grow faster than in the first half year.

The expansion of private consumers' expenditure could perhaps speed up somewhat: the trend of wages will clearly be upward as a result of new collective agreements and probably also because the rise in actual earnings is, if anything, tending to accelerate further. Furthermore, owners of one-man businesses might, in view of the improved profits situation, increase the amounts they withdraw from their undertakings towards the end of the year.

In the light of these expectations concerning the trend of demand and of the practical exhaustion of manpower reserves, it must be expected that shortages on the labour market will persist.

Since in addition technical capacity is already stretched almost to its limits, the growth of industrial production may well slow down somewhat. Advances in productivity will accordingly tend to be smaller.

As against this, the expansion of imports — at any rate of commercial imports—is likely to gain in vigour; in this connection the advance reductions of customs duties on imports from EEC countries, which came into force on 1 July 1964, will certainly provide some stimulus, although the scope and scale of these reductions will be smaller than originally intended by the Federal Government.

Except in the building trades, where a certain quieter trend seems to be emerging after price rises which have always been above the average, the general price climate may nevertheless worsen. This would mean that the price indices would again tend to move upwards rather more strongly.

Supply and utilization of goods and services

	1962 ⁽²⁾	1962 ⁽²⁾	1963 ⁽²⁾	1964 ⁽³⁾
	At current prices (in DM '000 million)	% variation by volume on preceding year		
Gross national product	354.5	+ 4.1	+ 3.2	+ 6.5
Imports ⁽¹⁾	65.3	+ 11.4	+ 8.3	+ 7.5
Private consumption	204.0	+ 5.9	+ 2.8	+ 4.5
Public current expenditure	53.1	+ 12.1	+ 6.7	+ 3.5
Gross fixed asset formation	90.1	+ 5.7	+ 2.1	+ 9.0
Exports ⁽¹⁾	69.0	+ 4.3	+ 9.6	+ 10.5

⁽¹⁾ Goods, services and factor income.

⁽²⁾ Wirtschaft und Statistik, September 1964.

⁽³⁾ Commission forecasts.

Note : The forecasts are approximations based on particular hypotheses generally mentioned in the Quarterly Surveys. They have been discussed with experts from the member countries, but are established and published on the sole responsibility of the Commission.

Because of the relatively high elasticity of supply in the first six months, and in view of the developments expected between the present time and the end of the year, it might be advisable to adjust slightly upwards the forecasts on the real gross national product for the full year 1964; a growth rate of about 6.5 % over 1963 is now considered quite probable.

There can be little doubt today that the upswing of demand will continue at a lively pace in 1965. Although the speed at which exports are expanding may slacken further, the growth still to be expected is quite appreciable. In addition, total domestic demand should rise all the faster; at least in the first half year but probably thereafter as well, it will reflect the further upward movement of investment expenditure by enterprises, accompanied probably by an increasingly strong expansion of private consumers' expenditure resulting from the increasing rate of wage rises.

In these circumstances the severe shortage of manpower will probably persist, and technical capacity will probably suffer more and more from bottlenecks. In any

case the growth elasticity of domestic supply is likely to decline appreciably. At present an increase of about 5 % in real gross national product is considered possible. Although this rate would be lower than that for 1964, it implies only a slight slackening in the pace of expansion in the course of 1965.

Although commercial imports will rise, perhaps even at a speedier rate, it is not impossible that the sharper upward push of prices will continue.

Nevertheless, the outlook for short-term economic policy is today perhaps somewhat more favourable than a few months ago. This is due, among other things, to the changed trend in the balance of payments. For one thing, the surpluses on current account may prove to be smaller than was initially forecast; among the most important reasons for this are the repercussions produced by the movement towards stabilization in Italy and France, which must be considered largely as the fruit of the efforts being made to apply a co-ordinated anti-inflation policy in the Community. In addition the outflow of capital, stemming largely from the announcement that there would be a 25 % capital yields tax on interest from internal securities held by non-residents, has damped down the expansion of internal liquidity. The authorities responsible for credit policy are also reported to have taken certain steps to slow down somewhat the expansion of credit and, finally, the policy of limiting the expansion of public spending—at least by the Federal Government—seems to have had some effect. In connection with the revenue side of public accounts it should also be mentioned that on 1 August the Post Office raised telephone charges; by and large these increases are quite within the framework of the recommendations made by the EEC Council of Ministers on 14 April, the more so as the Post Office was showing deficits (though not, it should be pointed out, in the telephone service). In a full year the extra revenue will be about DM 785 million.

However, the dangers of a too rapid expansion of demand are in no way eliminated, particularly in view of the fact that the Government seems to be standing firm on the policy of making a permanent reduction in income tax from 1 January 1965 and increasing various facilities for writing off capital—despite the Economic Advisory Council to the Federal Ministry of Finance having now also expressed weighty economic policy objections to this. It will therefore be all the more necessary to watch carefully that in all cash expenditure by the public authorities which can affect internal liquidity the 5 % limit recommended by the Council is not exceeded and, if possible, not even reached.

Nor will it be possible simply to assume that the balance of payments will continue to contribute to internal stability as much as it did in the second quarter. In the first place surpluses on current account will still tend to be fairly high. They will need to be combatted mainly by further efforts to step up imports. In this connection agricultural imports should not continue to be a *de facto* exception. As for the balance of capital transactions with abroad, the policy of curbing capital inflows should be pursued, coupled with a more vigorous drive to promote exports of financing capital.

Finally, a continued policy of restraint on credit also seems very desirable. It would perhaps still be advisable to envisage the introduction of quantitative credit expansion ceilings similar to those applied in the Netherlands and France. This could lead the banks to invest surplus liquidity abroad, while they would be unable to use at home any credit taken up abroad. However, it is questionable whether it is possible, without danger of lasting disturbances from outside, to make credit policy so restrictive that the current upswing of investment by enterprises would be curbed sufficiently. The shortage on the labour market and the upward wage thrusts caused by the boom constitute the main short-term economic problem for the near future. The question should really be examined whether after all it could not still be tackled by fiscal measures.

3. The economic situation in West Berlin

In the second quarter economic activity in West Berlin was marked by further expansion. The development of demand—in particular from abroad—justifies the expectation that the upward trends will continue during the remainder of this year.

Exports again rose vigorously; they were up almost 11 % in value on the comparable period of last year (first quarter 1964 : 12 %). Deliveries of goods to the Federal territory also increased considerably (+ 11.3 %), and this was again a rather stronger increase than that of the corresponding purchases (+ 9.4 %).

Investment in building continued to advance. The building production index in the second quarter was 9 % above the corresponding level of last year. Spending on capital equipment, too, seems to have picked up somewhat, and there was a further distinct rise in private consumers' expenditure. Retail trade turnover in the period under review was up about 6 % in value on the level of a year earlier (first quarter : + 9 %).

According to the index of production per working day, industrial production was 3.9 % higher than in the same period of 1963 (first quarter : 5.9 %). In this connection it is striking that the trends in the various branches were the opposite of those observed in the Federal Republic: while the production of consumer goods rose at an annual rate of 8.5 %, output in the capital goods industries only just reached the 1963 volume. This is mainly due to the trend of production in the electrical engineering industry, where output in the second quarter was appreciably lower than a year earlier (— 6.5 %).

The balance of visible trade with the Federal territory further improved, closing with a deficit of DM 105 million, as against DM 129 million in the second quarter of 1963.

The rise in consumer prices speeded up somewhat. In mid-August the cost-of-living index was consequently 3.8 % higher than a year earlier.

The further trend up to the end of the year should be one of continuing expansion. Not only is demand in building and construction still very high, but there is also a distinct increase in the flow of orders being received by industry, their volume in the second quarter being 8.4 % higher than a year earlier (first quarter : + 8 %). Mechanical engineering and chemicals in particular registered a very vigorous rise in orders; largely as a result of some reticence on the part of the public authorities, however, the inflow of orders in electrical engineering was relatively weak; true, it was 6 % higher in the aggregate than in the second quarter of 1963, but this growth was not sufficient to prevent a further fall in the already appreciably reduced backlog of orders.

By and large, then, the general trend of demand is favourable and should ensure a further vigorous growth of production. The elasticity of supply is however limited, particularly because of manpower shortages, and this means that in Berlin, too, it is considered necessary to continue the encouragement being given to immigrant labour.

B. France

In the last few months demand has been expanding at a more moderate pace. One reason for this is that exports have ceased to exert the same powerful influence as in the early part of the year; in addition public expenditure has been rising at an appreciably lower rate than in the preceding months; the increase in private consumption, too, has been slower, chiefly owing to the fact that a larger proportion of the additional disposable income has been saved. On the other hand, expenditure by enterprises on fixed assets may have tended to be if anything rather firmer than before.

This trend in overall demand has meant some reduction in the pace at which supply has been growing. While agricultural production—helped by the weather—has achieved excellent results, the growth rate of industrial production, especially in the consumer goods sector, has tended to fall. Imports too have increased less quickly.

Altogether there has been some easing of the overall imbalance of the French economy. This is reflected both in a slight reduction in the strain on the labour market—although this has not yet had any perceptible damping effect on the upward thrust of wages—and in a further improvement of the price climate. The advance of prices remained modest—owing, of course, in part to the continued effect of measures of direct supervision and control by the Government.

With the deficit on trade almost as high as before, the balance of payments is likely to show only a relatively modest surplus in spite of further considerable net imports of capital. The more rapid rise in the gold and currency reserves by \$260 million during the second quarter was partly due to a worsening of the net foreign exchange position of the commercial banks. For the rest of 1964 and in the early months of 1965, a moderate expansion of economic activity is to be expected.

Exports should develop comparatively favourably, and this should contribute more than anything else to the further growth of overall demand. In addition expenditure on fixed assets can be expected to increase at least as much as before, perhaps even somewhat more. On the other hand, the rise in public expenditure on consumption could be relatively slight. The rise in private consumers' expenditure should also be modest if in the coming months it proves possible to check the still excessive rise in wages.

Given this pattern of demand, it is fairly certain that there will be a further rise in domestic production of goods and services, although this will probably be slow.

On these assumptions, there is no reason to modify the earlier estimate that the real gross national product in 1964 would be about 5 % higher than in 1963. For 1965 the repercussions of the deceleration will of course have to be taken into account, but even so an increase of about 4 % in the national product is at present thought to be perfectly possible for the coming year.

By and large the forces now shaping the economic situation appear more clearly than before to be working towards a restoration of equilibrium—towards greater price stability and, since the demand for imports is also slackening, towards an improvement of the external balance. Of course these tendencies are still very weak; further consolidation is essential if permanent stability is to be achieved and safeguarded without direct state interference with the price mechanism. For the present, therefore, it is vital that the stabilization plan should be continued, particularly by limiting the growth of demand, and that measures of expansion which might interfere with stabilization should be avoided.

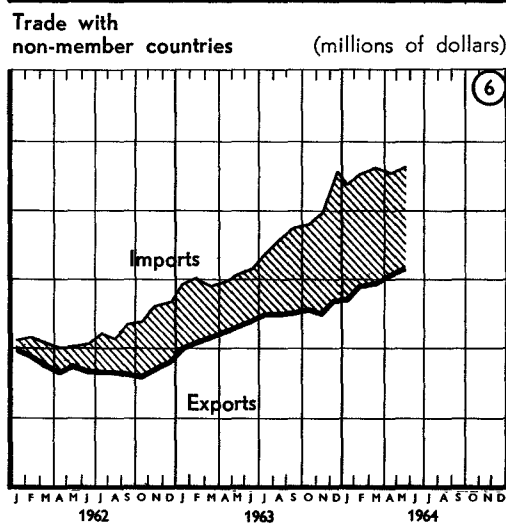
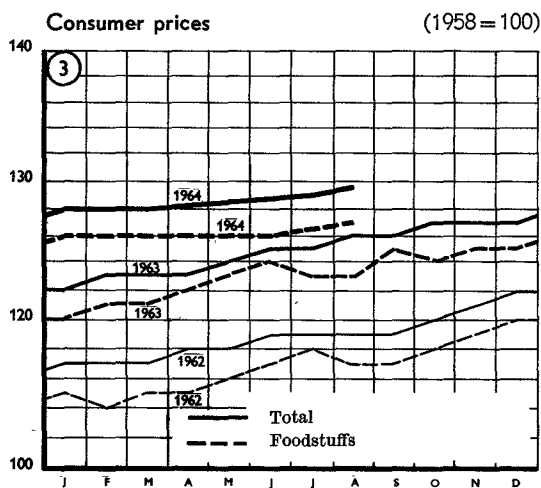
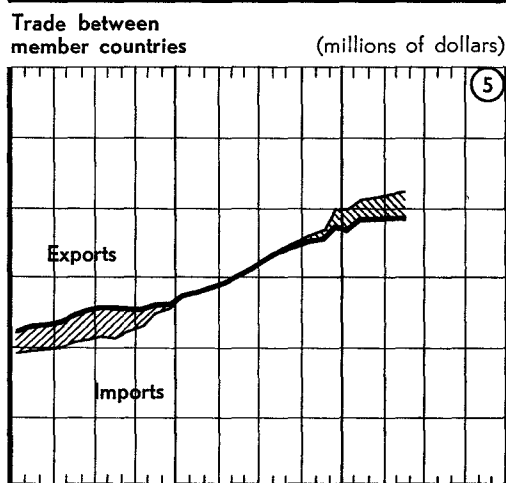
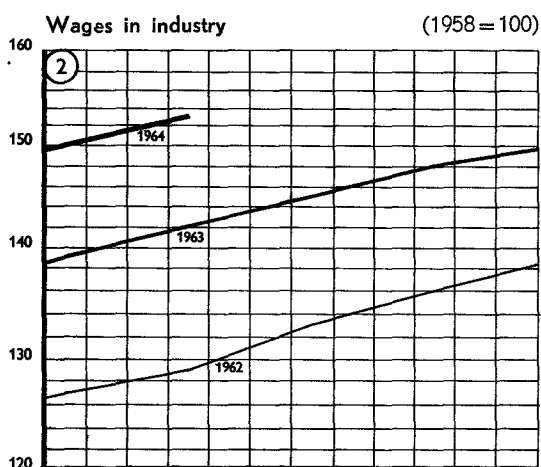
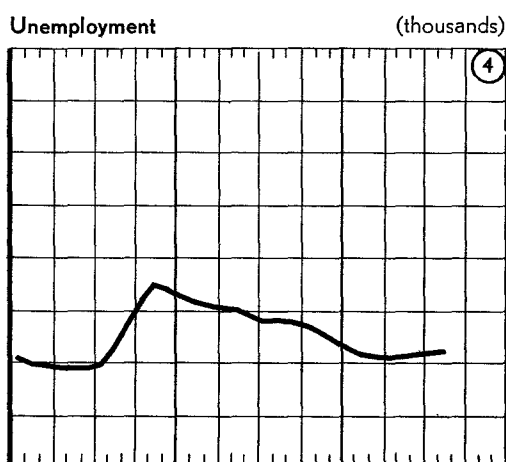
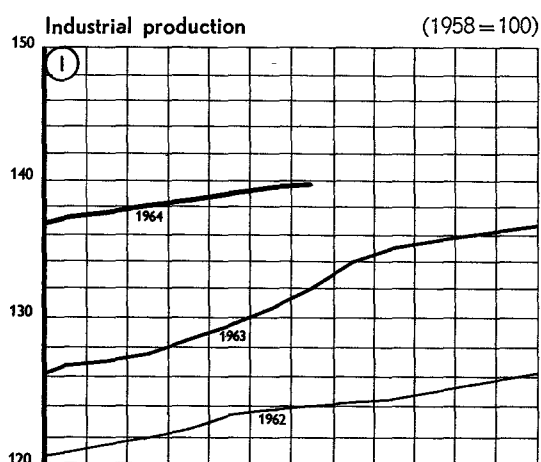
1. Recent developments

The reduction in the speed at which overall demand had been expanding has made further progress since the spring.

For one thing, the rise in exports of goods and services has slowed down very distinctly. Customs returns show that the value of goods exported in the second quarter exceeded that of the corresponding period of 1963 by only 8 %, and in July by about 6 %. Not only did deliveries to the franc area show no advance on the level of recent months, but there was even a marked decline in exports to Italy. In contrast to this, exports to the remaining EEC countries, especially the Federal Republic of Germany and the Netherlands, and to the other industrial countries of the West continued to increase at the same decidedly rapid rate as before.

In addition, certain downward tendencies in domestic demand, already becoming apparent during the first quarter, came out more distinctly. The rate at which gross fixed asset formation has been expanding does not however seem to have altered perceptibly. If perhaps the rise in investment expenditure by the State and by public enterprises has again been slowed somewhat, this has doubtless been offset by a rather firmer trend in private investment. It appears that in particular the big industrial

ECONOMIC INDICATORS



NOTES :

Source : Statistical Office of the European Communities (except as otherwise indicated).

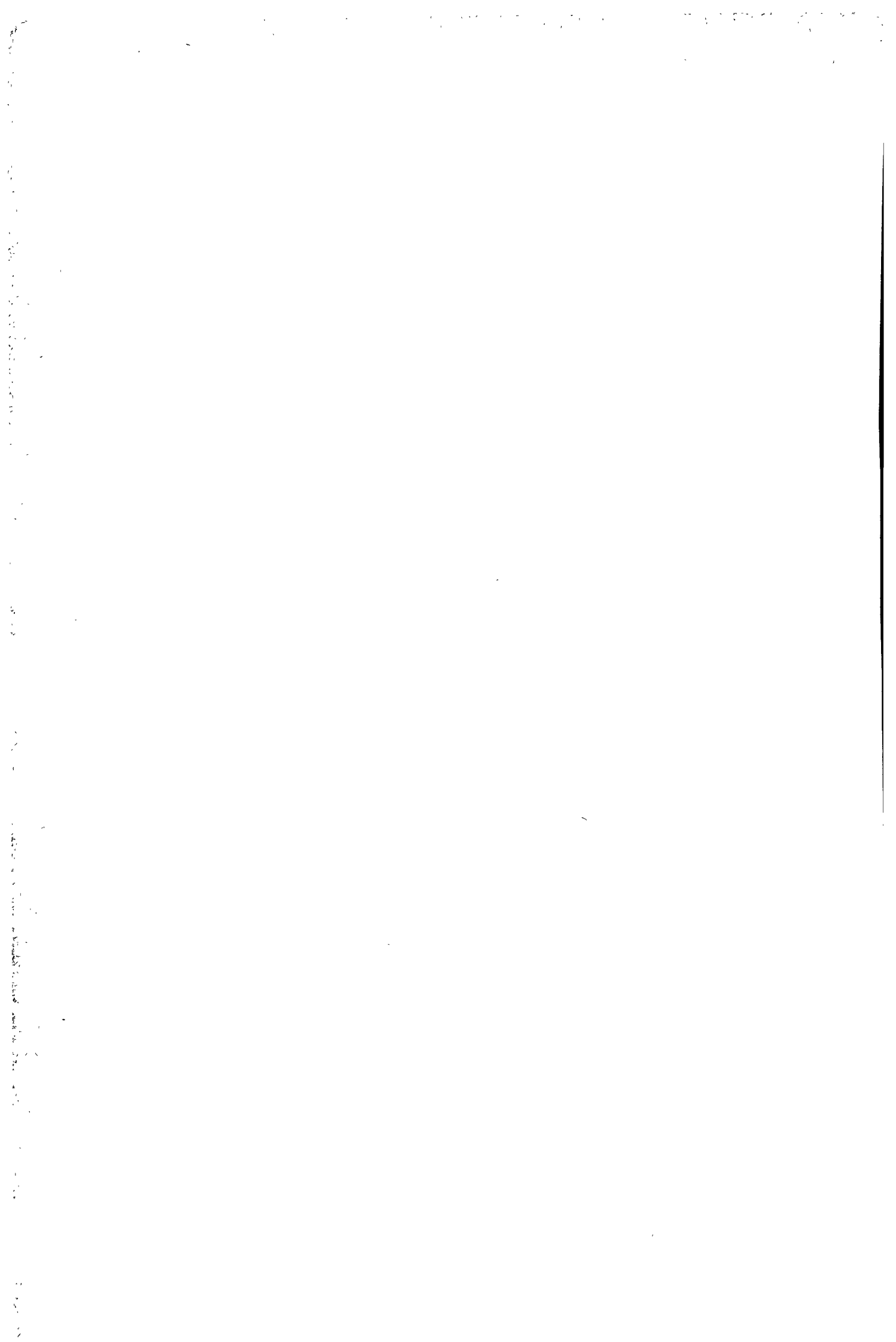
Graph 1 : Estimated trends based on SOEC seasonally adjusted data. Excluding construction, food, beverages and tobacco.

Graph 2 : Index of hourly industrial wage rates, excluding mining and quarrying.

Graph 3 : Index of prices of 259 items.

Graph 4 : Number of persons seeking employment; end-of-month figures seasonally adjusted by Commission; including repatriates from Algeria from August 1962 onwards.

Graphs 5 & 6 : Series adjusted by SOEC for seasonal and accidental variations. Trade with non-member countries includes trade with rest of franc area. Exports fob, imports cif. Conversion at official exchange rates.



concerns producing basic materials have, in view of the favourable economic situation in this field, begun to revise their investment programmes upward; as this sector of industry is of such size and importance, the change will have a considerable effect on the overall figure for fixed asset formation by enterprises. In agriculture and the services sector there seems also to have been a great increase in investment expenditure. In housing, too, the upward trend remained steep; in the second quarter the number of both starts and completions was much higher than a year earlier.

Stockbuilding of trade and industry has probably not risen very much—although stocks of finished goods, especially of consumer goods, have continued to accumulate. In agriculture, on the other hand, investment in stocks appears to have increased vigorously in the last three months.

The growth of consumer expenditure seems to have fallen off somewhat since the spring. Public expenditure may have been growing more slowly than in the preceding months, and private consumers' expenditure has probably also increased less. In any case retail sales—as far as they are covered at all by statistics—have not risen much more than is usual for the time of year. The Paris department stores managed to increase the value of their sales in the second quarter by only a bare 4 % over the comparable figure for 1963; in July the year-to-year growth rate even fell to 0.4 %. However, it is possible that consumer expenditure which by-passes the retail trade, especially expenditure on travel for instance, has risen disproportionately this year owing to the general introduction of a fourth week of holidays with pay.

The slower rate of growth of private consumers' expenditure is mainly attributable to a greater propensity to save. Household incomes have once again registered very considerable gains. The growth of income from entrepreneurship may indeed have been rather less than before, but it would seem that wage earners' incomes have continued to rise as fast as ever. In the second quarter hourly wage rates in private industry certainly continued to move up at the same speed as in the first quarter (1.9 %). As there was also a further rise in salaries in the public sector on 1 April—civil servants, for instance, were given a 2 % increase—and as certain social insurance benefits have also been increased, mass incomes have (when allowance is made for the continued rise in the number of persons employed) apparently continued during the last few months to be a good 10 % higher than they had been a year earlier.

With the gradual reduction in the speed at which demand had been expanding the slackening in the growth of supply has become more noticeable—except in the case of agricultural products.

The trend of agricultural production as a whole has been very satisfactory. The cereal and wine harvests especially benefited from the warm dry weather and should be much better than last year. Livestock production has also, generally speaking, exceeded the 1963 level—with the exception of meat supplies.

Since the spring, the growth rate of industrial production has evidently been somewhat slower. The seasonally adjusted INSEE index showed an increase of barely 1 % in the second quarter of the year compared with the first—after an increase of 2.2 % in the first quarter of 1964 compared with the last quarter of 1963. In April/June the year-to-year growth rate fell to 6.6 %. The slowdown was confined almost entirely to the production of consumer goods : textile production has been stagnant and the output of passenger cars has actually declined in the last few months. In the other branches of industry expansionary trends generally remained dominant.

Building output was again able to advance very appreciably, chiefly owing to a continuation of the vigorous demand for housing : according to the INSEE index, output in the second quarter exceeded that in the corresponding period of the previous year by 8.6 %.

The growth of domestic production has been made possible by a further considerable rise in employment. In the second quarter the numbers in paid employment have even risen slightly faster than in the preceding months, while the average length of the working week in industry remained at the same high level. Since the spring there have been more distinct signs of a slight easing of the labour market; here the immigration of foreign workers, which has shown a further significant rise, must have contributed in no small measure.

Like domestic production, imports of goods and services have shown some slackening in the pace of expansion. The volume of goods imported in the second quarter—calculated from customs returns—was only about 15.5 % higher than in the corresponding period of the preceding year, and in July only about 6 %. Imports of raw materials and energy products appear to have increased more slowly, whereas imports of finished goods continued to rise fairly steeply. The rise in agricultural imports seems even to have become steeper because, in the case of some products such as meat, the inability of domestic production to meet demand led for a time to greater dependence on foreign sources of supply.

The tendency for prices to climb further has persisted in the last few months, but the increases recorded by the various indices have been very moderate. The Government's price policy has doubtless contributed to this result, in particular its decision to maintain in principle the stop on producer prices for industrial goods and its decision not to put up the prices paid to farmers for important agricultural products; the general price climate, too, now seems to have improved. The fact that abundant supplies are available at this time of year, especially of fruit and vegetables, has made a far from negligible contribution to the relative stability of food prices. Altogether the index of consumer prices (covering 259 articles) went up by 0.7 % between March and July. In July it was only 2.9 % higher than a year earlier.

As the slackening in the rise of imports in the second quarter coincided with some slowing down in the growth of exports, the trade deficit continued to run, after seasonal adjustment, at much the same level as in the first quarter, i.e. at about \$1 100 million for the year. The balance of current payments would again seem to have closed with a deficit. Despite further considerable net inflows of capital and a probable increase in the foreign exchange surplus of the other countries of the franc area, the overall balance of payments seems to have shown a relatively modest surplus. The very considerable increase in the official reserves of gold and foreign exchange—\$260 million in the second quarter compared with only \$20 million in the first—can be explained in large measure by a deterioration in the net foreign exchange position of the commercial banks.

In the second quarter the availability of money does not appear to have risen very much above the level usual for the time of year. The tendency for the net inflow of foreign exchange to increase liquidity was largely neutralized by the financial actions of the public authorities: the cash transactions of the Treasury closed, in fact, with a surplus, and as a government loan of FF 1 500 million was issued in May, the Treasury was able to scale down its indebtedness vis-à-vis the banks. The advances made to business by the banks were kept within the prescribed limits in the second quarter; the increase amounted to only FF 1 000 million compared with over FF 4 000 million in the same period of the preceding year. Private industry made relatively little call on the capital market, which remained largely reserved for public authorities and public enterprises.

2. Outlook

As the main trends in the business situation have not altered substantially during the summer recess or at the beginning of autumn, the outlook as described in the last Quarterly Survey (2/1964) remains essentially unchanged: there should be a further, but moderate, expansion of demand, production and employment in the remaining months of 1964.

In particular it can still be expected that the trend of demand from abroad will be relatively favourable. Although certain sales difficulties may be encountered in individual markets (Italy) or for particular goods (cars), these should on the whole be outweighed by the opportunities to expand exports that are provided by a world economic situation which remains healthy and by the increased ability of domestic industry and agriculture to supply the goods required; a further advantage is that French export prices have recently been nearly stable and some have perhaps even fallen slightly.

The prospects for the development of domestic demand depend on factors which are rather less certain, mainly because—as was pointed out in the last Quarterly Survey—the investment intentions of the private entrepreneur are hard to predict. However, owing to the slight increase in new orders in important capital goods industries, expenditure on capital goods will probably tend to rise rather more strongly in the coming months. In any event expenditure on building should continue to rise; the demand for housing, in particular, is still as keen as ever. Building permits issued in the first year exceed the already very high level for the same period of 1963 by no less than 15 %.

Owing to the growth of incomes, the necessary conditions would seem to exist for a further rise in private consumers' expenditure. Lately, it is true, the strains on the labour market have—at least if the market is looked at as a whole—eased somewhat, but this has hardly made any significant change in the pressure on wages. New wage claims have been put in by the trade unions, especially in the public sector where the need to “catch up” with private industry is stressed, although the basic salaries of civil servants and other employees in the public services was raised by a further 2 % on 1 October. Recent price increases also brought—on 1 October—an improvement in the guaranteed minimum wage (SMIG) of 2.5 %.

As in all probability there should be a moderate increase in overall demand, the growth of industrial production should continue, although it may perhaps be even slower than before: the last EEC business survey before the summer recess showed that industrialists have become rather more guarded in their expectations concerning production. Incoming orders and those already in hand were judged less optimistically than in the spring.

Imports might also grow less rapidly; given the export prospects, described above, there may therefore be a slight improvement in the balance of trade during the coming months.

The price situation should also remain relatively calm, especially as a relaxation of the regulations governing industrial producer prices can hardly be expected yet, or for the moment any significant increase in the prices paid to farmers. There is also little likelihood of any further rise in the charges for particular public services before the end of the year.

This outlook for the economy up to the end of 1964 does not call for any substantial revision of the forecasts for the full year 1964 as a whole given in the last Quarterly Survey (2/1964). The real gross national product should be, as forecast, 5 % higher than in 1963—probably even slightly more, since harvests have been better than average and the output of the building industry has proved more elastic than was at first expected.

As to the probable developments in 1965, too, most of the forecasts made in the last Quarterly Survey are still valid.

Supply and utilization of goods and services

	1962 ⁽²⁾	1962 ⁽²⁾	1963 ⁽²⁾	1964 ⁽²⁾
	At current prices (in FF '000 million)	% variation by volume on preceding year		
Gross national product	356.3	+ 6.6	+ 4.4	+ 5
Imports ⁽¹⁾	48.6	+ 9.2	+ 12.0	+ 12
Private consumption	230.1	+ 7.0	+ 6.3	+ 5
Public current expenditure	47.9	+ 4.3	+ 1.9	+ 2
Gross fixed asset formation	70.0	+ 7.5	+ 5.9	+ 6
Exports ⁽¹⁾	51.1	+ 2.5	+ 7.6	+ 9

⁽¹⁾ Goods, services and factor income.

⁽²⁾ Rapport sur les Comptes de la Nation de l'année 1963; SEEF, Paris.

⁽³⁾ Commission forecasts.

Note : The forecasts are approximations based on particular hypotheses, generally mentioned in the Quarterly Surveys. They have been discussed with experts from the member countries, but are established and published on the sole responsibility of the Commission.

The growth of demand should continue. Investment activity might again come more to the fore as an influential force—together with exports, which will continue their relatively favourable trend within a world economy in expansion. The draft budget for 1965 provides not only for a substantial rise in public expenditure on investment but also for certain measures to stimulate the capital market and, thereby, the financing of private investment. On the other hand the rise in both public and private expenditure on consumption should prove comparatively slight—provided that wage increases can really be kept within reasonable bounds during 1965.

On the whole the outlook for demand makes a further rise in domestic production in 1965 seem probable, even if this is unlikely to be very rapid. Bearing in mind that there will be probably only a slow rise in imports and consequently, a tendency for the deficit on current account (in terms of national accounting) to contract, there appears to be every chance, given normal weather, that real gross national product will be some 4 % higher than in 1964.

All things considered, present trends could in fact now make a more definite contribution to better economic balance. These trends still need, however, to be encouraged

and supported by those responsible for short-term economic policy, as it will not otherwise be possible to achieve and to maintain stable prices and stable production costs. It is therefore still necessary, when formulating economic policy, to adhere strictly to the recommendations put forward by the EEC Council on 14 April of this year.

This applies in particular to the public authorities' budgetary plans for 1965. In the case of the national budget, the Government appears in fact to have given very full consideration to the requirements of stabilization policy in the Finance Act for 1965, which was put before the Assemblée Nationale at the end of September. For the first time since the end of the 'twenties a budget has been drawn up showing a perfect balance between total expenditure and total income—the budget for 1964 provided for a deficit of about FF. 4 700 million. This balanced budget for 1965 has been made possible not by transferring certain expenses from the budget to public financing institutions—an expedient which in 1964 enabled the estimated deficit to be greatly reduced— but, to a decisive extent, by limiting the growth of expenditure. The rate of increase of total expenditure, which is estimated at 8.7 % for 1964, has been limited to a bare 6.9 %. At the same time the pattern of expenditure has been improved by placing the strictest limits on increases in ordinary civil and military expenditure, while allowing capital expenditure to rise at about the same pace as before.

Even if, with this budget, total expenditure by the State continues to rise more quickly than the expected real gross national product (4 %) and also exceeds the rate of 5 % recommended by the EEC Council of Ministers, there will be on the other side a very substantial rise in income, estimated altogether at 12.6 %. Part of this additional income will of course again be occasioned by price increases, but it appears that a considerable proportion of the additional income will not be the result of inflation.

As the precise details are still largely unknown, it is at present too early to appraise conclusively, or even assess in terms of figures, the effects which the proposed budget will have on economic development in 1965. It is also too early to see whether the other public authorities as well can be induced to accept a pattern of expenditure as moderate as that adopted by the State. The Government has sent the authorities concerned an appeal to this effect.

Moreover certain important decisions, which could have a considerable effect one way or the other on the overall development of the public finances, have been put off. These concern, for one thing, the problem of financing investment in public enterprises, which is closely connected with the question of possible increases in charges for public services. In addition the problem of how to cover the much increased social insurance deficit—and therefore of a possible increase in contributions—is still not solved. In the interests of the Government's stabilization policy and also of a reasonable long-term growth rate the solutions chosen should as far as possible avoid imposing additional burdens on either the national budget or business.

Finally, it is not yet certain how far the practical application of an incomes policy will contribute towards stabilization in 1965. An incomes policy which restricts the growth of incomes by direct action appears especially important. The dismantling of the measures of direct price supervision and controls must come sooner or later as the harm done to the market price mechanism may otherwise lead to serious distortions, and also because the most useful criterion for determining the degree of stability or instability would otherwise remain out of action.

C. Italy

In the second quarter and in the summer months that followed there appears to have been once again a distinct loss of momentum in the Italian economy. Domestic demand even betrayed signs of incipient stagnation.

Partly for this reason, but also because of expanding world business, visible exports rose further and even more rapidly. Exports of services, however, gained less ground, mainly because the growth of foreign travel in Italy was rather unfavourable.

Total expenditure on gross fixed asset formation, despite probable further growth of investment in building and construction from the first to the second quarter, probably suffered an actual decline. At the same time the expansion of private consumers' expenditure again lost momentum, one reason being that the total number of hours worked declined slightly; this slowed the development of actual earnings, although agreed wages including cost-of-living allowances were still rising vigorously.

Whilst agricultural production—particularly crops—again improved, the adjusted trend in industrial production sloped definitely downwards. In the second quarter output reached only about the same level as a year earlier (the year-to-year increase for the first quarter had been 7.6 %). The levelling out of demand had an even more marked impact on imports. The year-to-year growth rate for visible imports (value) slumped, in the second quarter, to about 1 %, compared with 22.6 % in the first quarter, and by July imports were running as much as 18 % below the figure of a year previously.

In general, prices went on rising. The weakness of investment demand and the slight tendency for the prices of auxiliary materials used in industry to decline meant, it is true, somewhat lower wholesale prices, but consumer prices again rose quite appreciably. The July wholesale and consumer price indices were 3.4 % and 6.8 % up on the corresponding 1963 figures. For March the corresponding figures had been 4.2 % and 5.2 %. The year-to-year disparity in the cost-of-living index was as much as 7.5 % (5.9 % in March).

The balance of payments developed very favourably in the second quarter and in July (apparently also in August); over this period it yielded a surplus for the first time since 1962 (second quarter, \$227 million; July, \$151 million). In the first place the deficit on trade shrank appreciably, and in addition there was an appreciable surplus on capital transactions with abroad. Official gold and foreign

currency reserves increased by \$79 million from March to July to a total of \$2 903 million; that this increase was relatively small is accounted for mainly by the fact that the banks continued to make rapid cuts in their short-term indebtedness abroad.

The weakness of economic activity in the first two quarters, particularly the second, is likely to persist in the second half of 1964; towards the end of the year building investment might, however, rally. Mainly because of the good harvests forecast, the growth of the real gross national product in 1964 should however still reach 3 %. In view of the latest developments, a distinct improvement in the balance of payments is likely. On the other hand, the appreciable upward pressure on prices and costs could well continue, although it is likely to slow down.

Failing appropriate measures, the danger would arise that economic development in 1965, too, might suffer for a while from the concurrent effects of persistent inflationary tendencies in the field of unit costs and prices, coupled with deflationary pressure on investment—which would lead to steadily increasing pressure on consumption as well. There would be small hope of real economic growth in these circumstances. In fact, the new Government is now applying new and important measures to counter these hazards, which must be regarded as the consequence of an unduly rapid and inflationary expansion process which might have been stemmed by the prompt mobilization of all appropriate weapons. In the light of the latest developments, the measures adopted would seem for the most part in line with the need to further price stabilization and combat recessive trends.

If general measures to get business on the move again, taken too early, are avoided there are good reasons to believe that the Italian economy will recover its internal and consolidate its external equilibrium, and thus be able to embark on a new period of balanced expansion.

1. Recent developments

Exports of goods and services on the whole expanded vigorously in the second quarter of 1964, and evidently at a still faster pace than hitherto. Customs returns show that visible exports were 18.7 % up in value for the period, and 27 % up in July, on the corresponding 1963 figures (the year-to-year increase for the first quarter

had been 12.1 %). Volume growth may well have been even a little greater : prices of exported products, rising slightly towards the end of 1963, tended thereafter, if anything, to ease, although unit costs probably continued to increase.

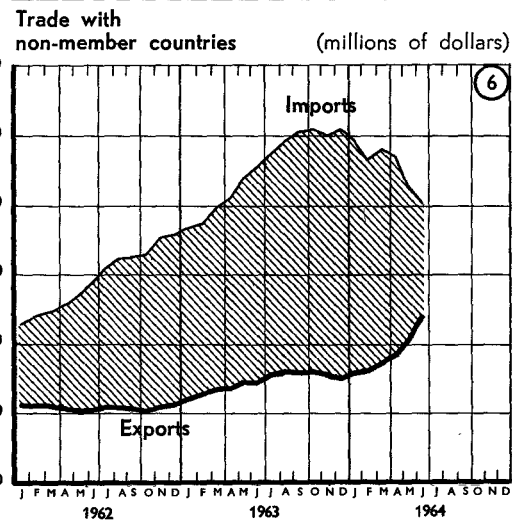
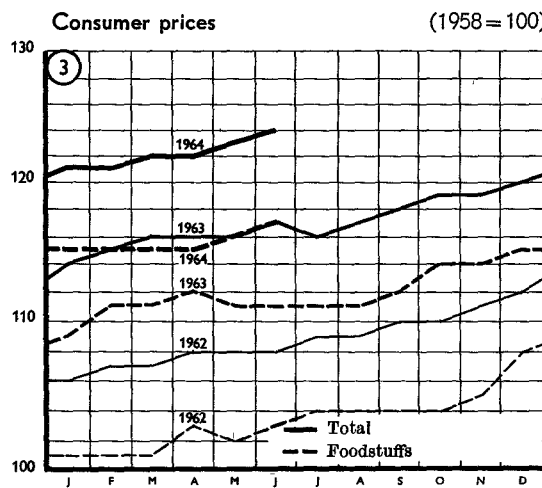
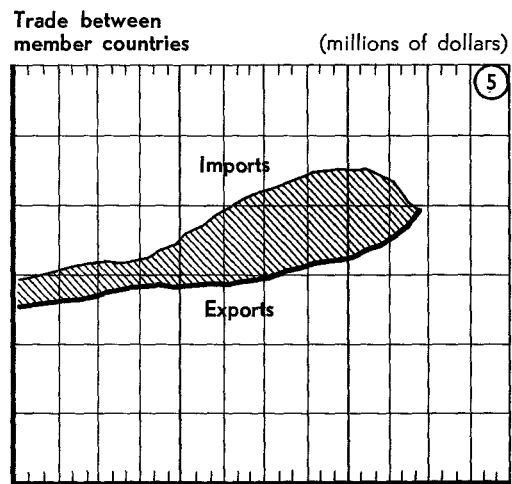
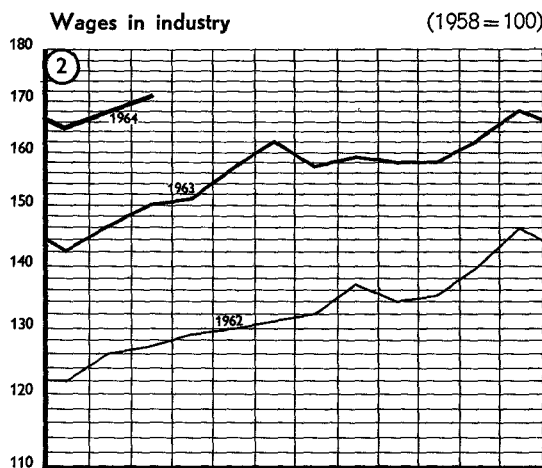
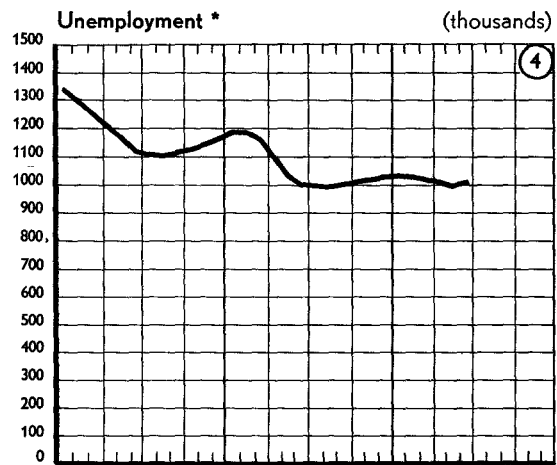
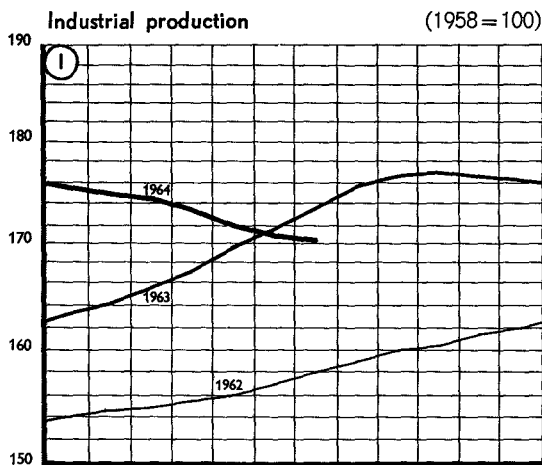
Exports of products for which home demand declined substantially, such as iron and steel products, motor-cars, and machinery and equipment, expanded particularly sharply. By contrast, the trend in exports of agricultural products and foodstuffs was again rather weak. Deliveries to the other member countries, notably the Netherlands and the Federal Republic of Germany, and to the developing countries made great strides.

On the other hand, exports of services seem to have risen only slightly, largely because the growth of foreign tourism in Italy has once again been poor.

All the indicators available suggest a further loss of pace in domestic demand. Total expenditure on fixed asset formation probably actually declined. However, investment in building and construction may well have expanded further in the second quarter—completed housing at all events, showed a 13 % improvement over the corresponding 1963 figure (dwelling-rooms) and industrial and commercial building made a gain of as much as 56 % (cubic metres). Expenditure on public works was also higher than a year previously—in April/May the year-to-year increase was 22.6 %, compared with 18 % for the first quarter. The employment returns and other sources of information show, however, that activity in the building sector was almost certainly expanding far less rapidly than these growth rates might suggest; moreover the year-to-year rates are inflated because of the unusually low figures recorded in the same period of the previous year and also because of certain fortuitous factors. Nor is a notable improvement in the seasonally adjusted figures for output of cement per working day, at least until May, any reason for modifying this cautious assessment : according to the results of the EEC business surveys, part at least of this output merely led to an involuntary build-up of stocks : domestic sales of building materials showed a distinct decline. Both the production trends and external trade trends in vehicles, machinery and equipment suggest that capital goods investment suffered an appreciable setback. The figures for new vans and lorries registered, for example, were in the second quarter 25.4 % and in July as much as 48 % below the corresponding 1963 figures (in the first quarter the decline had been 18.9 %).

As for investment in stocks, trends in respect of raw materials on the one hand and industrial finished products on the other differed markedly. While the decline in overall demand and the weaker cash position of industrial enterprises led them in the second quarter to run down their stocks of raw materials (which in many cases had been built up partly for speculative reasons), stocks of finished products in industry grew appreciably, since sales lagged behind output : imports of raw materials, which had still been growing

ECONOMIC INDICATORS



NOTES :

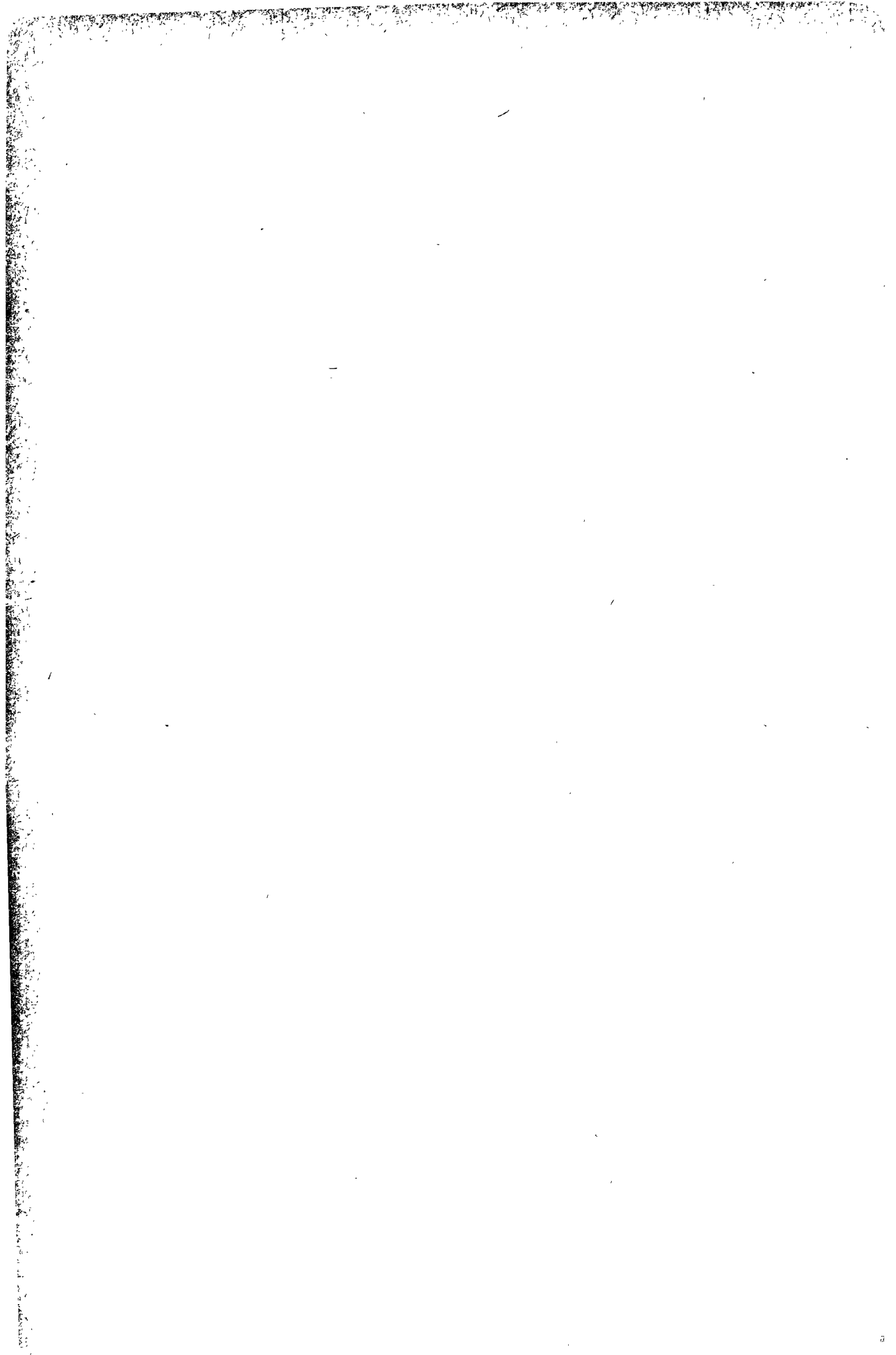
Source : Statistical Office of the European Communities (except as otherwise indicated).

Graph 1 : Estimated trends based on SOEC seasonally adjusted data. Excluding construction, food, beverages and tobacco.

Graph 2 : Index of minimum wage rates (Source : Italian Central Statistical Office).

* Graph 4 : Registered as unemployed at end of month. The effective number of unemployed is certainly lower. Data seasonally adjusted by Commission.

Graphs 5 & 6 : Series adjusted by SOEC for seasonal and accidental variations. Exports fob, imports cif. Conversion at official exchange rates.



at an increasing rate in the first quarter, seem to have faltered in the second, and up till June the replies to EEC business surveys pointed to a general and appreciable increase in stocks of finished industrial products. Stocks of agricultural produce, too, doubtless rose sharply, since crops were much better than in 1963. It is not, however, certain that total investment in stocks really grew much, since there are some signs that the stocks held by retailers were being reduced.

The trend of private consumers' expenditure seems to have been rather hesitant in the second quarter. The seasonally adjusted production figures for industrial consumer goods, at any rate, showed an actual decline in this period. At the same time, net exports of these goods made distinct gains. One reason for this development is the fact that of late the propensity to save seems to be rising: given the progressive relaxation of strain on the labour market and the restrictive measures adopted at the end of February (higher petrol tax and a special tax on passenger cars), there is no mistaking a certain diffidence among customers, at least where the purchase of durable goods is concerned. For example, the number of new passenger cars registered was 16 % down in the second quarter and 24 % down in July on the corresponding 1963 figures (in the first quarter there had been a 20 % increase). A second reason was that mass incomes were probably by then growing relatively slowly. It is true that agreed minimum wages and salaries (including family allowances) again rose appreciably because of a further 2-point increase on 1 May in the cost-of-living allowances paid in agriculture, industry and trade on the basis of the sliding scale, and as a result of the conclusion of new collective agreements in important industries, notably in food and textiles. In most sectors of the economy (industry, agriculture, trade, transport and the public sector) agreed minimum wages and salaries were in the second quarter of 1964 running at 11 % above the average 1963 figure. However, the total number of hours worked by paid workers was almost certainly less than in the preceding months.

According to ISTAT sample surveys, the number of persons in paid employment, which had for the last few years been steadily growing, was in April 1.3 % down on the May 1963 figure, and was running at much the same level as in January 1964. The same source indicates that the number of unemployed was 13.5 % up on the figure for May 1963; in July the year-to-year difference seems to have expanded still more vigorously. Although in interpreting these comparisons it must not be forgotten that economic activity is normally slacker in April than in May, and that the level of employment had been exceptionally high in January 1964 because of the warmer winter, there is no doubt that there was again a tendency for conditions to ease on the labour market; the further cuts in the working week decided on in important industries, notably metalworking and construction, also point in the same direction.

On the supply side, agricultural production made noteworthy headway, notably—once again—in the field of livestock production.

On the other hand, there appears to have been a fairly distinct decline in the adjusted trend of industrial production; by the second quarter it was only just as high as in the same period of 1963, whereas in the first quarter it had been 7.6 % up on the corresponding 1963 figure. According to provisional information the July figure, too, will probably be disappointing. The ISTAT index, corrected for seasonal variations by ISCO, declined by about 2 % for each of the three months April, May and June, whereas in the first quarter it had on average maintained the level of the preceding quarter. While the output of intermediate products tended to increase, the production of consumer goods and, above all, of capital goods declined.

The trend in imports of goods and services was even less impressive. According to customs returns, visible imports were in the second quarter only 1.1 % in value higher than a year earlier (the increase for the first quarter had been 22.6 %), and in terms of volume they will probably have been distinctly lower. The elimination of seasonal variations shows that between the first and second quarters of 1964 there was even a sharp fall. The fall continued in July when, partly as a result of special factors, imports in terms of value were running 18 % below the July 1963 figure. It is true that the good harvests weakened the demand for imports of farm produce; the decline of investment expenditure, the running down of stocks of raw materials and the loss of pace in the growth of private consumers' expenditure are however likely to have played a more important role in the weakening of imports. This was therefore spread—in varying degrees—over all the main categories of goods and areas of origin. Statistics of foreign exchange transactions indicate that imports of services also lost a good deal of pace.

The upward trend in wholesale prices lost considerable momentum in the first quarter and actually dipped slightly downwards from March to July, but consumer prices went on drifting upwards. They showed a further increase—of 1.7 %—from March to June and of 0.6 % in July (the increase from December to March had been 1.2 %). The disparity between wholesale and consumer price trends was mainly due to the fact that the prices of goods intended for fixed investment and those of auxiliary materials used in industry tended to ease, whereas the cost of services supplied to private consumers rose especially fast—partly as a result of the heavier telephone charges, which had been raised in May as a cyclical measure. A more abundant supply of home-produced food-stuffs exerted a distinctly restraining effect on price trends, at least until May.

In July, wholesale prices were 3.4 % up and consumer prices 6.8 % up on the July 1963 figure. The cost-of-living index was as much as 7.5 % higher than a year earlier.

The trend in visible trade summarized above meant a very considerable reduction in the deficit on trade in the second quarter, which—on the basis of customs

returns—was \$459 million, against \$667 million a year previously and \$758 million in the first quarter of 1964. In July exports actually outweighed imports, whereas in the same month of 1963 the deficit had still been as high as \$214 million. As net income from services was also rising rapidly, there was even a surplus on current account for the first time in 18 months. Capital movements also developed favourably, yielding a considerable surplus. Repatriation of Italian capital from abroad and a decline in exports of Italian banknotes (both very probably due mainly to the tightness of internal liquidity), the floating of a loan abroad by IRI, the state-controlled industrial holding company and—above all—the purchase by a foreign company of an interest in Montecatini doubtless accounted for a good deal of the improvement in the balance of capital transactions. Consequently, for the first time since 1962, there was a surplus—and it was considerable—on the overall balance of payments (\$227 million in the second quarter and \$151 million in July). The fact that official gold and foreign exchange reserves increased relatively little (from March to July they gained only \$79 million, to reach a total of \$2 903 million) is explained mainly by a further reduction in the banks' short-term indebtedness abroad (by \$229 million in the March-July period, bringing the reduction to a total of \$540 million since the end of August 1963). In August too the trend of the balance of payments appears to have been favourable. At all events, the transfer of \$123 million in gold to the International Monetary Fund in that month, made to replenish the Italian gold subscription after a drawing in March and to provide for the increase in the overall subscription (raised from \$270 million to \$500 million), was entirely covered by the August payments surplus.

In contrast with the first quarter, the balance of payments thus helped in the second to build up bank liquidity a little. The Treasury's cash transactions worked in the same direction, but to much greater effect—mainly once again because of the operations of the Cassa depositi e prestiti. In April/May, the transactions of this institution which, as an autonomous Directorate-General in the Ministry of the Treasury, uses the liquid funds received from the postal cheque offices and the post office savings banks for investment in government-guaranteed securities or to make long-term loans, mostly to the local authorities, involved total disbursements of Lit. 230 000 million by the Treasury. This and the tightness of the capital market forced the Treasury to borrow from the Central Bank; its indebtedness towards the monetary authorities (Bank of Italy and UIC) increased by Lit. 113 000 million in the second quarter and by nearly Lit. 150 000 million in July, reaching Lit. 1 601 000 million. The Bank of Italy's advances to the banks also helped, although to a very small extent, to increase bank liquidity. Since at the same time the expansion of bank credit came almost to a halt (the year-to-year increase fell to 11.6 % in the second quarter, compared with 17.8 % for the first quarter) and since there was no great change in either the banks' compulsory reserves or notes and coin in circulation, bank liquidity increased from March to June both in absolute terms—Lit. 100 000 million—and relatively; the ratio between liquid reserves and deposits (the latter had practically stopped rising) reached 4.2 % in June, compared with 3.9 % in January and 3.6 % in March. On the other hand, the liquid funds available to enter-

prises tended, if anything, to decline further—a development betrayed by such pointers as the tendency for current accounts to shrink.

Despite the inflow of capital from abroad and certain measures taken by the authorities (notably through the Cassa depositi e prestiti), the capital market remained under strain because of the reticence of private investors. At least until June, therefore, long-term rates of interest tended to rise. The net yield on government securities, for instance, rose in June to 6.1 % (January, 5.6 %; March, 5.9 %). In the subsequent months, activity on the securities market was at times rather more lively. This must have been connected with reports on certain governmental measures (adjustment of rules governing investments by insurance companies, approval of investment trusts, forthcoming implementation of the reduction decided on in February in the taxation of stock exchange transactions), and perhaps, too, with a rather more optimistic assessment of prospects on the part of investors.

2. Outlook

In the second half of 1964 the growth rate of overall demand in money terms will probably be relatively low. The development of home demand is likely to remain hesitant, but demand from abroad will probably develop favourably.

Visible exports should continue to expand sharply, although the pace can hardly be as high as in the second quarter. The reasons for believing that exports will expand briskly were set out in the last Quarterly Survey: the favourable outlook for the development of world business conditions, the increased supply of agricultural products for export, the export drive stimulated by the weakening of domestic demand, and government measures to assist the growth of exports. Moreover in respect of delivery dates Italy has, of course, gained in competitiveness. At all events the Community's business surveys in May and June revealed longer foreign order-books in industry for the first time for many months and the "Forum" survey made by *Mondo economico* shows that the forecasts of heads of enterprises concerning visible exports have become distinctly more optimistic in the second half of the year. Exports of services are likely to develop less vigorously than visible exports, if only because the growth of spending by foreign tourists is again likely to be sluggish.

As for domestic demand, there is good reason to expect a tendency for expenditure on gross fixed asset formation to decline: for some time yet the adjusted trend in building

investment is likely to dip fairly sharply, at least as far as new housing and new industrial and commercial building are concerned. Expenditure on public works, however, might continue to expand. The number of dwelling-rooms planned, which at the end of 1963 was still running well above the corresponding 1962 figure, fell in the first quarter of 1964 by 8 % and in the following quarter by 24 % below the figures for a year earlier.

Plans for buildings for industrial or commercial purposes have developed along similar lines; the volume of space enclosed was already 28 % down in the first quarter and 30 % down in the second on the 1963 figures. Home order-books in the building materials industry and the short-term forecast on production prospects made by heads of enterprises in this industry point to a fairly appreciable decline of investment in building and construction during the second half of the year. However, towards the end of the year housing construction might rally since, mainly for reasons of employment policy, the authorities have relaxed the restrictions on building loans. For the same reason it is also quite likely that activity in public works will gather speed in the final months of 1964.

The trend of output and foreign trade and the short-term production forecasts in the equipment industry both suggest that industrial spending on these capital goods, at least in the private sector, will continue weak for some time to come.

As mentioned in the last Quarterly Survey, budget figures for 1964/65 point to a fairly appreciable increase, though less than hitherto, in public current expenditure on goods and services. This applies, at all events, to the Government's expenditure on staff; this item shows an increase of 12 % over the budget of the preceding year.

The growth of private consumers' expenditure is likely to slow down further : it is fairly certain that the expansion of mass incomes will again lose momentum. A number of factors are, it is true, helping to boost mass incomes, notable among them being the wage increases which will result from the new collective agreements reached in a number of industries, such as chemicals, the increase (under the sliding scale) in cost-of-living allowances in the public sector on 1 July and in agriculture, industry and trade on 1 August (and the fresh increase in these allowances expected in autumn, plus an increase in family allowances in October) and the great increase in payments made by the wage adjustment funds. However, these expansionary factors are likely to be offset by the further decline expected in the total number of hours worked. Moreover, an increase in the turnover tax at the end of August is likely to hold down the volume growth of consumption.

Whereas it is reasonable to look forward to a noteworthy increase in agricultural production, provided the weather remains good, industrial production is likely to be

rather weak, and output in construction too may remain disappointing for some time yet. At all events, order-books in industry were until recently still shrinking considerably despite the rapid rise in foreign demand, and the output forecasts made by heads of enterprises pointed, if anything, to a small loss, although the business climate does not seem to have deteriorated further of late. On the other hand, the output of services should continue to grow.

All this being so, the seasonally adjusted figures for imports may again be below—but now only slightly below—the figures attained in recent months. At the same time the upward movement of prices may tend to slow down further, despite the raising of the turnover tax.

If these assumptions are correct, the trade balance will again develop favourably in the remaining months of 1964, and this will make a crucial contribution to improving the 1964 balance-of-payments figures.

Most of the tendencies referred to in the last Quarterly Survey became appreciably more marked in the second quarter. The trend of investment, for instance, was appreciably more unfavourable than was at first thought and than it probably would have been, had it proved feasible to adopt in good time the measures recommended by the Community Institutions on various occasions since the summer of 1963, measures which concerned public expenditure and revenues, the financing of the deficit, policy on the capital markets, policy on incomes, and so on. This failure to act in time, the prolonged rise in costs to which it made a substantial contribution, and the relatively sharp brake that had, in the absence of other measures, to be placed on the expansion of credit (the balance-of-payments situation alone would have made some action on these lines inevitable) were all factors, if not the cause, underlying the distinct decline that occurred both in the amount spent by enterprises on capital goods and in the demand for building; this in turn affected production, employment and, consequently, the development of incomes and of consumption. Despite recent official measures, these trends will almost certainly continue for some time. This is why the growth rates for the full year 1964 in the main components of home demand—notably fixed asset formation—and for gross national product and imports have been adjusted downwards. On the other hand, the growth rate of exports has been adjusted upwards. These adjustments throw into even sharper relief the unsatisfactory relationship between the development of consumption expenditure and that of investment are developing.

Unless appropriate measures are taken, i.e. *if* the forces effective at present were allowed to continue unchecked, a sluggish situation would probably persist for some time yet in 1965, with relatively weak demand in the field of gross fixed asset formation involving a further loss of pace in private consumers' expenditure; meanwhile, on the wages front, there might be further increases—appreciable though not as heavy as hither-

to—in rates of pay, including cost-of-living allowances through the working of the sliding scale. Consumer prices would continue to rise, forced up for the most part by rising costs, especially as productivity gains will, for a time at least, almost certainly be very small : at the outset industrial production, given the economic climate, might well remain weak despite a continuing fairly rapid expansion of exports. Imports would be once again very hesitant and the balance of current payments would almost certainly again improve. In general, both inflationary and deflationary trends would be discernible at one and the same time in the economy.

Supply and utilization of goods and services

	1962 ⁽²⁾	1962 ⁽²⁾	1963 ⁽²⁾	1964 ⁽²⁾
	At current prices (in Lit. '000 million)	% variation by volume on preceding year		
Gross national product	24 789	+ 6.3	+ 4.8	+ 3
Imports ⁽¹⁾	4 365	+ 15.1	+ 20.7	—
Private consumption	15 006	+ 7.4	+ 9.7	+ 3.5
Public current expenditure	3 645	+ 4.3	+ 5.7	+ 4
Gross fixed asset formation	5 846	+ 8.8	+ 5.7	— 8
Exports ⁽¹⁾	4 357	+ 10.7	+ 6.3	+ 13

⁽¹⁾ Goods, services and factor income.

⁽²⁾ General Statistical Bulletin 1964, No. 7-8, Statistical Office of the European Communities.

⁽³⁾ Commission forecasts.

Note : The forecasts are approximations based on certain hypotheses, generally mentioned in the Quarterly Surveys; they have been discussed with the experts from the member countries, but are established and published on the sole responsibility of the Commission.

In short, the outlook is on the whole rather unfavourable, and the problem facing those responsible for the short-term management of the economy is no longer that of containing the expansion of internal demand in money terms, but rather one of restraining the growth of incomes affecting costs and of encouraging investment, particularly directly

productive investments, which bring down unit costs. Measures in this field should, however, be properly synchronized; it would be risky to take artificial steps to assist the revival of investment demand before production costs have been brought sufficiently under control.

It is clear that the prime need is for the Government itself to orientate its budgetary policy along these lines, in particular by curbing the expansion of public current expenditure on goods and services and of public transfer expenditure. The overall growth in the actual disbursements of the public authorities, at any rate in 1965, should be kept within the limits recommended by the Council of Ministers of the Community. At the same time credit policy should be relaxed a little and further efforts made to encourage saving, to channel more of the money saved on to the domestic capital market and so to strengthen the propensity to invest from this side as well.

In point of fact the authorities have now taken or put forward proposals for new and important measures of short-term economic policy intended to strengthen the earlier measures that have been fully explained and evaluated in previous Quarterly Surveys. After an increase at the end of July in the tax on the manufacture of certain alcoholic beverages and on the receptacles containing them (the additional revenue is estimated at about Lit. 12 000 million in a full year), the rates of the general turnover tax (IGE) were with effect from 31 August also increased 20 % by means of a decree-law (this is still awaiting the approval of Parliament). Among other items, certain foodstuffs, such as meat, butter, fruit, vegetables and wine have been exempted from this increase, as has petrol, the tax on which had already been raised in February. The additional tax revenue expected from the raising of the turnover tax is estimated at about Lit. 200 000 million per year.

It was decided at the same time that the State would accept responsibility, for a period from 1 September to 31 December 1964, for part of the social charges normally borne by employers and workers, namely 2.88 % and 0.35 % of the total wage, to be covered from the workers' and employers' contributions respectively. According to the official estimate this will cost the State Lit. 70 000 million for the period, corresponding to more than Lit. 200 000 million in a full year. This additional expenditure is to be financed, at least in the last four months of 1964, from funds that are usually used for repurchasing long-term government securities.

In addition, a proposal has been tabled in Parliament for some increase in taxation rates for the higher income brackets and the institution of a special tax on incomes from luxury apartments and houses. This source will probably yield additional revenue of about Lit. 30 000 million in a full year.

Furthermore, the Government intends to stimulate the propensity to invest of industrial enterprises by granting tax reliefs and by providing financing facilities for

small and medium-sized enterprises : capital gains realized on sites sold by industrial enterprises will qualify for favourable tax treatment if the yield is reinvested in equipment by the same enterprises; further reliefs are to be granted on the equipment purchased. A Government Bill on the financing of small and medium-sized enterprises provides for the establishment of a fund of Lit. 100 000 million, half of which will be covered from budgetary resources (the increased yield of the turnover tax) and half from loans. A second fund, into which, under another Bill, Lit. 17 500 million are to be paid during the second half of 1964 from the proceeds of the petrol tax increase, is intended to finance the investments of small and medium-sized enterprises in southern Italy and the islands. Next year and in subsequent years this fund also is to be replenished from budgetary resources. In addition, the construction of subsidized housing and of schools is to be encouraged and speeded up.

The Government also intends to step up the supply of capital on the capital market by licencing investment trusts and by amending the investment rules for insurance companies so as to enable them to use a larger proportion of their available funds to purchase securities.

Last but not least, the Italian Prime Minister, M. Moro, has announced that the increase in public expenditure will not exceed 5 % in 1965, and that part of the increased revenues from taxation should be used to cut the budget deficit. In addition certain public service charges will be increased.

Since most of these measures were taken or proposed only at the time when this report was at the drafting stage, and since, in a number of cases, it is still not known when or how strictly they will be applied, it is not easy to assess their economic impact with any degree of accuracy. Be that as it may, it would seem in the light of the most recent developments that the new measures are in line with the need to stabilize prices while avoiding any sharp drop in overall economic activity.

However, it seems essential that the authorities should make some progress in the field of incomes policy, and circumstances are now rather more propitious than they were : what the Italian economy now requires—not only to stabilize prices, but even more for reasons of growth and employment policy—is the stabilization of unit costs.

Despite the new measures and the favourable outlook for exports, business activity might well in 1965 remain sluggish for some time. The Commission's staff now estimates that the annual growth in gross national product from 1964 to 1965 is liable to be small, although it is quite possible that the development through the year will show a recovery in the growth of production in the course of 1965. Even in the longer term, the unduly sharp decline that has occurred in investment will continue to be a limiting factor in the ability of the Italian economy to expand in real terms. But measures to boost the growth of overall demand should only be contemplated if and when there has been a

sharp decline in overall economic activity. Such a decline is, however, unlikely mainly because Italy should benefit from the boom conditions obtaining in the rest of the world, but also because the Italian Government has, as mentioned above, already taken a number of selective measures to counter a recession. But any *general* measures to get the economy moving, taken too soon, might well lead to a fresh and dangerous deterioration in the balance of payments and give new impetus to the upward movement of prices.

D. The Netherlands

Economic expansion continued at a fast pace in the second quarter. As far as can be judged at present, the summer months brought no appreciable change in the general trends.

Exports again rose quite vigorously and there was also a distinct increase in gross investment expenditure. On the one hand further considerable progress was made in building and construction and, on the other, investment in capital goods again went up appreciably. Finally, enterprises made extensive purchases of raw materials. Despite the strong improvement in wage incomes registered in April, the expansion of private consumers' expenditure was weaker in the second quarter than at the end of the previous year and in the early months of 1964.

Domestic supply rose further in spite of the high rate of utilization of production factors. According to the gross index of the CBS, industrial production in the second quarter was up 7.5 % on the comparable level of the previous year. Agricultural output also developed quite favourably. Since however demand rose substantially more than production, imports increased at a distinctly faster pace than in the previous quarters.

Manpower reserves again contracted. Towards mid-year the ratio of unfilled vacancies to numbers of unemployed was 7.6 : 1, as against 6.3 : 1 at the same time last year.

The underlying tendency for prices to rise continued in the second quarter. Despite the damping influence of seasonal factors and of public price controls, retail trade prices in mid-August were up 2.7 % on the March level and 8.4 % on August 1963.

The imbalance is also reflected in the balance of current payments, which closed with a deficit of about Fl. 600 million, as against only Fl. 60 million in the corresponding period of 1963. As capital movements were roughly in balance, the net gold and foreign exchange position of the monetary authorities (down Fl. 100 million) and the commercial banks (down Fl. 500 million) together deteriorated to much the same extent as the balance of current payments.

Provided some success is achieved in holding back the expansion of wages in 1965, economic trends are hardly likely to show any appreciable change before the end of the year. There is nevertheless a possibility that the expansion of demand

might slow down somewhat, mainly as a result of investment by enterprises losing something of its momentum. Exports will probably rise quite vigorously. Although forecasts concerning the growth of private incomes are particularly uncertain, the increase in private consumption can be expected to continue. Industrial production will again rise, even if at a slower pace. Imports might expand less strongly than in the first half year.

The upward price trends will probably continue. The deterioration in the balance of current payments could be less pronounced than hitherto.

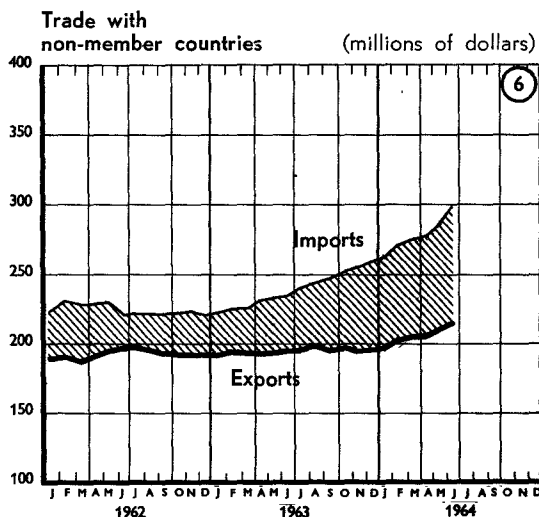
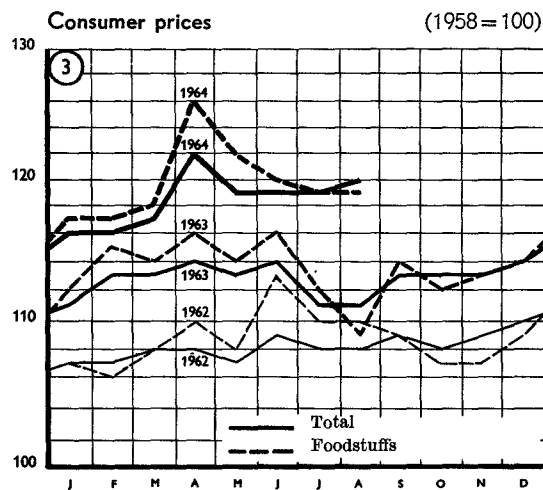
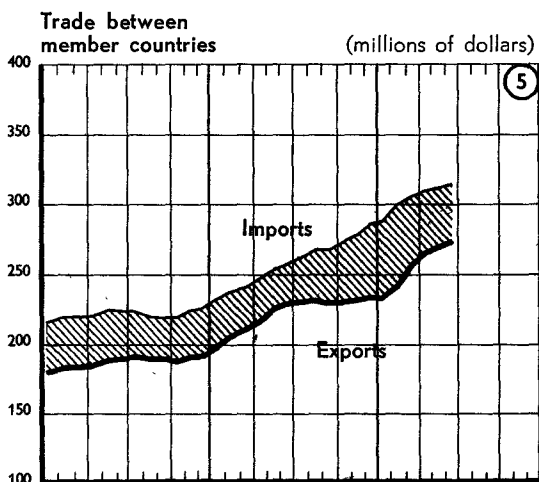
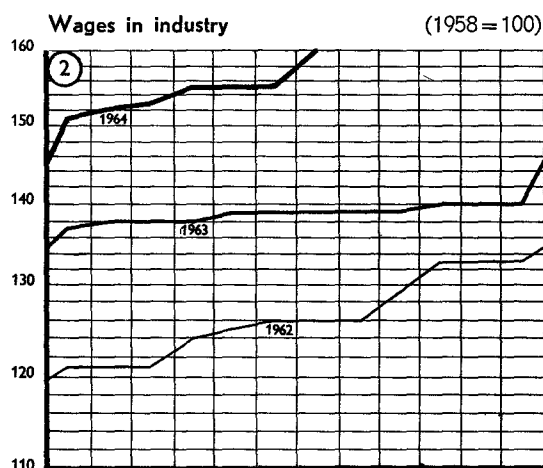
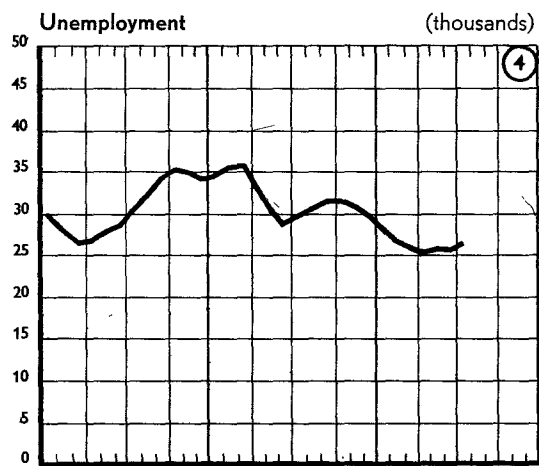
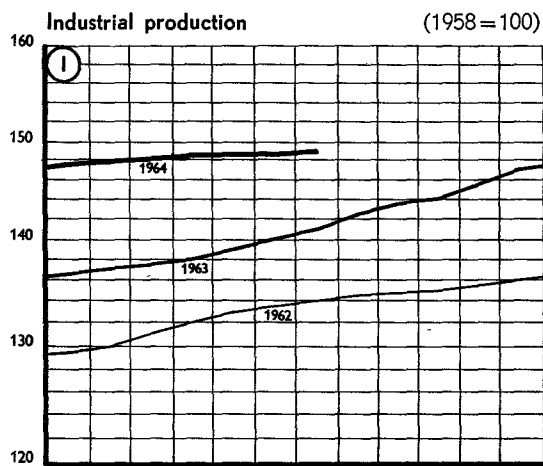
At present officials of the Commission estimate that the growth of the real gross national product for the full year 1964 will be nearly 6 %. For 1965 on the other hand, on the basis of certain assumptions, only about 3 % to 3.5 % is considered possible, particularly if it is assumed that enterprises will make some reduction in their investment in capital goods. Private consumers' expenditure will certainly increase further: however, like the further development of costs and prices, the extent on its expansion will depend in the main on the economic policy decisions taken for the year 1965. The wage restraint which is absolutely essential if price stability and external balance are to be regained is made more difficult by the fact that the trend of total demand, far from helping to ease the labour market situation, has rendered it more acute. It will in fact be necessary to apply strictly those arrangements planned or already made in connection with national budgets and credit policy which are intended to ensure a general limitation of the expansion of nominal domestic demand. In addition it seems advisable to make greater efforts to moderate the growth of spending by other public authorities.

1. Recent developments

In relation to the first quarter, exports of goods and services in the second were probably marked by a further speed-up. True, customs returns showed exports of goods to have risen only 13.4 % in value and 8.5 % by volume on the corresponding period of 1963, compared with growth rates of 17.7 % and 19.5 % in the first quarter; it must, however, be remembered that exports in the early months of 1963 had been very low because of the exceptionally hard winter. The distinct acceleration of exports, which lasted till June, slackened slightly in July and August.

The increase in sales of finished and certain semi-finished goods (especially products of the metal processing industry) was particularly strong in the second quarter.

ECONOMIC INDICATORS



NOTES :

Source : Statistical Office of the European Communities (except as otherwise indicated).

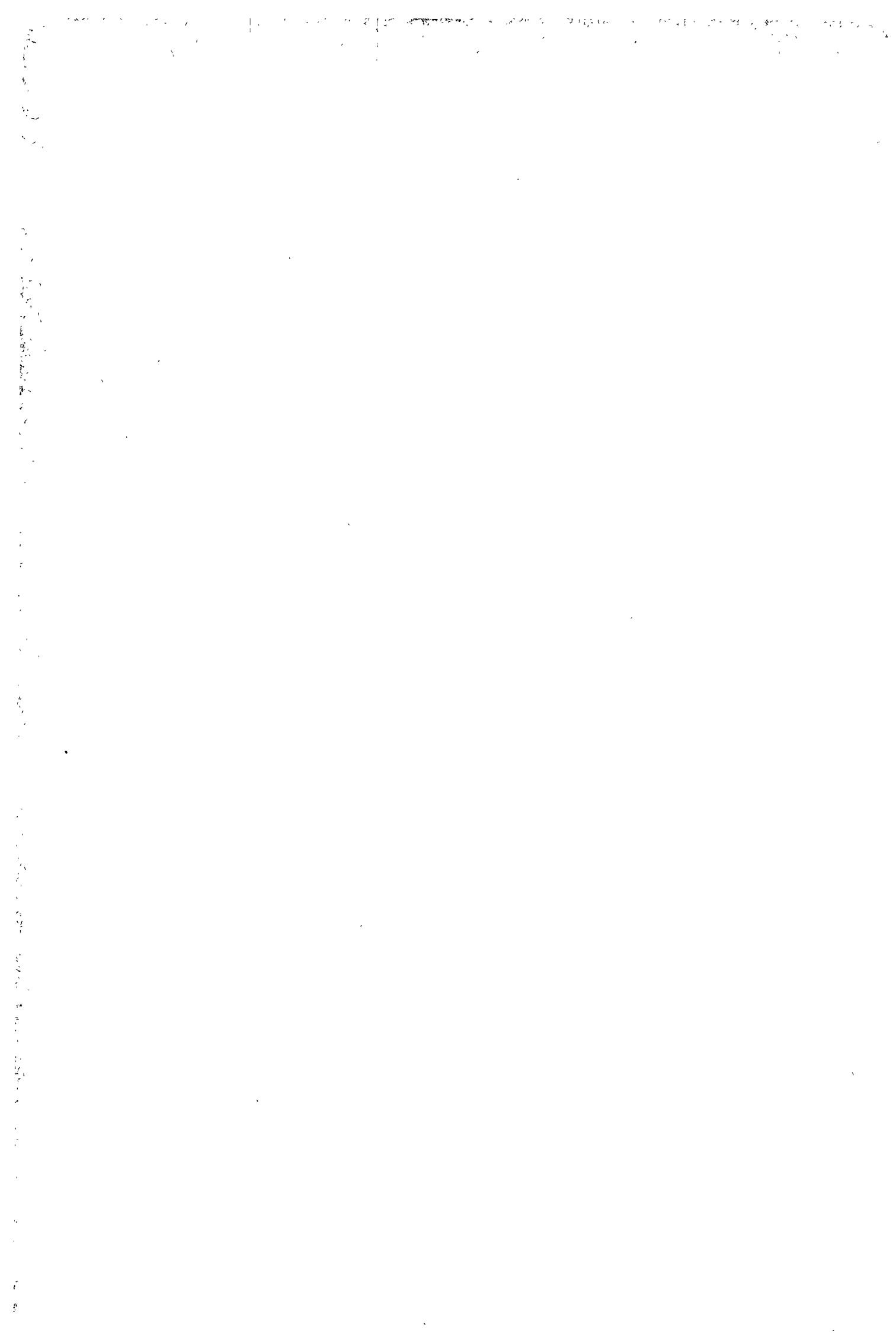
Graph 1 : Estimated trends based on SOEC seasonally adjusted data. Calculation of the trend in the Netherlands encountered certain difficulties which it will not be possible to eliminate till the new Dutch index is available; this amended index is expected shortly. Excluding construction, food, beverages and tobacco.

Graph 2 : Index of wage rates, excluding construction, mining and quarrying.

Graph 3 : Cost-of-living index for wage-earners and employees.

Graph 4 : End-of-month figures, seasonally adjusted by Commission.

Graphs 5 & 6 : Series adjusted by SOEC for seasonal and accidental variations. Exports fob, imports cif. Conversion at official exchange rates.



The upward trend of total exports was due principally to the expansion of deliveries to member countries, especially the Federal Republic of Germany, while sales to non-member countries showed only a moderate increase, with the trend of sales to the EFTA countries and the United States apparently marking time.

Domestic demand in the second quarter continued its rapid expansion, though the pace was probably lower than in the preceding months.

Expenditure on gross fixed asset formation again increased considerably. The investment activity of enterprises (with the exception of housing) probably continued to grow vigorously into the summer months, to judge by the way imports of capital goods and of activity in industrial building were expanding. In this connection rationalization, and the expansion of capacity achieved in the housing sector, have without doubt played an important part. Although the liquidity situation of enterprises probably deteriorated, and despite measures to curb credit, it was apparently still possible to finance the expansion of investment without any great difficulties. Moreover the effect on profits of rising production costs seems in many cases to have been partly offset by the rapid increase of turnover.

Housing demand continued to rise strongly. Evidently, too, the expansion of expenditure on public works has so far been little affected by the restrictive measures taken in this sector; indeed public investment has apparently continued to climb rapidly.

As regards consumption expenditure there was, on the one hand, a further considerable expansion of public spending. On the other hand private consumers' expenditure, which after its strong growth in the second half of 1963 was still rising rapidly in the first three months of 1964, increased but little in the second quarter. In terms of volume its expansion tended if anything to come to a standstill, mainly because of rising prices. Nevertheless private consumption in the second quarter was probably up 10 % in value and some 3 % by volume on the corresponding period of the previous year—after year-to-year growth rates of 13.5 % and 8.5 % in the first quarter. Since mid-year, however, the consumer spending of households may once again have been rising more strongly. Experience shows that considerable rises in disposable incomes, such as took place in the spring, exert their full effect on actual spending only after a certain timelag.

In fact wages and salaries in the private sector again rose appreciably between the first and second quarters. This was mainly because of the new increases in agreed wages and salaries in April, but a further growth of employment also played a part. According to the arrangement reached between the two sides of industry, most of the wage agreements which ran out after March 1964 were already renewed at that time. The increase under the new agreements, which should have been 5 % on 1 April, was certainly exceeded. In industry at any rate agreed wage rates were increased 5.6 % on average between the first and second quarter. In July wage rates and also wages and salaries in the public sector were put up a further 1.6 % to offset higher rents.

This meant that in July the index of agreed wages in the private sector was already 17 % above the corresponding level in 1963. The growth of actual earnings, however, was probably lower than that of agreed wages, for it is certain that fewer "unofficial" rates were being paid than a year ago.

In view of this expansion of nominal overall demand no signs of an easier situation could yet be expected on the labour market; on the contrary, it has become more acute. The number of unemployed in June was down to only 19 900 and was thus more than 11 % below the level of June 1963. The number of vacancies continued to grow. In June it was over 151 000, i.e. about seven times the total of unemployed. As far as can be judged at this stage, this development continued in the summer months, when the number of unemployed—seasonally adjusted—remained at an extremely low level.

Demand from domestic sources again increased. This applies first to industrial production, which since the winter has again shown a quite appreciable increase. According to the CBS gross index it was in the second quarter 7.5 % higher than a year earlier—after being 10.5 % higher in the first quarter when, however, the annual growth rate was disproportionately swollen because the exceptional cold had caused considerable shortfalls in production in the first quarter of 1963.

On the other hand production in the building industry was again stepped up considerably thanks to increased employment, expansion of capacity and rationalization. In the services sector also the relatively rapid expansion probably continued.

With weather conditions more favourable than in 1963, the trend of agricultural output generally was decidedly satisfactory. Except for certain types of vegetables, harvests—in particular of grain—are likely to have been appreciably better than last year.

Total demand, however, rose much more strongly than domestic supply. As a result imports of goods and services probably again speeded up. At any rate visible imports in the second quarter were 21 % by volume and 24.1 % in value higher than a year earlier. This rise was even greater than in the first quarter (18.6 % and 22.3 %), when the year-to-year rate had been particularly high for the same reason as in the case of exports and production—the effects which the cold weather in early 1963 had on the level at that time. In July, however, the trend of imports seems again to have been somewhat weaker.

Imports of raw materials and semi-manufactures and also of consumer goods expanded with particular vigour in the second quarter as a result of stockbuilding.

The underlying tendency for prices to rise persisted into the second quarter, being strongest at the beginning of the quarter, but calming down from May onwards—at least

as far as mirrored in the indices; this, however, was probably due in large measure to direct government action on prices. None the less, the retail price index in August was up 2.7 % on its March level, and 8.4 % on that of August 1963.

The imbalance of economic development in the Netherlands was reflected not only in prices but even more in a further appreciable deterioration of the balance of external transactions. In the second quarter the deficit on trade (in terms of value and on the basis of customs returns) was Fl. 1 464 million, or Fl. 677 million more than at the same period of the previous year. This gives a deficit of Fl. 2 804 million for the whole of the first half year (Fl. 1 078 million higher than the trade deficit in the first six months of 1963). In July there was a further deficit of Fl. 551 million.

The total current payments balance (on a cash basis) was Fl. 600 million in deficit for the second quarter alone. This made a deficit of Fl. 900 million for the first six months already, as against a surplus of Fl. 190 million in January-June 1963.

Since the capital account was roughly in balance in the second quarter, the overall balance of payments showed a deficit identical with that on current account (about Fl. 600 million). Official gold and foreign exchange reserves declined by about Fl. 100 million and the net foreign exchange position of the commercial banks deteriorated by about Fl. 500 million. In July, however, the overall balance of payments again showed a surplus as a result of a surplus on capital account.

The banks endeavoured, by repatriating short-term external assets, to support their domestic liquidity, which was under pressure largely as a result of developments in the balance of payments and of the considerable expansion of notes and coin in circulation (connected with rising wages and prices), despite the fact that the cash transactions of the State in the second quarter helped to create liquidity. Moreover, the State in July called for a temporary loan from the Central Bank—the first operation of this kind for several years.

The banks continued to make advances on practically the same scale as hitherto. Short-term loans to business clients in June were no less than 15 % higher than at the comparable period in 1963, with the result that the 11 % limit laid down by the authorities for the expansion of short-term lending was again appreciably exceeded. By July the "penalty deposits" with the Central Bank stood at Fl. 204 million.

The rise of interest rates on the money and capital markets continued, and rates for long-term capital reached their highest point since the war.

On 5 June the monetary authorities raised Bank rate from 4 to 4.5 % and in July they took measures to limit borrowing abroad by banks.

2. Outlook

In the remaining months of 1964 the expansion of overall demand should continue.

As a result of the favourable world business situation—particularly the buoyancy that characterizes the leading customer countries—demand from abroad will most likely remain decidedly dynamic. According to the last CBS business inquiry, orders from abroad have again increased. At the same time it must also be assumed that as a result of the strict domestic price policy and because an appreciable levelling out of domestic demand in 1965 is expected in many quarters Netherlands enterprises themselves will make greater endeavours to export. This could affect in particular the capital goods industries, since the outlook for domestic investment demand is decidedly unpromising. If the expectations in this field prove right, the elasticity of domestic supply would in fact be large enough to permit a rise in exports. Finally, a further increase in farm exports can also be expected.

Expansion of internal demand could be slower in the coming months. At any rate there is a possibility that expenditure on gross fixed asset formation will tend to slacken.

This will certainly not be the case in expenditure on housing, where social policy requires that the rising trend shall be maintained. In industrial building also it is likely, in view of the investment plans already put in hand, that expansion will continue for some time. Against this, certain effects of the restrictive measures taken some time ago are bound to make themselves slowly felt in the field of public investment. Above all, however, distinctly weak trends may well emerge towards the end of the year in expenditure by enterprises on capital goods, despite the continuing large requirements for rationalization and a propensity to invest that remains high. This would be the result of the pressure exerted on the availability of funds for financing by the heavy wage increases, since at the same time official price policy has set limits on the raising of prices.

It is difficult to prophesy how far this weakening of investment will go. If the cash transactions of the public authorities continue to inject liquidity into the economy, and if the expansion of credit is still hardly affected by the measures so far taken, or if imports of capital counteract the efforts to put a brake on credit, the slowdown in investment spending will probably be relatively slight. Nevertheless it must be expected, particularly in view of the timelag before the restrictive measures taken at the beginning of the year become effective, that there will still be some reduction in the pace of investment.

Public current expenditure on goods and services will continue to increase, the more so as new wage and salary improvements in the public services, back-dated to 1 January 1964, were introduced at the beginning of September with the aim of aligning the rise in civil service pay on the increases granted in the private sector.

This naturally gives a boost to the further expansion of private consumers' expenditure, which will in any case still be rising as a result of the wage and salary increases made in the spring. Wage rates in private industry this year will hardly rise any further, but the expansion of employment will tend to increase further the total income of households. To this must be added the effects of the increase in transfer incomes, granted from September to offset the new increase in rents. On the whole, however, the development of private consumers' expenditure could be relatively moderate.

But this will be the case only if in the autumn there are no decisions on wages and salaries for 1965 which again hold out the prospect of large increases. Should this happen the fourth quarter of 1964—like the autumn of 1963—will see the beginning of a speed-up in the expansion of private consumers' expenditure in partial anticipation of the expected wage increases.

The danger of wage decisions being made for 1965 which would once more have very unfortunate effects on price stability in the Netherlands cannot be ignored, since the further development of demand likely to occur up to the autumn will certainly not have eased the situation on the labour market sufficiently to induce a quieter wage trend.

Despite the persistence of shortages on the labour market, domestic supply will doubtless maintain its upward trend, but it is unlikely that industrial production will grow at the pace which marked the first six months, and particularly the early months, of the year. First of all margins of productive capacity in a number of branches of industry are no longer large and, secondly, demand in some sectors might also cease to rise so vigorously.

Imports will probably tend to be weaker in the second half year than in the first; this is particularly because, largely as a result of increased financing difficulties, the readiness to build up stocks of imported raw materials and semi-manufactures will most probably slacken, and also because the upward movement of investment in capital goods is tending to flag and so to slow down the expansion of imports.

Prices will without doubt continue their upward trend. Should there be signs of further large wage increases for 1965, a resurgence of the upward pressure on prices could be expected. Mainly as a result of official price policy—in August the Minister of Economic Affairs even laid down for the first time maximum prices for individual firms and, in addition, resale price maintenance for a number of consumer durables has been forbidden with effect from 1 December—the retail price and cost-of-living indices will show a substantially slower rise than in the first half of the year.

In view of the probable slowdown in the growth of imports, a more favourable development of the trade balance can be expected than in the first half year; at least there should be no further deterioration.

Supply and utilization of goods and services

	1962 ⁽²⁾	1962 ⁽²⁾	1963 ⁽²⁾	1964 ⁽³⁾
	At current prices (in Fl.'000 million)	% variation by volume on preceding year		
Gross national product	48.09	+ 2.6	+ 3.6	+ 6.0
Imports ⁽¹⁾	23.67	+ 7.5	+ 9.6	+ 14.0
Private consumption	27.98	+ 4.9	+ 7.1	+ 6.5
Public current expenditure	7.19	+ 6.7	+ 2.8	+ 1.0
Gross fixed asset formation	11.55	+ 3.1	+ 3.9	+ 14.0
Exports ⁽¹⁾	24.30	+ 6.3	+ 6.4	+ 9.5

⁽¹⁾ Goods, services and factor income.

⁽²⁾ General Statistical Bulletin 1963, No. 7-8, Statistical Office of the European Communities.

⁽³⁾ Commission forecasts.

Note: The forecasts are approximations based on particular hypotheses, generally mentioned in the Quarterly Surveys. They have been discussed with experts from the member countries, but are established and published on the sole responsibility of the Commission.

The full year 1964 may none the less show a deficit on current account of Fl. 1 300 million, compared with surpluses of Fl. 350 million in 1963 and of Fl. 430 million in 1962. The deterioration is substantially greater than expected at the beginning of 1964 in the Netherlands itself.

As regards the forecasts of the Commission's services concerning the trend of the supply of goods and services and its utilization, it would be advisable, in view of the latest analysis of economic developments and trends, to adjust the growth rate of the real gross national product a little upwards, to nearly 6 % instead of 5.5 %. In particular output in building and construction, and consequently gross fixed asset formation, will, for the full year, be greater than was initially supposed. The forecasts for the expansion of imports and exports have also been adjusted upwards.

The outlook for the further expansion of the economy in 1965 is at present fraught with very great uncertainties. These especially concern investment and the wages trend and are to some extent interrelated. Provided that there is no further strong rise in unit wage costs, the upward movement of foreign demand for Netherlands goods and services should continue. Investment expenditure on the other hand might be marked by a more

or less pronounced slowdown, though in building and construction the growth of public investment expenditure and the great demand for housing will scarcely allow of any substantial slackening in the pace of expansion. On the other hand pronounced recessive trends could appear in expenditure on capital goods. How marked these would be depends on how far profit margins were reduced by any fresh upward thrust in wage costs. True, there is one important field which is influenced more by medium-term prospects and which is in any case likely to obtain the necessary funds for investment : the exploitation of natural gas. Be that as it may, it can be assumed that investment as a whole will expand considerably less than in 1964, if only because the restraints on credit will become more efficient.

Although this will perhaps mean some easing of the employment position, mass income and thus private consumers' expenditure could again rise quite appreciably. Already certain wage rises, particularly those in the public service and those intended to offset higher social insurance contributions, and a massive increase in old age pensions from 1 January 1965, are as good as certain. Nor will it be possible to avoid some general rise in wages; the scale of the rise will determine whether in 1965 the advance in private consumers' expenditure, in unit wage costs and—possibly—in prices is relatively small or once again rapid.

In this connection it is significant that the prospects for an increase in the real gross national product, and thus of productivity, in 1965 will probably be smaller than in 1964 (perhaps 3 % to 3.5 % instead of 6 %), first because of the limits imposed by capacity and also, perhaps, because of a slowing down in investment.

The decisive role which the trend of wages will play in the economic situation in 1965 is thus evident. Since the other instruments of short-term economic policy, in particular budget policy and credit policy, have so far not ensured, and will probably not ensure by the autumn, that the expansion of nominal domestic demand is reduced enough to ease the situation on the labour market, the wages policy of the two sides of industry and of the authorities is once again very much the spearhead of stabilization policy. On the other hand, however, a policy of wage restraint encounters very great difficulties precisely because the relationship between supply and demand on the labour market is still conducive to vigorous wage rises.

Despite these difficulties an endeavour should be made in the decisions on wages for 1965 to attain that restraint without which it will not be possible to avoid further inflationary price developments, rising costs, worsening balance-of-payments trends and, finally, the danger of a recession.

At all events, closer attention must be paid to the fact that wage policy is only one of the instruments of economic policy and that it must be adequately supplemented by the others. Measures in other fields, and first and foremost those for the general steering of domestic demand in money terms, should therefore be intensified. This could

apply to credit policy where such action is still necessary and possible in present circumstances—the danger of capital imports being a case in point. It applies however even more to budgetary policy, which should adhere strictly to the lines recommended by the EEC Council of Ministers on 14 April 1964. If the cash expenditure of the public authorities in 1965 were to expand on a scale substantially in excess of what corresponds to the growth of the real national product that would be possible without inflationary strains, and if, in addition, the tax burden is—from the angle of sound economic policy—prematurely reduced, then the chances of attaining a trend in earned incomes which would contribute to the recovery of internal and external balance would probably be very slight.

As regards the national budget, the Government has submitted estimates for 1965 whose aggregate figures, if adhered to, would be quite consonant with the requirements of stabilization policy. The increased spending budgeted for is within the limits of the recommendations of the EEC Council of Ministers.

If the Government's budget policy is to play its due part in promoting stabilization, it will this time really have to keep within the framework of the economic effects which the estimates foreshadow—which means that in the event of further supplementary spending, the necessary measures will have to be taken on the receipts side of the state budget to offset the greater increase in expenditure.

It is furthermore important that from now on not only the State but also all other public administrations should in their budgeting follow more strictly than hitherto a policy of restraint.

E. B.L.E.U.

Belgium

Economic growth continued in the second quarter and, as far as can be judged at the present time, on through the summer months, but there still appears to be a lack of balance in the way the economy is developing.

Overall demand continued to expand at a lively pace. The progress of exports lost, it is true, something of its momentum, but home demand, when adjusted for seasonal and fortuitous variations, increased at least as fast as in the first quarter. Gross fixed asset formation made appreciable headway; private consumers' expenditure again advanced quite vigorously in the train of considerable increases in incomes. A relatively sharp increase in public spending also contributed in some measure to the expansion of demand.

Domestic supply also increased. There was however a certain loss of pace in the expansion of industrial production, the elasticity of which is limited by factors such as the continuing shortage of labour. Nevertheless, output in the second quarter showed a further gain—of 6.5 %—over the corresponding 1963 figure (IRESP index).

The growth of demand, which was decidedly vigorous when compared with domestic supply, and the continuing increases in costs led to an import boom and tended to push prices upwards faster. In August, the retail price index was 5.3 % above the corresponding 1963 figure.

The balance of trade, and consequently the balance of current payments, deteriorated appreciably. It may well be, however, that in the second quarter there was a small surplus on the overall balance of payments, accounted for by imports of private capital.

The trend of demand, and probably the other trends too, are unlikely to change before the end of 1964, though the growth of production might slow down even a little further. Nevertheless, the increase in the real gross national product could well total a good 5 % for the full year 1964. The slowdown will doubtless occur mainly in 1965 when, if the preliminary forecasts are correct, the growth in gross national product is unlikely to be more than 3.5 % to 4 %. Although the expansion of certain components of demand might slow down, in particular exports and—partly as a result of the stabilization measures adopted—gross fixed asset formation, overall demand in money terms should continue to increase fairly sharply. Strains on the labour

market and the upward movement of costs and prices are thus likely to continue. If better results are to be obtained in connection with prices and the balance of current payments, it would seem necessary, particularly in respect of public expenditure for 1965, to strengthen stabilization policy along the lines recommended by the Council of the Community on 14 April 1964.

1. Recent developments

Overall demand again made rapid progress in the second quarter of 1964, and inflationary pressures persisted.

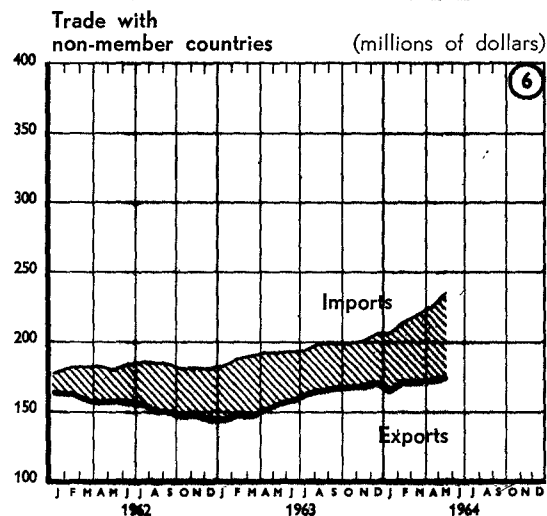
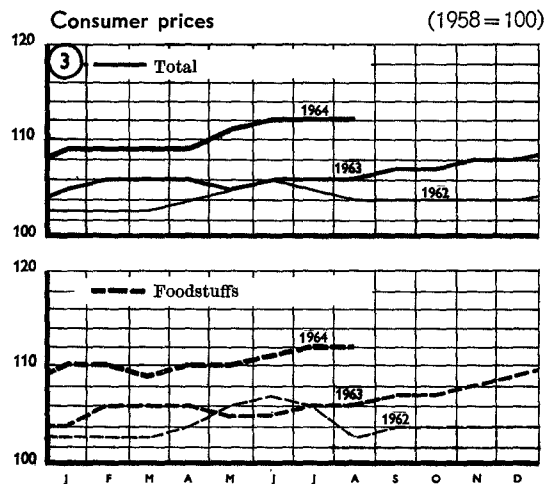
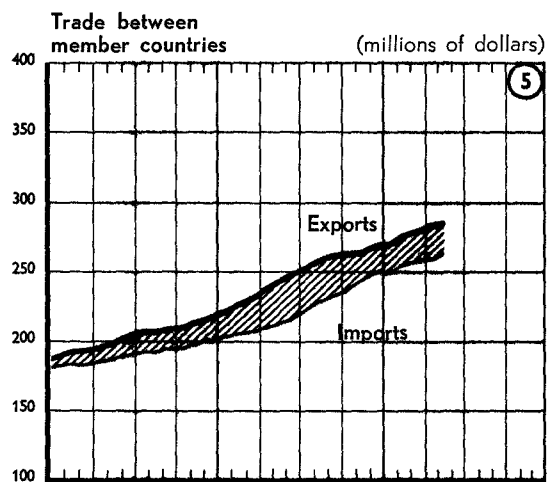
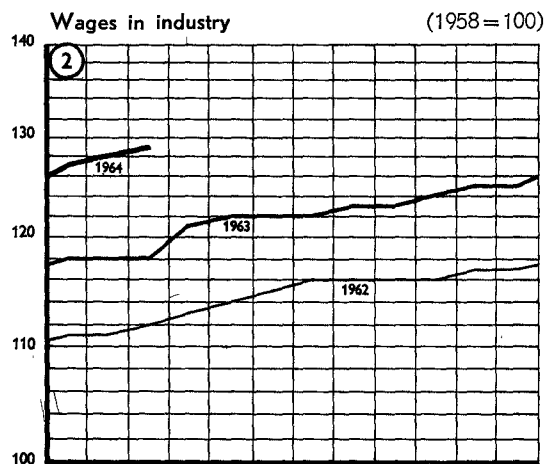
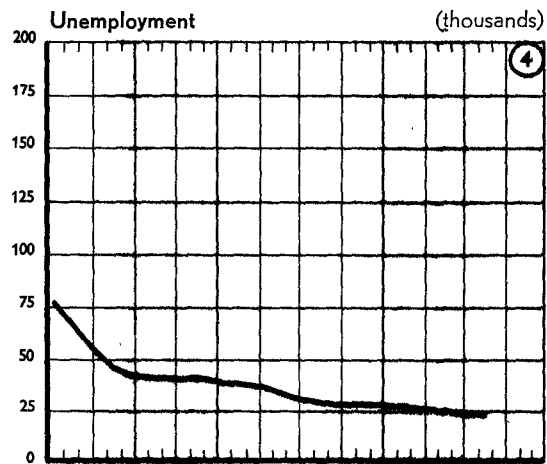
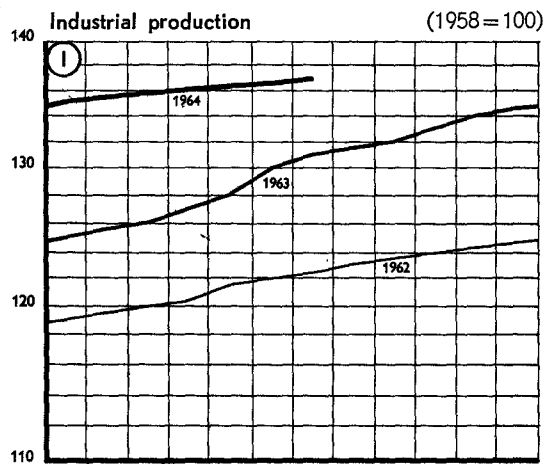
Demand from abroad, which in the first quarter had been expanding faster than previously, almost certainly ceased exerting any appreciable pressure on the economic situation in the second; but the value of visible exports (on the basis of customs returns) still registered a year-to-year growth rate of 13.2 % for the second quarter—against a corresponding figure for the first quarter (inflated to some extent by certain special factors) of 25.7 %. Remarkable in this connection is the fact that the growth of deliveries to France slowed down and that exports to Italy actually declined; despite this, the progress of exports to the Community countries as a group was again more rapid than that of exports to non member countries.

By contrast, the expansion of overall demand in money terms seems to have been stimulated, at least as much as in the preceding quarter, by expenditure on fixed investment. Information available on the gross fixed asset formation of enterprises, excluding new housing, suggests that this component of demand grew appreciably, no substantial difficulties having apparently arisen so far in the financing of investment out of borrowed funds. Demand in building and construction probably also developed further. This applies not only to housing but even more to public works : so far the restrictive measures adopted in this field do not seem to have had any appreciable effect on the growth of actual expenditure.

As for investment in stocks, the tendency to build up holdings of raw materials and of semi-finished products seems to have continued. About the middle of the year, manufacturers were in general describing their stocks of finished goods as "normal".

Public current expenditure on goods and services again increased quite appreciably. Although there is no question of any further increase of pace in the growth of private consumers' expenditure, it none the less grew considerably once again, most of the addi-

ECONOMIC INDICATORS



NOTES :

Source : Statistical Office of the European Communities (except as otherwise indicated).

Graph 1 : Estimated trends based on SOEC seasonally adjusted data. Excluding construction, food, beverages and tobacco.

Graph 2 : Index of wage rates.

Graph 3 : Index of consumer prices, excluding rents.

Graph 4 : Monthly average of day-to-day figures. From February 1962 onwards certain groups of only partially employable workers have been excluded. Data seasonally adjusted by Commission.

Graphs 5 & 6 : Foreign trade of Belgo-Luxembourg Economic Union. Series adjusted by SOEC for seasonal and accidental variations. Exports fob, imports cif. Conversion at official exchange rates.

tional money being spent on durable consumer goods and on services. After seasonal adjustment, the turnover of the big department stores also revealed a further gain from the first to the second quarter. Despite measures designed to hold down the expansion of hire-purchase sales and consumer credit, sales of private cars—which had already been rising very rapidly in the first quarter—were in the second quarter 12.5 % up on the corresponding 1963 figure.

The increase in private consumers' expenditure was a function of the increase in the disposable incomes of households: there was no sign of any change in the propensity to save. The rapid increase in wage rates, in particular, continued over the period from April to June, and from the middle of the year onwards the operation of the sliding wage scale led to further wage and salary increases in the main industries and higher pensions and family allowances. If the growth in the total numbers employed and wage drift are also taken into account, it must be assumed that the rate of growth of mass incomes was distinctly higher than in the second quarter of 1963 and than the average rate for the whole of 1963.

All in all, the increase in money incomes per person employed was certainly again considerably higher than that in gross domestic product per person employed. But the rapid increase in retail prices—itsself partly due to this disparity—served to hold down the real growth of private consumption.

Domestic supply has continued to advance in recent months. Agricultural production has almost certainly more than made good the 1963 losses; both crop and livestock production have advanced. Industrial production, which had registered a strong advance in the first quarter, continued its progress, though at a lower rate. According to the IRESP index industrial production in the second quarter was 6.5 % higher than a year earlier; in the first quarter the corresponding rate of growth had, partly owing to certain special factors, been 11.9 %. Expressed in terms of working months, the backlog of orders in industry has to all intents and purposes remained unchanged since the end of the winter, though it has each month been higher than in the corresponding month of 1963.

Although the number of foreign workers again rose, the situation on the labour market remained fairly difficult in the second quarter; the shortage of manpower did not however actually worsen. At the end of July the unemployed totalled 31 500 (20 300 fully unemployed, and the others partially or frictionally unemployed), i.e. 1.4 % of all workers insured against unemployment. The corresponding figure was 1.8 % in April 1964 and 1.7 % in July 1963.

Imports of goods and services again soared. Customs returns show that the value of visible imports in the second quarter was 20.1 % higher than a year before (figures by volume are not yet available). While this growth rate is lower than that achieved in the first quarter (26 % for value, 23.4 % by volume), the first quarter figures

had been pushed up by the special factors already mentioned. It should be noted that temporary imports (mainly goods processed in Belgium and then re-exported) made, as in the preceding quarter, only very modest progress.

Price trends confirm the persistence of inflationary pressures. Since last winter the retail price index has been moving up swiftly : after a period of virtual stability between December and March, it jumped by 1.9 % from March to June. In July, a further advance of nearly 1 % was recorded. In August the index was 5.3 % above the figure recorded a year previously. The increase in food prices—which accounts for nearly half the increase between March and August—played an important role in this development, but there was also the influence of the price increases which affected industrial products and even more the services sector, where heavier costs forced up prices relatively sharply. The wholesale prices of finished manufactures rose again between March and June, although not as much as in the first quarter. Available information on the way building costs have been developing suggests that there is a swift and persistent upward movement in this sector.

The trade balance (as shown by customs returns) deteriorated appreciably in the second quarter. While for the second quarter of 1963 the deficit was only Bfrs. 600 million, it was Bfrs. 5 000 million for the period from April to June 1964. Despite the very favourable business conditions throughout the world, conditions from which Belgium was able to benefit, the deficit on trade in the first half of 1964 was Bfrs. 9 200 million, compared with a deficit of Bfrs. 3 800 million for the first half of 1963. Although a changed pattern in the terms of payment may have softened the impact of this development on the balance of current transactions (on a cash basis), there may well have been a deficit in the second quarter on current account, contrasting with a surplus for the second quarter of 1963. The overall balance of payments may, however, have accumulated a slight surplus owing to net inflows of private capital. Official net foreign exchange reserves increased by \$29 million from March to June; reversing the trend of the first quarter, however, the net foreign exchange position of the banks seems to have weakened.

Transactions with abroad in the second quarter made only a modest contribution to increasing the funds available on the money and capital markets, though internal liquidity was also again helped by Treasury cash transactions. However, the demand for credit expanded sharply and consequently strain increased further; at any rate short- and long-term interest rates went on rising till the end of June.

From the beginning of the year there had been an official drive to curb the expansion of bank credit, but this had had little effect—the year-to-year growth rate in short-term loans to commerce and industry was, for example, 17 % in June. Further restrictive measures were adopted about the middle of the year in the field of monetary policy and credit policy. On 3 July bank rate was raised from 4.5 % to 4.75 %. In addition, the National Bank applied certain restrictions on rediscounting. Lastly, on a proposal from the Central Bank, the Banking Commission decided to apply a minimum

reserve rate (coefficient de réserve monétaire) for the first time from August onwards; it was fixed at 1 % of the total of the banks' money and near-money liabilities.

2. Outlook

It seems unlikely that, apart from seasonal variations, trends will vary greatly before the end of 1964.

The outlook for the development of external demand remains favourable. Even if the stabilization measures adopted in certain member countries will again further reduce the contribution the other EEC countries make to export demand in Belgium, business conditions in these countries and in non-member countries which are among Belgium's leading customers remain fairly favourable, and there will still be a ready market for Belgian exports. It is also reasonable to expect some measure of improvement in exports to the developing countries. As for the financing of exports, favourable factors include the recent decisions to increase the capital of the Institut de Réesc compte et de Garantie, to raise the maximum commitment that may be undertaken by this establishment and to increase the funds for the financing of export credits (Créditexport). The influence of these factors will not, however, be helped by the upward movement of production costs in Belgium; on the contrary, Belgium might on the whole suffer more from rising costs than the countries with which it has to compete.

The demand created by gross fixed asset formation will continue to expand in the last months of the year. Several factors will spur on the propensity to invest, notably the high degree of utilization of production capacity in industry, the incentive to invest in rationalization provided by soaring production costs, and the continuing lively interest of foreign investors in opportunities afforded by the Belgian economy. Again, the improvement of profit margins in certain metal-working industries and the general prospects for the development of the world economy should work in the same direction. However, the impact of a restrictive monetary and credit policy, together with the persistent rise of production costs, might to some extent hamper the implementation of investment programmes.

The trend of effective demand in the housing industry might also suffer increasingly from the effects of stabilization, depending on the stringency with which the policy is applied. However, in view of the limited elasticity of supply, it is unlikely that strains will ease appreciably in this industry before the end of the year. The same reasoning might, perhaps, be applied to public investment. The total order-books of builders, measured in terms of working months, have remained practically unchanged since the beginning of the year, although the weather has enabled the actual rate of work to be stepped up very appreciably.

Public current expenditure on goods and services will doubtless be an important factor in expansion in the coming months.

Lastly, it looks as though private consumers' expenditure will continue to be decidedly dynamic. Total wages and salaries will continue to increase as all their main components grow; the upward movement may once again be reinforced by additional increases resulting from the application of the sliding wage scale.

Although there is reason to forecast a decline in the elasticity of domestic supply, since production capacity is fully extended in certain industries and labour is scarce, it is reasonable to expect further progress in industrial production; but it is almost certain that, with the differences in trend between the major industries growing wider, this progress will be less marked than in the past (notably than in the fourth quarter of 1963 and in the first quarter of 1964).

Strain on the labour market is almost certain to continue. Even in the unlikely event of stabilization policy bringing about an early slight decline in actual vacancies, other factors, such as the agreed reduction of working hours, the smallness of the increase in the working population, etc., would be enough to prevent any appreciable relaxation of this strain.

It must therefore be expected that purchases from abroad will advance so uninterruptedly and rapidly that the trade balance will in the next few months at any rate fail to improve.

The upward movement of prices may well remain fairly pronounced. Official price policy has, it is true, been strengthened and its scope broadened, but the fundamental elements forcing up prices, as discernible in price index trends, do not seem to have been much affected by the treatment given. The process of passing on cost increases to the customers, fostered as it is by the boom in demand in money terms, may be expected to continue. At any rate, the results of the latest inquiries into how businessmen expect producer prices to develop from the middle of the year suggest that once again they will be rising. Price trends would seem however to be steadier in the public works sector.

Even when allowance is made for the latest information available, it does not seem necessary to adjust to any substantial extent the forecasts made in the last Quarterly Survey (2/1964) on the volume variations in the main components of demand and supply for the full year 1964. Nevertheless, largely because building showed a sharp increase in the first quarter over the first quarter of 1963 (owing to the freeze-up which had then badly hampered work) gross fixed asset formation for the full year might well prove to have grown faster than was originally expected. Consequently, the growth in the gross national product at constant prices might easily reach 5 % (instead of 4.5 %).

Supply and utilization of goods and services

	1962 ⁽²⁾	1962 ⁽²⁾	1963 ⁽²⁾	1964 ⁽³⁾
	At current prices (in Bfrs. '000 million)	% variation by volume on preceding year		
Gross national product	646.2	+ 4.3	+ 3.6	+ 5.0
Imports ⁽¹⁾	230.3	+ 8.0	+ 9.2	+ 11.5
Private consumption	435.4	+ 4.2	+ 4.6	+ 4.5
Public current expenditure	78.0	+ 5.2	+ 6.7	+ 3.5
Gross fixed asset formation	128.7	+ 3.8	+ 1.6	+ 8.5
Exports ⁽¹⁾	232.8	+ 9.2	+ 7.9	+ 10.0

⁽¹⁾ Goods, services and factor income.

⁽²⁾ General Statistical Bulletin, 1964, No. 7-8, Statistical Office of the European Communities.

⁽³⁾ Commission forecasts.

Note : The forecasts are approximations based on certain hypotheses, generally mentioned in the Quarterly Surveys. They have been discussed with the experts from the member countries, but are established and published on the sole responsibility of the Commission.

It is not easy to discern development prospects for the Belgian economy in 1965, in view of Belgium's great economic interdependence with foreign countries and the fact that there is as yet no way of assessing satisfactorily the effectiveness of restrictive credit and budgetary measures, some of which have not yet even been enacted. It would seem, however, realistic to expect some loss of momentum, notably in demand from abroad and in domestic production : world business activity is expanding less, the competitive position of Belgium has almost certainly deteriorated as compared with recent years, and home supply is less elastic. At present the Commission's staff consider that a 3.5 % to 4 % growth rate for the gross national product at constant prices can be expected in 1965.

The possibility of such a loss of pace in real expansion should be borne in mind by those responsible for short-term economic policy. In other words, pressure brought to bear on home demand in money terms should aim not only at eliminating inflationary strains already existing at the current level of real growth, but it should also be applied with due regard to any foreseeable loss of pace in the growth of home supply in terms of volume and, consequently, to a decline in the advance of productivity.

Now, it is perhaps to be expected that the expansion of demand due to gross fixed asset formation will slow down in the course of 1965, owing in particular to the

erosion of profits by rising costs, to the repercussions of the restrictive credit policy and to the fact that the measures adopted with regard to public investment are liable to curb actual spending in this field. It is, however, very doubtful whether a slower expansion of exports and of investment would at this stage weaken sufficiently the growth of those incomes which have an incidence on costs and the expansion of consumption expenditure. At all events, there is a risk that the further undue expansion of these aggregates will mean that the tendency for the consumer price level to rise and for the balance on current account to deteriorate will persist.

The authorities have already applied a whole series of measures designed to stabilize the Belgian economy. These measures were reviewed in Quarterly Survey 2/1964, except for the more recent ones, which have been referred to in this Survey. It is, however, obvious that the stabilization policy as pursued in 1964 does not yet constitute a full response to the recommendations made by the Council of the Community. In certain cases it was in fact impossible to enact measures that could take effect as early as 1964, since these would have come into conflict with legal provisions adopted previously.

There is no question but that the stabilization policy needs intensifying along the lines laid down in the recommendations; this should be done at the very latest as part of the arrangements for 1965. Monetary policy and credit policy must be included, in so far as the most recent provisions adopted fail to curb effectively the expansion of credit. Action in the field of budgetary policy is even more necessary; here the action taken, notably in regard to expenditure, should be if possible even more stringent than is required by the Council's general recommendations: for it has become clear that while the Government has reduced the pace at which its expenditure is growing, it none the less has had cash deficits which, though certainly smaller than in 1963, must be regarded as too high to be acceptable in a period of boom conditions. Moreover these deficits were again financed partly and temporarily by methods which have expansionary effects in the monetary field—though here too the situation has been better than it was last year.

Lastly, as part of incomes policy, the drive to moderate the growth of incomes needs intensifying. What seems really necessary in this field is somewhat greater flexibility in the mechanism by which the index tends to encourage inflationary tendencies and so to conjure up the threat of a recession.

Grand Duchy of Luxembourg

Exports, especially of iron and steel products, maintained the expansion recorded in the first months of the year and again made a very appreciable contribution to the expansion of overall demand. Domestic demand also continued to develop; both in the field of fixed investment and in that of private consumers' expenditure.

The dynamic development of demand brought with it a further considerable advance in industrial production, which showed a year-to-year gain of 11 % in the second quarter, compared with 9.4 % for the first.

Imports, too, seem to have expanded vigorously, but this did not prevent a further build-up of inflationary strain after the winter. The shortage of manpower persisted, costs went on rising, and prices rose distinctly more than in the past. In September the cost-of-living index showed an increase of nearly 3.3 % on the same 1963 figure.

There is not likely to be any essential change in the economic situation during the months ahead. Steel output and exports might well continue to grow, though at a slower rate. Investment will almost certainly also progress, and the increase in private consumers' expenditure should continue. The price and costs situation might tend to deteriorate. This being so, it would seem necessary and appropriate—in conjunction with the work being done on these lines in the other Member States—to pursue and intensify the stabilization policy of the Grand Duchy along the lines of the recommendations made by the Council of the Community.

1. Recent developments

Demand from abroad has developed in line with the situation on the world iron and steel markets, where business has picked up fairly sharply since the autumn of 1963. The Grand Duchy's exports therefore continued to expand in the second quarter of 1964 and also, if the preliminary information now available is reliable, throughout the rest of the summer. Despite the boom in exports of iron and steel products, export order-books lengthened; about the middle of the year, the figure for the same period of 1963 had been left well behind. Export prices also increased further as far as the middle of the year.

In the second quarter, gross fixed asset formation in general almost certainly made further progress. The propensity to invest of entrepreneurs improved in the iron

and steel industry; elsewhere the main feature of investment activity was the implementation of investment programmes in important new industries. Building investment must have increased both in the private housing sector and in the public works sector.

The incomplete information available suggests that private consumers' expenditure again made a vigorous contribution to expansion. In particular, demand for a number of durable consumer goods and for services grew. This advance is accounted for by a further improvement in income from wages and salaries. The number of persons employed increased fairly sharply, and in certain sectors of the economy agreed wages were raised in the second quarter. The increase in the total of wages and salaries was also due to increased bonuses in the iron and steel industry and to the fact that the sliding wage scale came into operation and raised wages about the middle of the year.

In the second quarter, public current expenditure on goods and services seems to have again increased.

Domestic supply increased sharply, although the dry summer meant that agricultural production was disappointing. In building, where an exceptionally high year-to-year growth rate had been recorded in the first quarter, output in the second quarter seems to have tended to be higher than in the first. The expansion of industrial production was far in excess of the usual seasonal growth. Mainly because of the heavy increase recorded in the iron and steel industry, the index of industrial production in the second quarter was 11 % up on the corresponding 1963 figure (the year-to-year growth rate for the first quarter was 9.4 %).

Luxembourg's imports almost certainly again made very rapid progress.

The situation on the labour market remained difficult. It is true that in the second quarter the number of persons employed in industry again increased, mainly thanks to the recruiting of foreign labour. The increase was 2 % over the corresponding figure in 1963 (1.6 % in the iron and steel industry). However, to assess these figures at their real value, it must be remembered that in 1963 the number of persons employed had fallen slightly; it seems that from now on it will be increasingly difficult to increase the number of persons employed. A comparison of growth rates for production and for numbers employed shows that the increase in output per person employed was very appreciable.

As before—perhaps even more than before—prices were subject to demand pull and cost push, but because of Government control and supervision measures this led to comparatively small price increases. After rising only very slightly between December 1963 and March 1964, the cost-of-living index (which covers only 36 articles) increased by about 1 % from March to June and again by 1.8 % from June to September. It was then 3.3 % above the September 1963 figure. The raising of the turnover tax and of

import duties on 1 July may well have contributed to the maintenance of upward price trends. Through imports, too, the upward price movements recorded in the neighbouring countries, particularly Belgium and the Netherlands, were felt increasingly strongly in Luxembourg.

2. Outlook

Economic activity should continue to rise until the end of the year.

The outlook for demand from abroad, notably demand for iron and steel products, seems again fairly favourable. This assessment is based on the foreseeable development of business activity in the main purchasing countries and on the results of the latest EEC business surveys. In addition, the decision to grant export refunds on the turnover tax from the middle of the year onwards is also likely to help the development of sales abroad.

As for gross fixed asset formation, there is no reason to expect that in the private sector there will be any change in the propensity to invest, which has gained considerable strength. In the iron and steel industry, investment programmes previously planned but not yet implemented because of the discouraging situation on world markets in recent years, will now probably be put in hand. Demand (in money terms) for new housing will remain high in the coming months. In addition, the value of investment by the public authorities and public enterprises should make further fairly vigorous progress.

Private consumers' expenditure may well grow particularly fast, even if in relation to the foregoing months the growth rate, which had been unusually high in the first half year, is bound to be lower. With workers still scarce, negotiated wages will continue to rise; moreover, there is a chance that the sliding wage scale may come into operation once again before the end of the year. Transfer incomes, too, could well rise sharply.

Despite the possibility of some easing in the pace at which productivity is rising now that the reserves of manpower and of production capacity in iron and steel are being increasingly exhausted, industrial production should continue to expand briskly until the end of the year.

The upward trend of prices will persist, especially as higher costs will probably mean that certain industries will have to be allowed to put up their prices. Building prices will again be affected by the relative inelasticity of supply.

An analysis of recent developments and the short-term outlook shows the need for some upward adjustment of the forecasts made in Quarterly Survey 2/1964 on the volume variation in the 1964 gross national product at constant prices. An increase of from 5 % to 6 % is now considered possible, as against the earlier forecast of about 4.5 %.

The outlook for 1965 still depends to a great extent on developments on the world steel market. It would perhaps be wise to expect the contribution to the development of the Luxembourg economy made by the demand for iron and steel products to weaken somewhat as compared with 1964. On the other hand the opening of certain new industrial enterprises in and after the middle of 1965 should provide a not inconsiderable fillip to the growth of exports.

The expansion of domestic demand in money terms will almost certainly remain fairly lively, particularly in the field of private investment. It is likely, at any rate, to play a part in the maintenance of strain on the labour market, and so to reinforce the persistent upward wage-cost trend.

The new Government born of the elections of 7 June 1964 has clearly stated its intention of ensuring economic expansion in a setting of equilibrium. For this, the battle against inflationary tendencies must continue, and budgetary policy should be used more fully than in the past. For example, the measures implemented in 1964 to curb the increase of public expenditure should be amplified in 1965 and should bear not only on public investment but also on consumer and transfer expenditure, which rose sharply in 1964. As strict compliance as possible with the recommendations made by the Council of Ministers of the Community with a view to a co-ordinated stabilization policy is, in any case, essential for Luxembourg as well as for others. In this context, it may be noted with satisfaction that substantial practical improvements are planned (establishment of economic budgets and reform of the cost-of-living index), which will make it easier to shape short-term economic policy.

**First report from the Commission to the Council
concerning action taken by the Member States on
the Council's recommendation of 14 April 1964**

Brussels, 22 July 1964

I. Introduction

1. On a proposal of the Commission and by virtue of Article 130 of the Treaty, the Council on 14 April 1964 adopted a recommendation addressed to all the Member States urging them to take measures to restore the Community's internal and external economic balance. In accordance with paragraph 14 of this recommendation the Member States were to inform the Commission within two months of the action they had taken and the Commission was to report to the Council after consulting so far as possible the Short-term Economic Policy Committee and the Monetary Committee.

2. In the second half of June the Governments of the Federal Republic of Germany, Belgium, France, Luxembourg and the Netherlands informed the Commission of what they had done to implement the Council recommendation. These communications are appended. Because of the political situation the Italian Government has not so far supplied any particulars of its stabilization policy, the appraisal of which is therefore based on information gathered by the Commission's staff.

Account has been taken of the comments of the Short-term Economic Policy Committee on a draft submitted to it on 17 July 1964. (This report was also examined by the Monetary Committee on 24 July 1964.)

3. The Commission wishes to emphasize the provisional nature of this report: the general effect of the measures taken is not yet clearly perceptible. Moreover, the execution of the Member States' stabilization policy calls for a sustained effort involving further decisions, especially as regards national and other public budgets for 1965. Finally, it was materially impossible in some sectors to obtain the necessary data on which to judge how far the Council's recommendation had been followed. This is the case, for instance, with the receipts and expenditure of local authorities, the trend of which only becomes known after a considerable lapse of time.

II. Interpretation of the Council's recommendation

4. In order to assess more precisely the effect of the stabilization measures the Commission has kept the following considerations in mind :

i) It appears advisable to base the calculation of the rate of increase in Treasury disbursements on the figures for two calendar years. On this basis internally effective public spending should not exceed, in actual money disbursements in the calendar year 1964 by more than 5 % the level of the calendar year 1963. The same principle could then be adopted for supplementary revenue arising from the introduction of new taxes, increases in existing ones or higher charges for public utilities, revenue which can be set against any increase of expenditure above the 5 % limit. However, such supplementary revenue should not be taken into account unless it actually accrues during the calendar year 1964.

ii) It follows that the same method of calculation should be applied to 1965 whenever it is necessary to take decisions in 1964 which will become effective in 1965, which is very often the case. In this respect also the calendar year would be the period to which the calculation applies. If, for instance, an increase in expenditure above 5 % was foreseen for 1965 arrangements would have to be made to ensure a corresponding increase in receipts for that year too.

iii) According to paragraph 5 of the recommendation an increase in revenue resulting from the ascending scale of certain taxes can be considered as increased taxation. The yield of increased or new taxes should be calculated on the basis of stable prices and of an increase in domestic production not exceeding 5 %. In fact, on the information at present available it has not been possible to say exactly how far the excess expenditure would be covered by new taxes on the one hand, and by the "non-inflationary" effects of the graduated nature of existing taxation on the other.

iv) In the event of certain taxes being reduced in 1965 it would be advisable to take account of this in determining the desirable increase in public revenue. Special care should be taken to see that the total increase in tax revenue is sufficient to avoid any too strong stimulus to economic expansion.

v) Adoption of the system of calendar years as the basis for computing the desirable trend of public expenditure and fiscal receipts implies that account must also be taken of measures adopted before 14 April 1964, independently of the fact that most of these already accorded with the recommendation and that their repercussions necessarily extended over a fairly long period. The Commission therefore took into consideration all measures introduced in 1964 and any important decisions made towards the end of 1963 whose effects have mainly been felt in 1964.

vi) An appropriate administration of the Treasury is necessary even if budget accounts show a surplus of receipts over expenditure. Any such surplus should be used chiefly to repay existing debts either to the Central Bank or to abroad. Failing this, the surplus should be neutralized with the Central Bank.

vii) Several Member States have supplied details in their report on the measures for supervision or direct control of prices taken by public authorities. Although the Commission thinks that such direct intervention can have its uses for a certain time in order to get away from the climate of rising prices or prevent its worsening it has not taken account in this report of any such arrangements, which were not explicitly recommended by the Council.

viii) Some Member States have mentioned measures to increase domestic supply. In a general way, although an appropriate policy to mobilize manpower resources can have certain beneficial effects in the short term, its full incidence is only felt in the longer term. For this reason the Council made no mention of it in a recommendation whose purpose was to promote rapid action affecting the near future. Furthermore, a policy favouring higher elasticity of production by a stronger increase in investment cannot be unreservedly justified in present circumstances in view of its immediate repercussions on the development of overall demand and consequently on economic balance.

III. Implementation of the Council's recommendation

Measures taken by the Member States

5. Reports received from the Member States show that, generally speaking, the Governments have in fact given priority in recent months to restoring or consolidating the stability of prices and unit production costs, as was urged in paragraph 2 of the Council's recommendation. Although good progress has been made, it is nevertheless doubtful in most member countries whether this objective can be attained by the end of 1964. An inventory of the measures so far taken reveals certain gaps. Failing further action the success of the stabilization effort may be jeopardized in some countries, particularly Italy.

6. As regards the general points in the Council recommendation, the following comments may be made :

i) The Member States have in general maintained a liberal policy in regard to imports. The Federal Republic of Germany, as well as proposing a 25 % reduction in the common customs tariff relating to industrial products, has reduced its customs duties on imports from Community countries and, for certain products, on imports from non-

member countries. On the other hand, it is possible that the indirect effect of certain measures recently taken in Italy might be to put a brake on imports.

ii) In most Member States the increase in public spending will exceed 5 % in 1964. Even if account is taken of the introduction of new taxes and of the effects of graduated taxation, the target as regards public finance will not be reached in certain member countries—particularly the Netherlands and Italy—mainly because the basic decisions determining the trend of receipts and expenditure in 1964 were already taken in the second half of 1963.

iii) Several Member States have proclaimed their intention not to increase public spending by more than 5 % in 1965. Furthermore, two of them, the Federal German Republic and (conditionally) the Netherlands, have announced or proposed in Parliament a reduction of taxes. In the former country, however, the tariffs of certain public services have just been considerably increased. In the Netherlands the reduction of direct taxes on 1 July 1965 will only come into force if the increase in the volume of domestic demand does not exceed certain limits. As this condition implies moderation in wage increases, it will also result in a fairly slow growth of public consumption, since the wages and salaries of public servants are linked with those in the private sector.

iv) Although in a general way there has been a clearly -expressed determination to curb the growth of government expenditure, it is not certain that the same objective can be achieved in the case of local authorities, since the governments, under the laws in force and in some cases the constitution, do not all possess the necessary power to see that effect is given to the Council's recommendation.

v) In most member countries Treasury operations seem to be directed towards more extensive funding of the national debt. However, in Belgium the Treasury has again had recourse, admittedly for a fairly small amount, to medium-term borrowing abroad. In Italy, short-term borrowing by the Treasury did not expand during the first five months of 1964, but this presupposes both stricter discipline in public finance and improved conditions on the capital market.

vi) All the Member States have made it their policy to check the expansion of bank credit. The Federal Republic of Germany itself took certain measures for this purpose early in July 1964. In France and the Netherlands, however, the maximum rates set for the increase of lending have on occasion been exceeded. In Belgium, appeals to the banks to exercise moderation not having met with a satisfactory response, the monetary authorities have taken a number of restrictive measures in recent weeks.

vii) Whereas in the Federal Republic of Germany during the first half of 1964 the increase in income per worker employed was only marginally greater than the increase in production per worker, the gap continued to be appreciable in the other countries of the Community. This state of affairs will probably continue in the second half of 1964,

although the trend should slacken a little in France and Italy and appreciably in the Netherlands. From the information supplied to the Commission by the Member States concerning contacts with the two sides of industry, there is no assurance that the objective set out in paragraph 8 of the Council recommendation will be attained in 1965, particularly as regards wage costs.

On the other hand, with regard to restraint of competition, regulations have been issued by the Netherlands on resale price maintenance. The Government of the Federal Republic intends to tighten the existing regulations by an amendment to the cartel law.

viii) In most member countries the construction sector continues to be under strain, despite restrictive measures chiefly concerning work commissioned by public authorities.

7. As regards the points in the Council's recommendation which refer to individual Member States, the Commission notes that :

a) In the course of their stabilization policy, the Italian authorities took certain steps after 15 April 1964, tightening in particular their already restrictive credit policy, the effects of which on the development of investment are being very clearly felt. However, it cannot be said that Italy has followed all the Council's recommendations, more especially those in paragraph 11. In fact, there is very little likelihood that the financial policy objective can be attained in the second half of 1964. For this it would have been necessary to apply the brake more strongly to the expansion of public expenditure and to increase tax revenue. It is also doubtful whether any balanced incomes policy will be introduced in the near future.

In conformity with paragraph 10 of the Council's recommendation, the Commission has initiated, by agreement with the Italian Government, the procedure laid down by Article 108 of the Rome Treaty.

b) The competent authorities in the Federal Republic of Germany have taken or are contemplating a number of measures on the lines recommended in paragraph 13. Particulars of these will be found in the annex; most of them are designed to neutralize the inflow of liquidity resulting from the surplus on the balance of payments and to slow down the growth of the surplus on current account. Attention should particularly be drawn to the reduction of customs duties and the abolition of the "Wertpapiersteuer" (security stamp duty). As regards the placing of a larger share of government orders abroad, the possibility is being studied of implementing before schedule the draft EEC directive on the co-ordination of procedures for the award of public contracts. Faced with a too rapid increase in the amount of short-term bank lending, the Central Bank took restrictive measures at the beginning of July 1964. While welcoming these steps, the Commission considers that in certain fields, particularly agricultural imports, the effort accomplished is inadequate. Moreover, the German authorities are of the opinion that to give effect to certain recommendations, in particular the easing of restrictions on the operations of institutional investors, will take some time.

As to making exports of capital less dependent on exports of German goods and services, the Federal Government states that, as in the past, it recognizes the principle that these should not be tied and will continue to adhere to it in practice unless there are overriding reasons to do otherwise. It is prepared to accept this principle as an obligation if all the other important capital-exporting countries do the same. If such countries depart from this principle for valid balance-of-payments reasons the Federal Republic will not take this as a pretext to adopt the same course.

IV. Recent business trends and outlook

8. By paragraph 14 of the Council's recommendation the Commission is instructed to keep the Council regularly informed of the situation and of how it is developing. Apart from the analytical studies and forecasts which are made by the Commission's appropriate departments, the confrontation in the Committee on Short-term Economic Policy of preliminary economic budgets for 1965 furnished interesting information on this matter. The Committee's conclusions at the close of this confrontation are embodied in its formal opinion rendered on 25 June 1964.

9. The effectiveness of stabilization policy should mainly be reflected in the trend of prices, production costs, trade between member countries and economic relations with non-member countries. In this context it may be noted that owing to the general lines of short-term economic policy during the first half of 1964 and to the spontaneous action of economic factors, a tendency towards a better balance has become apparent in certain fields although it cannot be said to be very definite.

10. As regards prices it may in fact be noted that there has been a tendency for some months now for the increase to slacken in most member countries. However, this tendency is less marked than the movement of general consumer price indices in almost all the Community countries might suggest. Under the influence of seasonal factors the average level of food prices has become stable or has even fallen, thus partially offsetting the effects of higher prices for manufactured goods and services. These price rises have become less acute in France and Italy, the two countries where inflationary pressures had been most severe. In the Netherlands, on the other hand, particularly because of very considerable wage increases, the rise in the cost of living has clearly speeded up. Similarly, in Belgium the rise in the retail price index became sharper towards the middle of the year.

11. As regards production costs, and more particularly wage costs, present estimates do not suggest that 1964 will see any appreciable slowdown in the increase of wage costs per unit of output. In the Netherlands, because of the trend observed during the first

half of the year, this increase will even be substantially higher than in 1963. In Belgium too, it will be slightly more rapid. France and Italy, especially the latter, will doubtless experience a slowdown. The Commission's estimates point to definite disparities between the EEC countries, particularly in relation to the Federal Republic of Germany, where wage costs per unit should rise little if at all, and in relation to the leading non-member countries, especially the United States, where they will probably remain practically stable.

In 1965 the trend of wage costs will largely depend on how the Council's recommendation is applied in general, and more particularly in the sphere of incomes policy. It is essential that it be put into effect in all Community countries, especially those where spontaneous tendencies are likely to accelerate the rise in wages, making it more difficult to pursue a policy for the balanced development of incomes.

12. As regards intra-Community trade a moderate improvement in the situation was noted in the first quarter of 1964. In fact, if seasonal fluctuations are left out of account, the balance of trade of each Community country with other Member States remained substantially the same. In other words, the growing tendency towards disequilibrium which appeared in 1963 came to an end. In the last few months, a slightly more balanced trend has even appeared (a smaller surplus in the Federal Republic and B.L.E.U. and a reduction of the deficit in Italy and France).

The trend in the coming months, particularly in France, Italy and the Netherlands, will be determined by the effectiveness of stabilization measures. In the Federal Republic of Germany some speed-up in imports from the other member countries can normally be expected in view of the new tariff measures and more especially the buoyancy of domestic demand.

13. The trend of current payments with non-member countries has proved less unfavourable than was at first expected, owing mainly to a more rapid expansion of Community exports to these countries and to a lesser extent to a slower growth of imports from them, particularly by Italy. Contrary to the forecasts made at the end of 1963, which assumed that there would be no new measures and foresaw a deficit of the order of \$500 million, the Community's current account will therefore probably be roughly in balance in 1964. Similarly, present estimates are that the deterioration of the Community's trade balance should not be more than \$300 million. In the first six months of 1964 the overall balance of payments seems to have been more or less in equilibrium.

14. However, behind this overall picture of the trend of external payments the situations of individual countries are very different. The Federal Republic of Germany continues to have very large surpluses on current account. In the Netherlands the balance of current payments shows a mounting deficit, but this can be expected to contract

towards the end of the year, especially since the growth of industrial investment will slacken owing to tighter credit and the erosion of profit margins. In Italy current payments, despite the improvement observed in recent months, are still showing a heavy deficit.

V. Conclusions

15. This survey of the measures taken or contemplated and the recent evolution of the economic situation show that action in recent months is beginning to bear fruit. But the necessary conditions for a rapid recovery of the Community's internal and external economic balance are still lacking. This is partly due to the fact that the Council's recommendations have not all been followed in every member country. It would appear desirable to apply them strictly to economic policy for 1965. In other words, all the basic decisions should be taken as soon as possible so that the measures called for can exert their full effect next year. By the same token, no decision should be taken which might run counter to the imperative need for stabilization.

16. The Commission particularly draws attention to the need to conform with the recommendations on the administration of public finance, including fiscal policy. Here it is important that the principles valid for the State should also be followed by local authorities. If this part of the Council's recommendation is not fully applied because the central government lacks the necessary powers, effective co-ordination is urgently needed, not only for the purposes of the recommendation but also in a more general way.

The Commission would like to see a tighter control over the expansion of credit in most member countries. It considers that certain countries, in particular the Netherlands, Belgium and the Federal Republic, should continue their efforts to alleviate the pressure on the building and construction sector.

In the matter of incomes, more contacts with a view to obtaining firm commitments from both sides of industry seem to be an essential precondition for the success of the stabilization policy.

Finally, as regards the Italian situation more especially, the economic balance of this country could be promptly restored if a stricter budget policy were pursued and real progress made on incomes policy. If this were achieved some easing of credit restrictions could be envisaged, particularly with a view to avoiding any too severe cutback in investments.

17. The implementation of the stabilization policy will no doubt lead at Community level to a slight slowdown of growth in real terms. In Italy, in view of the extent of the imbalance this slowdown may even be appreciable. But it is important that its significance should not be exaggerated, particularly in the eyes of the public. On the contrary, the stress should be laid on a return to stability as an essential condition for the balanced development of the member countries' economies in the years to come. Moreover, in a general way, the Council's recommendation still leaves a fair margin for expansion. According to the Commission's still very provisional forecasts, the growth rate of the Community's gross product in real terms would not be much below 4 % in 1965, even if the trend of prices and trade were in fact to draw nearer to a balanced situation during that year.

18. In conclusion the Commission would emphasize once more that action to combat inflationary trends must be of a Community nature. Success will largely depend on the unfavourable repercussions which measures taken at national level may have upon member countries. The interdependence of the economies of the Community countries has now gone so far that it must be accompanied by a deeper feeling of solidarity, finding expression, in particular, in a closer co-ordination of economic policies.

Economic Policy Committee

**Opinion of the Short-term Economic Policy Committee
on the preliminary economic budgets for 1965**

Brussels, 15 July 1964

1. On 24 and 25 June 1964 the Short-term Economic Policy Committee under the chairmanship of M. Pérouse examined the preliminary economic budgets of the member countries for 1965 and discussed the economic policy problems entailed. The Committee thus continued the practice begun in 1963 of working out in good time the preliminary lines for a co-ordinated economic policy. This will facilitate the decisions which have to be taken in the next few months if they are to exert an effective influence on developments in the following year—in particular when the national budgets are being drawn up.

2. Unfortunately the confrontation of the preliminary economic budgets was made more difficult this year by certain delays in working out and submitting the forecasts. The competent authorities in Italy and Luxembourg were not in a position to submit any preliminary economic budget. In the case of Italy forecasts made by the staff of the Commission had to be used for the purpose of confronting and combining the national budgets at Community level. The Committee also wishes to point to the uncertainties inherent in the preliminary economic budgets, particularly as the situation this year is marked by divergent and rapidly changing trends in the individual Member States. These uncertain factors concern in particular the basic assumptions underlying economic policy, the trend of wages and the consequent forecasts on prices and external balances.

3. On the assumption—and the Committee believes such an assumption to be warranted—that the world economic situation will continue to improve, the combination of these preliminary economic budgets suggests that there will be a further appreciable expansion of overall demand and production in the Community, though rates of growth might be somewhat smaller than in 1964. The real gross Community product could rise by about 4 %—against some 5 % in 1964. It seems that this slowdown will be accompanied by a slackening of price and cost rises, though these may well continue to be

appreciable, and by some improvement in the Community's external balance. This would help to restore the Community's internal and external balance, although present forecasts do not suggest that the process will be complete in 1965.

4. As the speed-up noted so far in the expansion of demand from non-member countries exceeds the forecasts, the Community's exports of goods and services to these countries should continue to expand in 1965, but perhaps at a less rapid pace. It is possible that the growth of imports may show a more marked slowdown because of the tendency to stabilization now becoming apparent in certain countries and in spite of a slightly more rapid growth of imports in the Federal Republic of Germany; the deficit on trade will nevertheless continue to be large.

5. According to the preliminary economic budgets, the expansion of domestic demand in the Federal Republic of Germany should continue at a rapid pace in 1965 after the acceleration forecast for 1964; in Italy, the Netherlands and France domestic demand should register a more or less pronounced slowdown. Investment demand could show some dynamism, particularly in the Federal Republic, but also in the Belgo-Luxembourg Economic Union and—to a lesser extent perhaps—in France; only in Italy and the Netherlands is a slowing down of investment foreseen. However, the differences expected to occur in the expansion of global domestic demand between one country and another are mainly due to the probable trend of the total wages bill and, consequently, of private consumption. The basic assumptions of the preliminary economic budgets imply a stronger upward wage push in the Federal Republic of Germany and a slowdown in the expansion of wage incomes in Italy, the Netherlands and, to a lesser extent, France. The Committee considers that any speed-up in the rise of wages must be avoided in the Federal Republic and that the pace of rise must be reduced in the other countries, particularly Italy.

6. The preliminary economic budgets for 1965 throw light on a certain number of problems to which the organs responsible for short-term economic policy should pay the closest attention :

- i) Persistence of cost and price rises in 1965, although at a slower pace in most member countries. Internal balance will therefore probably not yet be established in this field. In the Federal Republic of Germany there may even be a worsening of internal disequilibrium;
- ii) Slowdown of direct productive investment by enterprises in some member countries, in particular the Netherlands and Italy. There will still be a danger of wage rises outstripping production and so causing a long period of external imbalance and a tendency to recession;
- iii) In several member countries, particularly marked strains in building and construction.

7. In view of these trends and problems the Committee considers it still essential that in their economic policy for 1965 member countries should strictly follow the lines suggested in the Council's recommendation of 14 April 1964. Where the decisions recommended by the Council in various important fields of economic policy, particularly public budgets and incomes policy, have not already been taken this should be done with a minimum of delay.

8. In the opinion of the Committee an endeavour should be made when drawing up draft budgets to limit the expansion of public expenditure, particularly consumer expenditure, as proposed in the Council's recommendation. At the same time a fiscal policy should be adopted which will help to contain private consumers' expenditure if incomes policy should fail to do so. In the Federal Republic of Germany further measures are required to curb demand in the building sector, and in general it would be desirable to give the Government increased powers to apply an anti-cyclical policy in connection with amortization.

9. In addition, the global restrictions on credit should be maintained or strengthened in all member countries with the exception of the Federal Republic of Germany. In Belgium notably, the Council's recommendations on this point need to be applied more strictly. In the Federal Republic care should be taken that the upsurge of investment is not further accentuated by the expansion of credit.

10. In order to fulfil the Council's recommendation that the Governments of Member States should give stabilization of the price level priority over all other aims of economic policy or policy in other spheres, the housing sector should not be excluded *a priori* from the application of restrictive measures. In those member countries where construction is likely to be a source of strain in 1965, its expansion should, in conformity with the Council's recommendation, be curbed more energetically.

11. The Committee believes that even more extensive measures should be taken in the Federal Republic so that the part played by Germany in reducing the excessive external surplus should also be effective. Unless further measures are taken there will be a danger of prices and costs increasing next year more rapidly than foreseen. The tariff reductions planned and the measures envisaged to reduce imports of capital are on the right lines, but it is not clear whether they will suffice to produce the necessary improvement in the external balance. In particular it would be advisable to make better use of the possibilities of increased imports of agricultural products. In this way, by relegating other problems temporarily to a subordinate position, a very effective contribution could be made to the stabilization of consumer prices. In budget policy, the reduction of taxes decided on by the Federal Government makes it all the more necessary for the overall increase in public expenditure to be limited—and this must mean a curb on spending by the Länder and local government authorities.

12. The Committee also devoted particular attention to the situation of Italy. The Committee expressed the concern it felt, despite the signs of improvement, at the still very rapid increase in wages and the continuing deficit on current account. It considered that the monetary measures already implemented should be supported as soon as possible by provisions to restore balance in public expenditure. To this end it would be advisable to put a brake on the increase of spending by administrations and to make appropriate increases in taxes and in charges for public services. Furthermore, incomes policy should be strengthened, particularly by appropriate fiscal measures and by arrangements to correct the more extreme effects produced by the automatic character of the sliding scale.

