

EUROPEAN
ECONOMIC
COMMUNITY
COMMISSION



DIRECTORATE-
GENERAL
FOR ECONOMIC
AND FINANCIAL
AFFAIRS

**THE ECONOMIC SITUATION
IN THE COMMUNITY**

4

DECEMBER

QUARTERLY SURVEY

1963

**Commission of the European Economic Community
Directorate-General for Economic and Financial Affairs
Directorate for National Economies and Economic Trends
23, Avenue de la Joyeuse Entrée, Brussels.**

EUROPEAN ECONOMIC COMMUNITY

COMMISSION

The Economic Situation in the Community

DECEMBER 1963

Contents

	<i>Page</i>
Introduction	3
I. The overall situation.	5
A. <i>The balance-sheet for 1963</i>	9
1. The world economic situation in 1963	9
2. Demand	11
3. Production	14
4. The balance of the markets.	19
B. <i>Outlook for 1964</i>	27
C. <i>Economic policy</i>	33
II. The situation in each of the Community countries	41
A. <i>Federal Republic of Germany</i>	43
1. Balance-sheet for 1963	47
2. Outlook for 1964	51
B. <i>France</i>	55
1. Balance-sheet for 1963	59
2. Outlook for 1964	64
C. <i>Italy</i>	69
1. Balance-sheet for 1963	73
2. Outlook for 1964	78
D. <i>Netherlands</i>	83
1. Balance-sheet for 1963	84
2. Outlook for 1964	92
E. <i>B.L.E.U.</i>	97
Belgium	97
1. Balance-sheet for 1963	98
2. Outlook for 1964	105
Grand Duchy of Luxembourg.	110
1. Balance-sheet for 1963	110
2. Outlook for 1964	114
Annex	
Opinion of the Economic Policy Committee on Problems Arising from the present Economic Situation in the Community	117

Graphs

1. Trend of Community internal demand and of Community gross product	17
2. Intra-Community trade	23
3. Businessmen's view on the industrial situation	
a) Federal Republic of Germany	45
b) France	57
c) Italy	71
d) Netherlands.	85
e) Belgium	99
f) Grand Duchy of Luxembourg	111

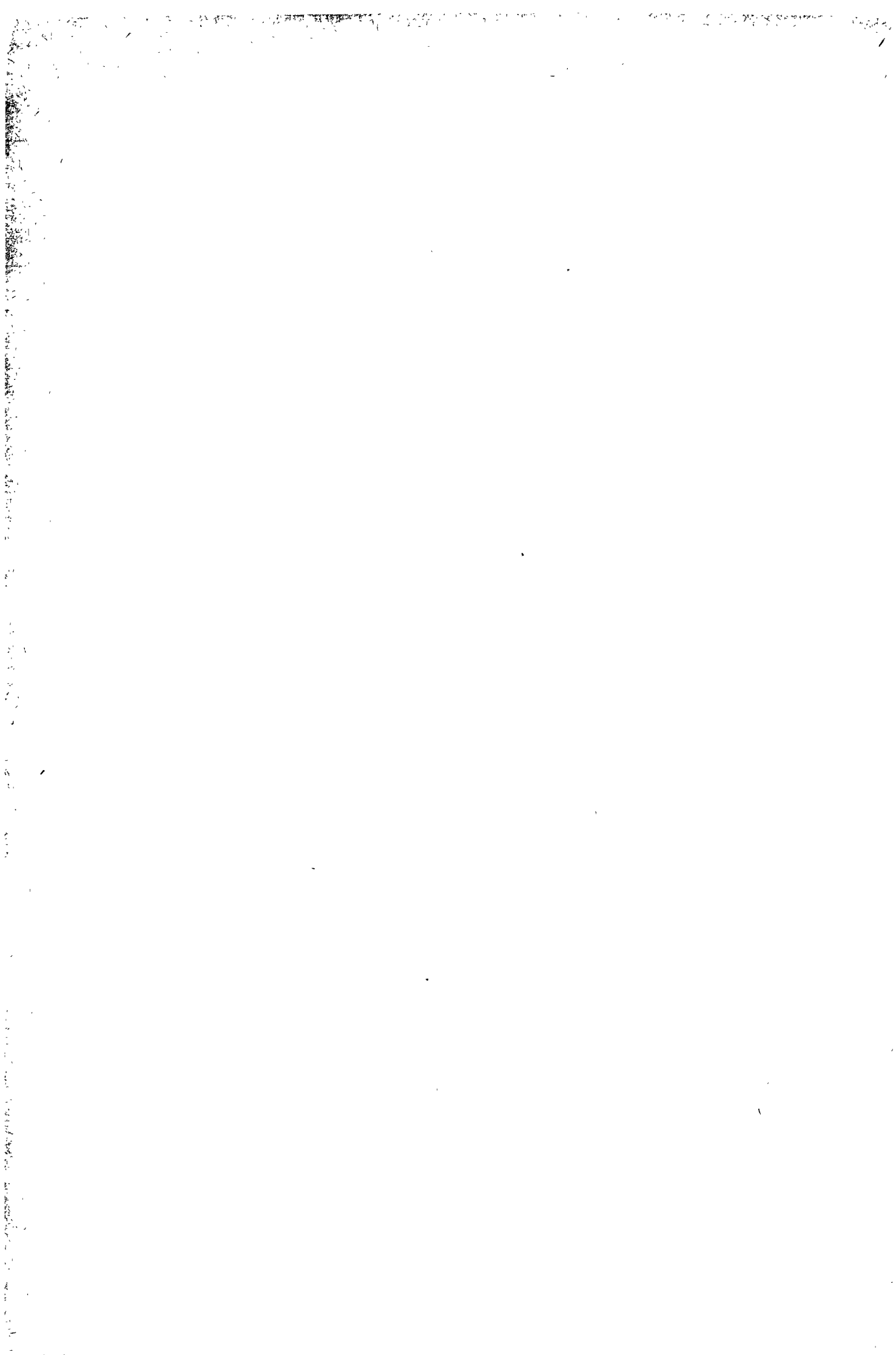
INTRODUCTION

This final Quarterly Survey for 1963 again gives, like that for 1962, estimated figures of the results of economic activity during the year and forecasts for the year ahead. These figures concern the percentage changes in the main aggregates only—gross Community product, imports and utilization. They are given this time in tabular form not only for the past but also for the coming year.

It should be pointed out once again that these figures, like other data contained in the text, do not necessarily correspond exactly with the relevant information in the economic budgets of the member countries. Apart from the fact that some member Governments wish their economic budgets to be treated confidentially, the Commission's opinions on this or that point may very well differ from official estimates, forecasts and statements made in the various countries. As always, the Commission's figures and statements have been discussed with experts from the member countries, but they are nevertheless published on the sole responsibility of the Commission.

The forecasts are approximations and it cannot be repeated often enough that they do not claim to show what will in fact happen. They show the developments that are likely to occur when certain assumptions are made concerning such factors as the world business situation and economic policy both inside and outside the Community. Naturally every endeavour is made to make these assumptions as realistic as possible. But this does not mean they may not need amending as time goes on. On the contrary, it is just when forecasts incite those responsible for economic policy to take action which prevents complete realization of the forecasts that they are most useful. Examples are forecasts of a price rise or of a deterioration in the trade balance.

On this occasion the choice of the most realistic hypotheses was particularly difficult, since only the broad outlines of the economic policy it was intended to follow in Italy was known and little in the way of specific measures had actually been decided on. In France on the other hand concrete decisions had already been made and measures taken; but it was not sufficiently clear whether a stricter anti-inflation line would be considered necessary and adopted. In the Netherlands again a complete change in wage policy had just occurred, whose full consequences for economic policy have probably not yet been drawn.



I. THE OVERALL SITUATION

In 1963 economic activity in the Community again expanded quite considerably. True, the rise in real gross Community product at about 4 % was somewhat smaller than the 5 % between 1961 and 1962 and the 5.3 % between 1960 and 1961. This does not, however, mean that there has been any significant strengthening of the longer-term factors which tend to weaken economic growth in the Community. The slower expansion of production in 1963 can be ascribed more to chance factors, in particular the exceptionally unfavourable weather. The tendencies which made for slower economic growth were without doubt still present at the beginning of 1963—and mainly affected the development of investment by enterprises—but they gave way to a more or less distinct recovery as the year went on.

Total demand in monetary terms rose none the less almost as much as between 1961 and 1962. Since, however, supply from domestic sources grew more slowly—the continuing labour shortages, which even became more acute in some areas, made it impossible to expand production more rapidly—this greater demand in monetary terms was in part reflected in higher prices and a considerable further deterioration in the Community's balance of current payments.

In 1963 external demand (from non-member countries) made a greater contribution than in 1962 to the expansion of total demand. For the full year, exports of goods were probably up about 4.5 % in value and 4 % by volume over 1962, after rising only about 1 % (value and volume) between 1961 and 1962. If we look at the

way exports developed in 1963, the change in trend—from the continued slackening in the pace of expansion that persisted into the early months of the year to the acceleration that marked the rest of the year—becomes clearly recognizable. The recovery is certainly to be attributed in the main to the direct and indirect impact of the business revival in leading non-member industrial countries.

Internal demand continued to expand briskly. If growth was somewhat slower than between 1962 and 1963, this was mainly due to slower expansion of gross fixed asset formation. Investment in building and construction did not attain the growth rate of the preceding year, despite efforts to recoup the relatively large production losses of the 1962/63 winter and despite a considerable increase in the numbers employed in this industry. In addition, the industrial propensity to invest was still relatively weak in the first half of the year, and this attitude affected in particular the demand for investment goods; though investment recovered somewhat in the second six months, its effect on the full year could not completely compensate for the earlier slowdown.

The expansion of consumer demand also weakened, albeit very slightly. This does not apply to current spending by the public authorities, but to consumer spending by households. Here again the slowdown was mainly confined to the Federal Republic of Germany, where the rise in wages lost momentum and the savings ratio increased. Although in Italy and France the opposite trend prevailed, there was on balance a slight slowdown for the Community as a whole. In volume the growth of private consumption between 1962 and 1963 was about 5 %, compared with 6 % from 1961 to 1962.

As already stated, supply from domestic sources rose somewhat more slowly than in the preceding year. Industrial production (as defined in the Index of the Statistical Office of the European Communities) was probably up 5 %, after increasing by 6 % between 1961 and 1962. The growth of agricultural output was decidedly weaker than in the preceding year, whereas the lively expansion in the services sector continued.

Imports from non-member countries rose rather more rapidly than in 1962. Imports of goods were up about 10.5 % by volume and in value, compared with 8 % between 1961 and 1962.

The internal trade of the Community expanded even faster. The increase in merchandise trade between the member countries may be estimated at about 16 % in value, as against 14 % for 1962. Decisive for this development were not only the further steps taken to establish the common market and the lively expansion that

despite everything was a feature of overall demand, but also the appreciable differences from one member country to another which developed during 1963 in the relation between expansion of internal demand and expansion of internal supply.

These differences are clearly reflected in the way price levels developed. For the Community as a whole the trend was again upward, with relative stability in the Federal Republic of Germany and also—in the first half of the year—in the Netherlands and Belgium, but a stronger upward price push in Italy and France. It is clear that expansion of the Community's internal trade was an essential factor in preventing prices in these two countries from rising even further. On the other hand, there can be no doubt that it also affected prices in those member countries where they are still comparatively stable.

Since imports increased more than exports, the Community's deficit on trade swelled further: in 1963 it probably amounted to about \$2 800 million. This means that the deterioration since 1959 has been almost \$4 000 million.

Although, mainly because of the trend in merchandise trade, there were practically no further surpluses on current account, the Community's overall balance of payments again showed a surplus in 1963, particularly as a result of greater imports of private capital. However, these trends grew distinctly weaker in the second half of the year.

With these estimates of results for the full year 1963 it may be useful to give a few figures about longer-term economic developments in the Community. Between 1958 (the first measures to set up EEC came into force at the beginning of that year) and 1963, the gross Community product grew by about 30 % (USA 22 %; United Kingdom 16 %). The index of industrial production alone rose 41 %. The general standard of living, in terms of real private consumption per head, has gone up about 23 % in the last five years, while the Community's internal trade has risen by approximately 130 %. In trade with non-member countries, imports have advanced 51 % and exports 35 % (world trade, exclusive of intra-Community trade, rose by 31 %).

In 1964 economic expansion will continue. Demand should grow at roughly the same pace as between 1962 and 1963 and the growth of supply from sources within the Community might speed up a little.

On the demand side a speed-up is expected mainly in external demand, i.e. in exports of goods and services from the Community to non-member countries. This is chiefly because of the expansive outlook for world business.

Within the Community the volume, and perhaps also the value, of investment can be expected to grow more rapidly. The livelier trend in the expansion of investment by enterprises observed in the second half of 1963 will probably continue. Despite certain limitations on the expansion of public activity in building and construction, normal weather in 1964 after the abnormal conditions of 1963 should of itself ensure that investment in building rises more rapidly than between 1962 and 1963—an additional impetus will come from the continued briskness of demand.

The growth of private consumers' expenditure on the other hand will probably slow down somewhat. However, since the price rise might simultaneously flatten out a little, the real increase in consumption is unlikely to fall off significantly.

Assuming normal weather, the increase in production could be somewhat greater than between 1962 and 1963. All in all, the Commission's staff at present consider that an increase of about 4.5 % in the Community's real gross product between 1963 and 1964 is possible.

Imports from non-member countries will probably again rise appreciably, although their annual growth may be somewhat smaller than between 1962 and 1963. There could be some further deterioration in the balance of trade, and current payments may even show a moderate deficit in 1964.

The forecasts at present established in no way suggest that there will be a sufficient movement towards stable prices. Even if there is a fall in the rate at which prices rise in France and Italy (there will be more chance of this if stabilization policy is tightened up), in the Netherlands and Belgium stronger rises are probable. In the Federal Republic of Germany it is quite conceivable that upward pressures on prices will become more marked as 1964 advances.

For the Community in general it must be noted that inflationary pressure will be the main problem facing those responsible for economic policy: such pressure must be eliminated or prevented from reappearing. Unless budget policy and credit policy are used in most member countries to slow down the expansion of internal demand generally, there is no prospect of success in this direction. One merit of this policy of general restraint, which has in part been put into practice already, is that it is the most likely to ensure that the balance of external transactions does not deteriorate too far and too long; if this were to occur, the Community would eventually have great difficulty in fulfilling its obligations in connection with development aid. Should such a policy result in a somewhat smaller real economic growth than at present forecast, this would have to be accepted in the interest of equilibrium, the more so as establishment of this balance would in turn be a major factor in rendering economic growth possible over a longer period.

A. The balance-sheet for 1963

1. The world economic situation in 1963

In 1963 economic developments in non-member countries provided greater stimulus to the Community's economy than in the previous year. The world economy was increasingly dominated by expansive forces which replaced the trends to slower economic growth that in many industrial countries of Europe, including some member countries of the Community, had continued right into the first quarter (when their effects were aggravated by the exceptionally severe winter). From the spring onwards the growth of production picked up again and there was a more positive attitude to stocks of raw materials. The economic pick-up in a number of leading industrial states, including those in the Community, quickly improved the sales opportunities open to the raw materials countries and to higher prices for their goods.

Without doubt the distinct improvement in the world economic situation was partly due to the economic measures that had been taken, particularly in the United States and the United Kingdom, but cyclical forces and—in the Community—the additional factors of integration and accelerated structural change also played a role. In some countries these additional factors were probably in part responsible for the brevity of the period during which investment by enterprises was slowing down.

In the United States expansion has again become more marked, and in the economy as a whole it has undoubtedly been gathering force. At first this was mainly due to considerably higher public spending and a quite rapid expansion of private consumer's demand, which in turn reflected not only an increase in the numbers at work and higher wages but also a vigorous expansion of consumer credit.

The development of private investment varied considerably during the year. In the first six months the main increase was in housing investment. Investment in stocks also rose strongly during this period as a result of uncertainty about the wage negotiations in the steel industry scheduled for mid-year. In the second half of the year the build-up stocks was therefore correspondingly weaker once the wages discussions in the steel industry had been concluded. It was only in the second half of the year that continuing economic expansion led to an appreciable increase in fixed investment by enterprises. Here the higher tax allowances for depreciation probably played a not unimportant role. Net exports also went up slightly in the course of the year.

Between 1962 and 1963 the real gross national product of the United States will have risen about 3.5 % (in monetary terms by 5 %) after having gone up 6.5 % (7 % in monetary terms) between 1962 and 1961, which, however, was a year of marked recession. Industrial production (as defined for the national index) rose 5 %. But despite the faster pace of expansion unemployment was still quite high (5.9 % in November). The deficit

in the balance of payments showed a distinct tendency to shrink in the second half of 1963, particularly as a result of a policy of higher interest on the short-term capital markets and of the Administration's proposed interest equalization tax. In the first half-year the deficit had risen, mainly because of greater outflows of capital; at about \$2 100 million for the whole of 1963 it will hardly have been any smaller than in 1962.

In the United Kingdom, where economic development was marked around the turn of year 1962/63 by clear signs of recession, a vigorous recovery occurred as the year went on. One factor in recovery was favourable development of exports which was partly a result of differences in the business situation between the United Kingdom and the other leading industrial countries, including the Community. At the same time the official measures to stimulate the economy were reflected first and foremost in the speedier expansion of private consumption. To this must be added, in the second half of the year, the impact of a reduction in income tax and the pump-priming effect of an appreciable rise in public expenditure, particularly investment expenditure.

Fixed investment by enterprises probably reached its lowest ebb in the first quarter of 1963. Here, however, as with investment in stocks, it is not possible to speak of any marked upturn even in the fourth quarter. As against this, activity in housing recovered fully after the end of the winter.

In September the seasonally adjusted index of production for all industries was up 10 % on the January level. On average, however, the increase in industrial production for the year will probably have been much more modest (about 3 %), and the real gross national product will have been about 2 % higher than in 1962.

In various other industrial countries of Western Europe, too, the loss of momentum gave way to a recovery in 1963. This applies especially to Austria, Norway and Sweden. In Switzerland, where growth is limited by the strained situation on the labour market, real expansion did not speed up, but it was nevertheless still quite considerable. Only in Denmark did growth decelerate sharply in 1963 under the influence of various measures taken for reasons connected with the balance of payments.

In 1963 these developments in the industrial countries led to a definite expansion of world trade, which was probably about 5 % to 6 %. An essential contribution to this expansion was provided by the Community, which stepped up purchases from non-member countries more strongly than in the previous year. The developing countries' exports also benefited from the recovery, and their total gold and foreign reserves rose slightly. However, this was due not only to improved exports but to some extent—especially in Latin America—to import restrictions. It is probable that between 1962 and 1963 any change in the total amount of development aid actually provided will have been negligible.

The growing demand of the industrial countries for raw materials was also reflected in rising price trends in the relevant markets, particularly those for non-ferrous metals, wool, cocoa, oils and fats. In a few cases, however, such as sugar and sisal, the price rise was determined more by special factors on the supply side. Under the influence of the extra demand from the Soviet block, cereal prices moved up appreciably in recent months. These developments in demand and in prices were also reflected in a further steep rise in freight rates for ocean-going shipping.

2. Demand

In the Community as a whole the expansion of demand continued between 1962 and 1963 at about the same pace as between 1961 and 1962.

The improvement in the world business situation has in fact contributed to a revival in exports of goods and services to non-member countries. From the first quarter of 1963 onwards, exports of goods, which had stagnated since mid-1961, showed a considerable increase. In addition, export activity in the second quarter was largely influenced by efforts to catch up on deliveries which could not be made during the rigorous 1962/63 winter, and the expansion continued in the second half of the year, although on a somewhat smaller scale. For the full year 1963 the rise was probably about 4.5 % in value and 4 % by volume, after an increase of only 1 % in value and volume between 1961 and 1962.

Despite having gathered pace, the expansion of the Community's exports remained below that of world trade, as it had already done in 1962. It may be wondered how far a deterioration of the competitive position was responsible for this. In 1963 wage costs in the Community as a whole again rose more rapidly than in the United States, but the pace was now also more rapid than in the United Kingdom and some other countries of Western Europe. In Italy and France, where the upward push of costs was very strong, this factor of impaired competitiveness probably played a certain part. In general, however, the explanation for the relatively weak development of exports must be sought primarily in the cyclical shifts in the composition of external demand. In some of the main non-member countries private consumption was the principal factor in the economic expansion of 1963. However, more than 60 % of the Community's merchandise exports consists of machines and semi-products, for which demand developed only very weakly in the phase of the world business cycle which was dominated in 1963. The supposition that this was more important than competitiveness is supported by the figures for the Community's exports. For instance, exports of mineral semi-products, which are far from wage-intensive, were in the first half-year lower than a year earlier, whereas exports of some very highly wage-intensive consumer goods, such as textiles and electric household equipment, registered a distinct rise.

The increase in exports between 1962 and 1963 consisted primarily of deliveries to the industrial countries. But exports to the developing countries also speeded up. This applies particularly to exports to the associated overseas countries and territories, which had reduced their purchases from the Community in 1962. Sales to the other African countries and Asia also improved somewhat, while to Latin America continued their recessive trend throughout the year.

Community exports to non-member countries
(Changes in value compared with the corresponding period
of the previous year in %)

Exports to	1962	1963			1963
	Total	1st quarter	2nd quarter	3rd quarter	Total (1)
United States	+ 9.5	— 6	+ 8	+ 9	+ 5
EFTA	+ 4.5	+ 1	+ 9	+ 4.5	+ 5
including :					
United Kingdom	+ 0.5	+ 3	+ 9	+ 5.5	+ 6
Developing countries	— 8.5	— 6.5	+ 6	+ 6.5	+ 3
including :					
Associated overseas countries and ter- ritories	— 19	— 7.5	+ 20.5	+ 22	+ 9
Total all non-member countries	+ 1	— 2.5	+ 7	+ 6.5	+ 4.5

(1) Estimate

Internal demand in the Community went up more sharply than external demand, although in monetary terms its expansion was probably no greater in 1963 than in 1962. Since prices, despite their greater stability in the Federal Republic of Germany, went up on average somewhat more strongly than between 1961 and 1962, there was even some slackening in the real growth of internal demand.

The decline in the year-to-year growth rate of gross fixed asset formation already observed between 1961 and 1962 continued between 1962 and 1963, although at a slower pace. The rate of growth, which was about 15 % in value and about 10 % by volume between 1960 and 1961, fell back to 11 % (value) and 6 % (volume) between 1961 and 1962 and was probably only about 9 % (value) and 4 % (volume) between 1962 and 1963.

The trend, however, changed in the course of 1963 and the decline registered in the first quarter gave way in the following months to a limited revival.

As a result of the almost complete interruption of outside work, investment in building and construction fell away in the first quarter; the slump was, of course, particularly apparent in housing. However, the spring recovery was relatively strong, with enterprises endeavouring to make up for production lost during the winter. In the third and fourth quarters also building activity advanced fairly strongly, aided in some countries by a vigorous increase in the numbers employed in the industry. In the Community as a whole, therefore, investment in building and construction may well have risen slightly between 1962 and 1963.

The trends towards a revival of investment in plant and equipment were confirmed in most member countries during the year. In the first place it seems that by and large the decline in profit margins has slowed down, either because of an appreciable slackening of the rate at which wage costs per unit of production had been growing—as in the Federal Republic of Germany—or because, with more rapid rises in wage costs continuing, selling prices have risen more or less vigorously—as in Italy and France. In absolute terms, profits seem generally to have developed a good deal more favourably—except in Luxembourg—than between 1961 and 1962, when they showed a marked deterioration.

Along with this the expansion of private consumption, which continued to be vigorous, had a stimulating effect on purchases of investment goods by the corresponding industries. Moreover, the pick-up in external demand, observed from the beginning of the second quarter onward, may well have increased the export industries' propensity to invest, especially in the Federal Republic of Germany, the Netherlands and Belgium. Enterprises in general, but particularly those engaged in building and construction, tried to combat continuing labour shortages and rising wages by increased investment in rationalization. In addition, the raising of funds on the financial markets was, at least till the summer, rather easier than in 1962. All these factors resulted in a fairly general revival of the propensity to invest and of actual investment. Only in a few branches, particularly iron and steel, where activity seems to be lagging behind the general trend and world-wide structural difficulties exist, was there, if anything, a tendency to limit investments.

Investment in stocks showed a recessive trend at the beginning of the year. This was due in particular to the exceptionally heavy demand for energy products coupled with temporary difficulties in transport and supply; pithead stocks of coal fell from 15 million tons at the beginning of January to 11 million tons at the beginning of April. This run-down continued in the following months, although at a slower pace, whereas vigorous endeavours to replenish and expand stocks of petroleum products were noted. Import figures for most raw and basic materials since the spring of 1963 also indicate a marked tendency to build up stocks, which was certainly due in part to the rising price trend on world markets.

The increase in consumption expenditure continued in all member countries. Current spending by the public authorities was particularly vigorous, much of it due to increased expenditure on personnel. In fact 1963 was marked by an appreciably greater rise in public service wages and salaries than 1962.

The growth of private consumer's expenditure again slowed down somewhat. From 1962 to 1963 it was about 9 %, as against 10 % between 1961 and 1962 and 11 % from 1960 to 1961. Prices rose at roughly the same pace as in the previous year. In real terms consumption in 1963 will therefore most probably have been about 5 % higher than in 1962, after rises of 6 % in each of the two preceding years.

These overall figures for the development of private consumption this time conceal differences in the way individual member countries developed : there was a slowdown in growth (in both real and monetary terms) in the Federal Republic of Germany, and, correspondingly, acceleration in the other member countries taken together.

Between 1962 and 1963 the real expansion of consumption in the Community as a whole was, for the first time in ten years, substantially stronger than that of investment. The real increase in consumption was most marked in the second half of the year, after having weakened in the early months because of the loss of income in the long hard winter and the rather sharp price rise usual at the time of year.

The expansion of private consumption was based chiefly on a vigorous rise in earned income. Thus, the total nominal income of workers went up 7 % in the Federal Republic of Germany, in B.L.E.U. by about 9 %, and more than 10 % in the other member countries, wage and salary increases being the determining factor. In 1963 the share of wages in the national income of most member countries went up again, the sharpest rise being without doubt that which occurred in Italy.

Thus in the year just passed there was a further clear rise in real living standards. The increase in real consumption per head of population in the Community as a whole was about 4 %; it ranged from almost 2.5 % in the Federal Republic of Germany to almost 7 % in Italy. This development was specially apparent in the number of consumer durables. Thus, the number of motor vehicles and television sets per thousand inhabitants in the Community as a whole in 1963 was over a hundred. At the beginning of 1961 there were only 78 cars and 60 television sets per thousand inhabitants.

3. Production

The increase in supply of domestic origin declined somewhat in the annual comparison particularly as a result of the production setbacks caused by the weather in the early months of the year.

The long freeze-up in the early months had an inhibiting effect on some agricultural production. Much seed was killed in the winter and new sowing with summer corn had to be undertaken in large areas of the Community. In addition, the production of vegetables—which at this time of the year is in any case small—was considerably lower than a year earlier. As the year went on, however, vegetable production was stepped up appreciably, so that in the annual comparison the results of the harvest were still quite good. It is true that the cereals harvests in 1963 was 3 % to 4% below the level of 1962 which, however, was a record year. More potatoes and fruit were harvested in 1963 than in 1962 and the results were above the average of recent years. Animal production on the whole increased only slightly, mainly because milk production was affected by the constant cold weather in the early months and then by the late green forage harvest. Similarly, slaughtering declined as the year went on after having speeded up in the early months.

In 1963 industrial production continued to grow. According to the Index of the Statistical Office of the European Communities (excluding building, food, beverages and tobacco) production was up 4 % in the first half-year and about 5 % in the third quarter over the corresponding period of the previous year. The unusually slow growth of production in the first six months is mainly attributable to losses caused in the first quarter by the exceptionally cold winter weather.

On the whole the increase in industrial production between 1962 and 1963 may have been 5 %, after 6 % in 1962 and 6.5 % in 1961 (in each case compared with the preceding year). If we disregard the dip at the beginning of 1963 and the efforts to make up for losses in the spring months, the underlying expansionary trend of production was unchanged in 1963 when compared with the last quarter of 1962.

As to the trend by branches, the basic materials and semi-products industries, with the exception of building materials and chemicals, showed no substantial production advances in the annual comparison. In iron and steel the 1962 level of production was hardly exceeded and the rate of utilization of capacity fell a little. In coalmining the main result of the exceptionally lively demand in the early months of the year was a decline in pithead stocks. In fact the amount of coal mined was even down more than 2 % in the annual comparison, and this is mainly attributable to the strikes in France at the beginning of the year.

In the investment goods sphere the second half of the year saw certain livelier trends in mechanical engineering after the marked slowdown in the first quarter. Consumer goods industries were distinguished by a further speed-up in expansion. Textiles, for instance, which in 1962 had increased production by only 2 %, expanded more than 5 % in 1963. Output of private vehicles was up about 17 % on the previous year (between 1961 and 1962, however, growth was 18 %).

Between 1962 and 1963 the real contribution of the services sectors to the gross Community product may have risen almost as fast as between 1961 and 1962.

All in all the Commission at present estimates the growth of the real gross Community product at about 4 %, following 5 % between 1961 and 1962 and 5.3 % between 1960 and 1961. The longer-term trend for real expansion to slacken has, however, hardly continued if we exclude the impact of special factors (weather, strikes). A year ago the Commission forecast a 1963 growth rate of about 4.5 %.

Employment in the Community continued to be increasingly determined in the main by the availability of additional manpower; the total rose less between 1962 and 1963 than between 1961 and 1962. Not only was the growth of the active labour force smaller, the number of immigrants having declined considerably following the sharp fall in repatriation from Algeria to France, but the average number out of work in 1963 was slightly higher than in 1962 because of difficulties in employing people in the winter months. As the slowdown in the growth of employment was rather less pronounced than that of the growth of domestic production, the advance of productivity (defined as the worker's contribution to GNP) in the economy as a whole was not as high as between 1961 and 1962.

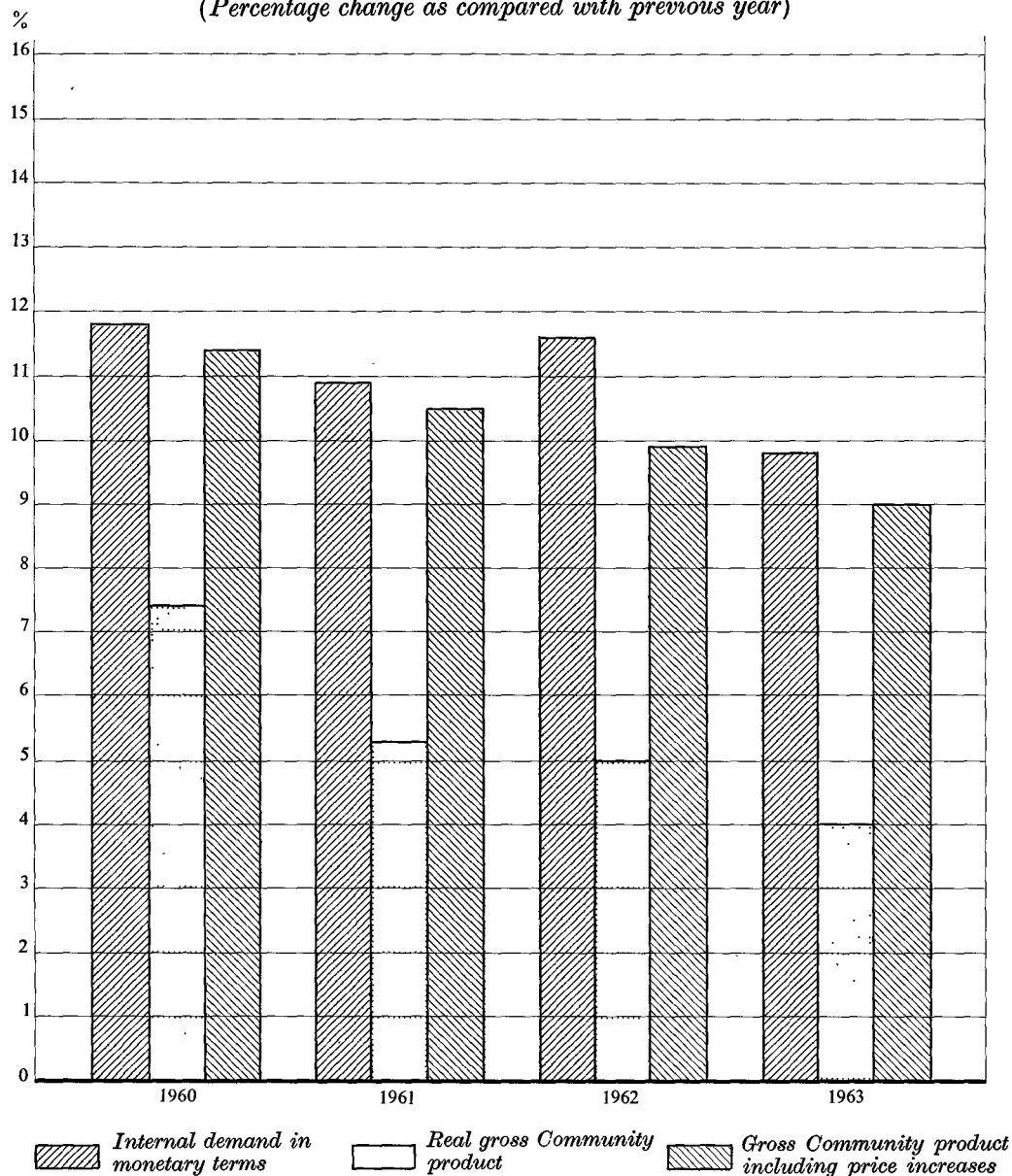
The increase in paid employment mainly affected building and construction and the services sectors. On the other hand in industry (exclusive of building and construction) employment remained practically unchanged, and in the Federal Republic of Germany it even declined.

Although on the one hand the further reductions in the working week agreed upon in the wages agreements hardly affected industry, the working time lost in the winter months and the longer paid annual holidays introduced in some member countries nevertheless brought about a reduction of hours actually worked during the year. The increase in output per man-hour in industry was probably therefore rather higher than the growth rate of industrial production.

In most member countries the number of unemployed continued to be extremely low, if the large increase due to special circumstances in the early months of 1963 is disregarded. In France, where unemployment had risen appreciably in the autumn of 1962 as a result of repatriation from Algeria, there was a downward trend throughout the whole of 1963. The slightly easier situation observed at times in this country, due partly to the reduction of the period of military service, again gave way to strains after mid-year. In Italy the number of unemployed declined further, although not to the same extent as between 1961 and 1962. In the north of the country the labour market

TREND OF COMMUNITY INTERNAL DEMAND AND OF COMMUNITY GROSS PRODUCT

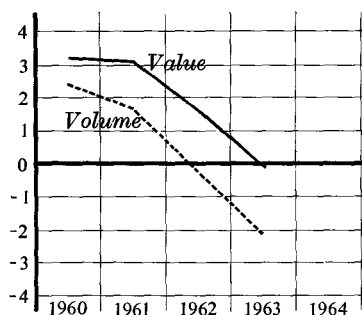
(Percentage change as compared with previous year)



Note:

1. Excluding the Grand Duchy of Luxembourg;
2. On the basis of official exchange rates;
3. Gross product at 1958 prices.

BALANCE WITH NON-MEMBER COUNTRIES (goods, services, factor income)



Note:

1. Excluding the Grand Duchy of Luxembourg;
2. Value: official exchange rate;
3. Volume: 1958 prices, 1962 exchange rate.

situation increasingly resembled that in other member countries, i.e. it showed distinct features of overemployment. This applies also to the Netherlands, in particular, where labour shortages became more acute as the year went on, and to Belgium, where there is not only full employment but abnormal strains have appeared on the labour market. In the Federal Republic of Germany the labour market situation became slightly easier until autumn, without, however, achieving balance. Since then the trend has rather been for new strains to appear.

4. The balance of the markets

The Community's imports from non-member countries rose more strongly in 1963 than in the previous year. On the basis of customs returns the rise in imports of goods for the full year was 10.5 % in both value and volume, compared with 8 % between 1961 and 1962. After a very marked slowdown in the early months of the year due to weather conditions, the second quarter saw a distinct recovery, which continued as the year went on. This not only showed how great was the tendency for the Community to go on importing but, in view of the quite marked inflationary trends in certain member countries, especially France and Italy, it may also have distinctly enhanced the market position of exporters in non-member countries—the more so as some of these non-member countries, in particular the United States and the United Kingdom, have greatly stepped up their efforts to export to the Community.

In keeping with the very vigorous expansion of consumption, particularly in France and Italy, import activity was most lively in manufactured consumer goods. From mid-year, however, there was also some tendency for imports of investment goods to pick up, and imports of raw materials rose considerably. Lastly, imports of energy products to replenish stocks rose strongly from spring onwards. As against this, farm imports in the first half of 1963 were at a lower level than in the previous year because of the relatively good harvests in most member countries in 1962. In the second half of the year imports probably picked up to some extent following the rather smaller 1963 cereals harvest.

The available statistics again point to a comparatively strong rise in the Community's purchases in non-member industrial countries : imports from the EFTA countries again increased briskly in the first nine months. The growth rate of purchases from the developing countries on the other hand did not rise. A vigorous upsurge in imports from the Near East and Commonwealth countries was accompanied by stagnation in those from the associated overseas countries and territories (with a distinct drop in Algerian sales to France) and by a slowdown in the growth of imports from Latin America (due to a decline in agricultural imports).

Community imports from non-member countries
(Changes in value compared with the corresponding period
of the previous year in %)

Imports from	1962 (1) compared with previous year	1963			1963 (2) compared with previous year
		1st quarter (1)	2nd quarter	3rd quarter	
United States	+ 9.5	+ 9	+ 16	+ 14	+ 13
EFTA	+ 11.5	+ 9	+ 16	+ 14	+ 13
including :					
United Kingdom	+ 19	+ 15	+ 24	+ 21	+ 20
Developing countries	+ 7	+ 9	+ 6.5	+ 8	+ 8
including :					
Associated overseas countries and territories	+ 4	+ 3	— 0	+ 4	+ 1
Non-member countries as a whole	+ 8	+ 7.5	+ 12	+ 12.5	+ 10.5

(1) Excluding purely statistical adjustments made to the import figures in France and the Federal Republic of Germany.

(2) Estimates by the Commission's staff

Trade between the member countries grew at a much more rapid pace in the second and third quarters after the slowdown caused in the early months of the year by the extreme winter weather. In comparison with the corresponding periods of the previous year the increase in value was 21 % in the second quarter and 19 % in the third, as against only 9 % in the first three months of the year. For 1963 as a whole the expansion of trade within the Community probably reached 16 % in terms of value, as against 14 % between 1961 and 1962.

The increase in trade between the member countries is partly explained by the strong flow of imports to France and Italy as a result of the excess demand in those countries. In the first nine months of the year French and Italian imports from the other member countries were no less than 25 % and 29 % respectively above the level of the same period in 1962. Trade between the member countries was also stimulated by the fresh cuts in internal customs duties on 1 July 1963 and also by some tariff reductions introduced by France and Italy for reasons of economic policy.

Although at the time of writing complete statistical data on the development of internal trade by categories of goods are not yet available, it appears that the greatest

increase was again in finished goods. Deliveries and purchases of energy products also went up strongly, as did trade in chemicals. Unlike trade in farm products with non-member countries, intra-Community trade in these products again rose this year. One reason for this may have been the way the agricultural markets in Italy and France developed and the temporary customs and other liberalization measures in these countries. It may also be a reflection of the gradual implementation of the common farm policy, which had a stimulating effect on intra-Community trade.

The trade balances of the individual member countries with other members of the Community showed a sharp deterioration in the case of Italy, largely because the vigorous expansion of internal demand, rising costs and also certain losses in agricultural output slowed down the expansion of this country's exports; by comparison, the deterioration in France's trade balance was on a smaller scale and the inflationary trends in that country hardly affected the growth of exports. The counterpart of the vigorously increased import demand in Italy and France is a considerable speed-up of deliveries by the Benelux countries and the Federal Republic of Germany. As a result the balance improved in the Benelux countries despite an appreciable increase in their purchases. The Federal Republic's export surpluses in trade with the other member countries also increased, the more so as the growth of imports, particularly of farm products, slackened.

By contrast to the expectations entertained at the turn of the year 1962/63, upward price trends hardly weakened in most member countries in 1963. Only in the Federal Republic was a clear slowdown noticeable until the autumn. In Italy and France, and to a lesser extent also in Luxemburg and Belgium, the upward push of prices even gained in strength. In October/November the cost of living was up on the corresponding level of the previous year by 8.1 % in Italy, 6.8 % in France, 4.6 % in the Netherlands, 3.9 % in Luxembourg, 3.4 % in the Federal Republic, and 3.2 % in Belgium.

The price rises were largely the result of the interplay of imbalances in the supply and demand relationship and of continually rising costs, with the importance of these various factors varying a great deal from country to country. The effects of excessive demand were noticeable in Italy and France particularly. Also in previous years, the rise in wage costs per unit of output hardly weakened in most Community countries, except in the Federal Republic of Germany, where the upward movement of wages was less lively than in 1962. To this must be added the fact that a number of imported raw materials became dearer, whereas in the previous year raw material prices had still in the main been declining.

The price level of industrial finished goods remained relatively stable, owing largely to the sharper competition caused by heavier imports from non-member countries and by the wider trade possibilities within the Community, one reason for which was the further reduction in duties on trade between member countries. Only in France and Italy did average prices for finished goods again rise considerably, but in some other countries

too rising price trends for certain items came to the fore in the second half of the year. In keeping with the divergent trends in the demand for finished goods, there was generally a further increase in the price of industrial consumer goods and a tendency for the price of investment goods to continue its slight decline—with the exception of building prices, which again rose considerably in all member countries.

Prices for services also continued their 1962 rise unabated. Finally, the trend of consumer prices was again largely determined by changes in food prices. The increase in consumer prices, which was particularly marked in the first quarter, was largely due to the higher food prices which were to a great extent caused by the weather. At mid-year the rise in consumer prices had indeed slowed down with the seasonal weakening of farm prices, but later in the year rising trends again predominated in most member countries.

Despite the recovery of exports, the vigorous rise in imports led to a further deterioration of the Community's trade balance. On the basis of customs statistics the deficit probably rose by about \$1 200 million between 1962 and 1963 to reach about \$2 800 million. This means that since 1959, when there was still a surplus of almost \$1 000 million, the Community's trade balance has deteriorated by almost \$4 000 million, which has certainly greatly helped to underpin the world economy in recent years. This development is also reflected—although to a lesser extent—in that of the Community's total balance of current payments. In 1959 this had still closed with a surplus of \$2 800 million, in 1962 the surplus was only \$850 million, and for 1963 there will probably be practically no surplus at all.

As against this, however, the balance of capital transactions in 1963 probably improved. One factor here was increased foreign buying of securities (particularly in the Federal Republic of Germany), and greater borrowing abroad by the Italian banks also played a part. Between January and October the gold and foreign exchange reserves of the member countries' monetary authorities rose by no less than \$1 300 million, whereas the increase in the same period of 1962 had been only \$574 million. At the same time, however, there was probably a distinct deterioration in the net foreign exchange position of the commercial banks.

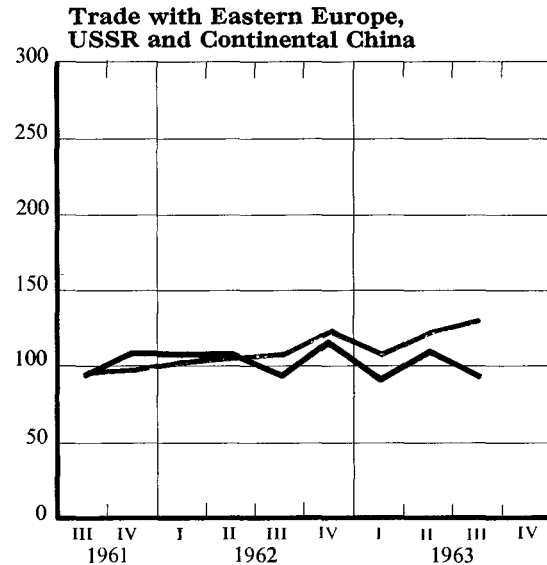
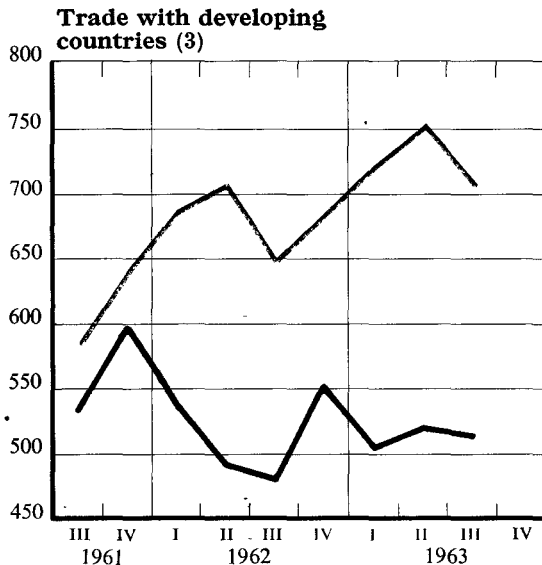
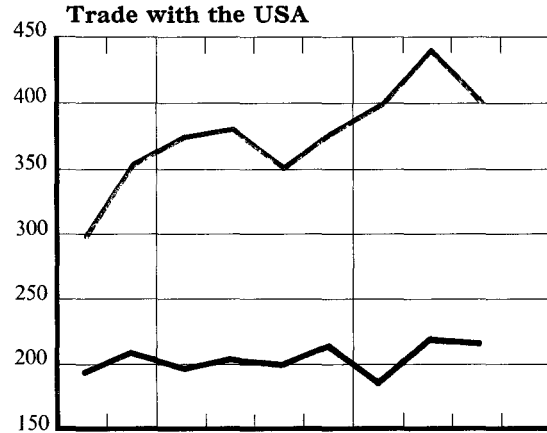
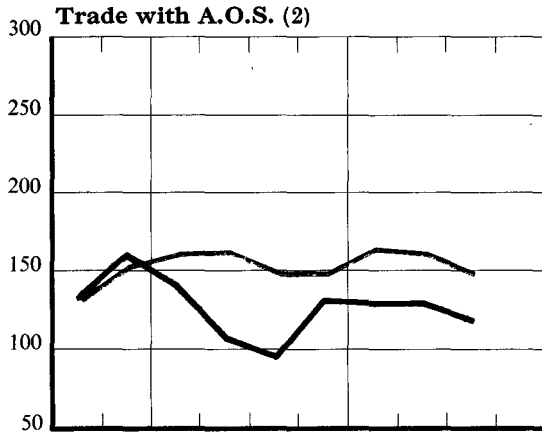
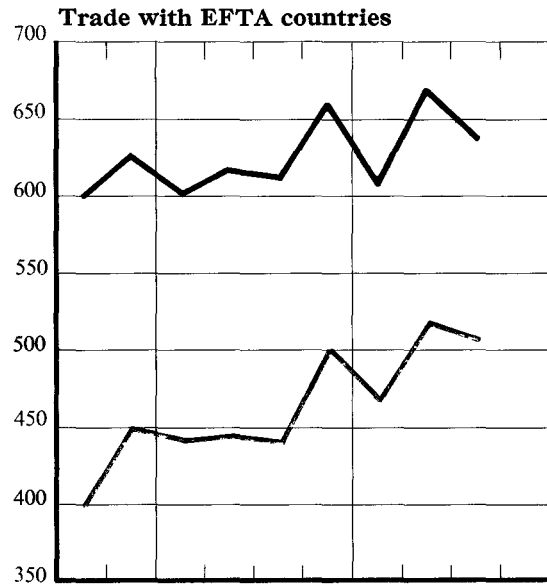
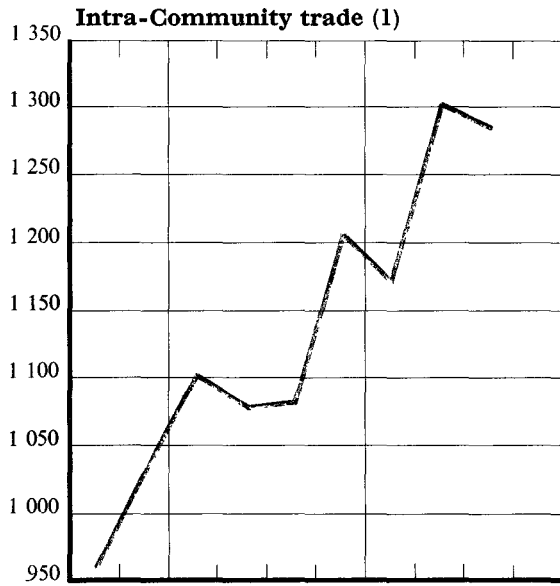
The development of internal liquidity in the Community as a whole was chiefly marked by the fact that the inflow of funds from abroad lost somewhat in importance in 1963 while the expansion of domestic credit advanced. In most member countries the availability of money increased further and contributed either, as in Italy and France, to the emergence of pronounced disequilibrium or, as in the Netherlands and Belgium in the second half of the year, to a threat of disequilibrium.

In all these member countries a change in liquidity and credit policy occurred in 1963 against the background of a clearly altered basic monetary situation. This change

COMMUNITY TRADE

Monthly averages

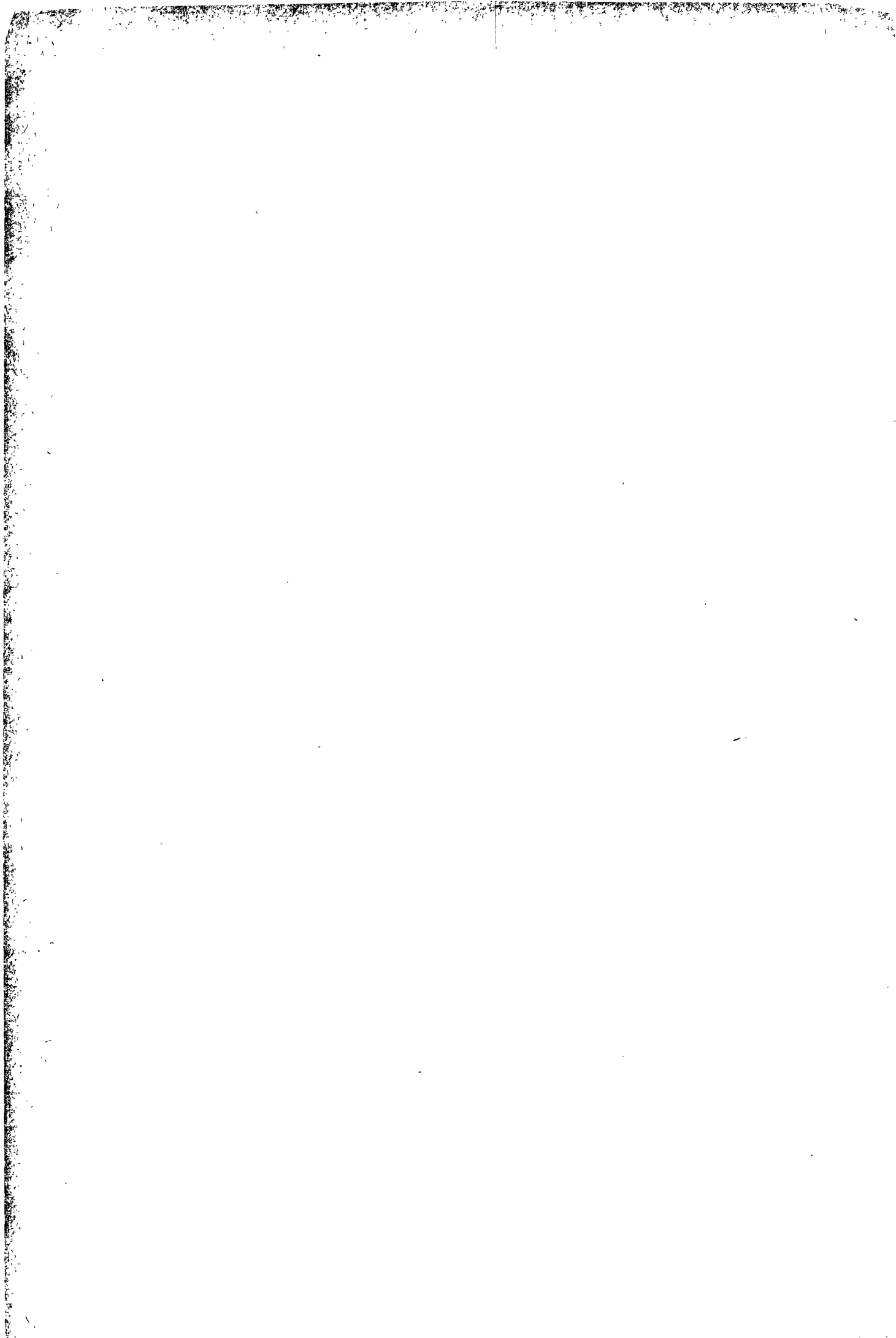
In millions of dollars



— Exports

— Imports

- (1) According to import returns.
- (2) A.O.S. : Associated Overseas States (overseas departments, countries and territories).
- (3) According to GATT classification : non-industrialized regions other than A.O.S.



was particularly marked in France, less so in Italy. In both countries money supply in the first nine months was 17 % and 18 % respectively above that of the corresponding period of the previous year. In France the first liquidity and credit measures were introduced as far back as the beginning of the year. As the year advanced, strains in the national economy increased and these measures were supplemented and tightened up by the "September stabilization programme". In November, bankrate was raised by 0.5 % after the inflow of foreign exchange had clearly abated. In Italy also liquidity and credit policy had in the early months of the year tended to be expansionary, but here too a more restrictive line was adopted as the year went on. For a good part of the year, however, the shortage of ready capital in Italy, due to the deterioration in the balance of payments, was not felt to the full, since the banks increased their external borrowing to an almost equivalent extent. It was only towards the end of the year that this means of raising funds became increasingly difficult and thereby improving the chances of a genuine restrictive policy on liquidity. In the Netherlands the quantitative limit on credit was first lifted at the beginning of the year, but when expansion of credit again speeded up as the year went on, the banks were once more advised to keep it within limits. In Belgium certain consequences of the tax reform and the increased claims of the Treasury led to a rise in interest rates, which was further encouraged by the strength of the expanding business demand credit. For this reason the National Bank raised the discount rate to 4 1/4 %. As against this, interest rates for shorter term financing in the Federal Republic of Germany still tended slightly downwards. When liquidity was low the banks in this country mainly used internal possibilities of procuring money; on balance in any case the net change in their short-term foreign holdings has been negligible. With interest rates tending to move upward in the leading financial centres abroad, the Bundesbank's liquidity and interest policies remained largely neutral.

In 1963 more capital was taken up through the securities markets than in the previous year. In particular distinctly more fixed-interest-bearing securities were placed in most member countries. The increased capital raised went chiefly to the public authorities, while—to judge by the partial figures available — issues of bonds and shares by industrial enterprises were lower than in the previous year. Calls on the capital market by the public authorities in the Federal Republic, the Netherlands and France were particularly high in comparison with the previous year. In the Federal Republic and in the Netherlands this undoubtedly contributed to some increase in the cost of capital. In Belgium and Italy level of interest on the capital market was distinctly higher at the end of the year than at the beginning. In Italy this was due less to the demand for capital than to its increasing scarcity (capital outflows).

In 1963 there was a distinct change in the cash position of public budgets in some countries. Thus in France the cash deficit in the first nine months was more than twice as heavy as a year earlier. As in Italy, where the trend of cash transactions also made a great contribution to liquidity—this development was a decisive factor in the obviously excessive expansion of domestic demand. In Belgium the increase in State indebtedness

in the first ten months of the year was more than 40 % greater than in the same period of 1962. As against this, in the Federal Republic of Germany in the first half-year there were relatively high cash surpluses of the type which affect the internal economy. In the second six months, however, the trend towards greater liquidity predominated here also. In the Netherlands too, with incomes growing at a distinctly slower rate, a quite vigorous increase in expenditure occurred.

B. Outlook for 1964

The outlook for world business in 1964 can be considered favourable. The extent and duration of expansion will however depend in no small measure on whether or not the proposed tax reduction in the United States is quickly implemented. The most recent developments seem to show that the expansionary forces in that country are strong enough to ensure that, in the first half-year at any rate, economic growth will be considerable. If, however, the tax reduction has not yet come into force at the end of this time, there would be a real possibility of a distinct slowdown in growth later in 1964, the more so as enterprises are probably already reckoning to some extent on the effects of the tax reduction, and the propensity to invest would certainly decline if the reduction were not in fact made. However, as the bill had a generally favourable reception in the competent Congressional Committee, the 1964 forecasts can be made on the assumption that it will be approved in good time.

There can be no doubt that expansion should then be very lively in the United States throughout 1964. Private consumption and investment by enterprises will receive an extra stimulus at a time when both components of demand are in any case very expansive. In addition a further, albeit rather more moderate, rise in public expenditure is to be expected in 1964. Present forecasts of economic development therefore start from the assumption of a strong increase in the gross national product (about 5.5 % in terms of volume). Expansion of this order would be accompanied by a considerable rise in imports, which would doubtless again give a distinct boost to world business. A reduction in the surplus on current account which, in view of the favourable prospects for American exports, would certainly be a small one, will not necessarily harm the overall balance of payments, whose high deficit in past years was largely due to the outflow of private capital. The tabling of the bill on the interest equalization tax has already produced an improvement in this respect in recent months. Strong domestic economic expansion in the United States could in addition further cut the deficit on the balance of capital transactions because the expectation of higher profits provides an incitement to invest more savings at home than hitherto.

In the United Kingdom also economic prospects for 1964 are quite favourable. The still incomplete figures for the final quarter of 1963 point to an unabated vigorous upswing. The outlook for exports in 1964 is definitely promising, especially in view of the generally satisfactory trend which at present seems to govern wage costs. Along with a further increase in public spending and private consumption, a revival of fixed investment by enterprises could encourage the business upswing in 1964. The effects on the growth of production may be enhanced by the fact that the expansion would affect various branches (in particular, mechanical engineering and certain investment goods industries) which still have ample reserve capacity. The real gross national product for the year will perhaps be about 5 % higher than in 1963. At the same time, however, there will

also be an appreciable increase in imports, although the volume will mainly depend on the propensity to build up stocks, and this is difficult to judge in advance. Taking the year as a whole, the rise in imports likely to be generated by this growth of domestic demand could still be almost offset by increased exports.

In general slightly accelerated expansion is to be expected in the other EFTA countries. The average increase in gross national product could be more than 4 %. A somewhat stronger growth is considered possible in Sweden and Switzerland, and in none of the other countries is any distinctly lower growth rate expected. In Denmark a slight recovery in the pace of economic growth is likely to take place.

The generally quite favourable trends in the industrial countries—the economic outlook for Japan and Canada is also judged propitious—will without doubt also increase the capacity of the developing countries absorb to exports in 1964. Until the autumn of 1962 these countries had to accept continually declining prices for their exports. At the same time the structural process of substituting industrial products for primary products of vegetable and animal origin left them little opportunity to increase exports, as it restricted the expansion of demand for their products in industrial countries. In 1964 on the other hand the effects of increased demand may substantially outweigh those of this substitution process. In addition, raw material prices in world markets improved considerably in 1963 and reached a level which may be maintained in 1964. In these circumstances it seems likely that demand in the developing countries for products of the industrial countries will grow more rapidly between 1963 and 1964 than in the preceding years.

Finally it seems, in the light of the economic outlook for the Community described below, that world industrial production could grow all in all about 6 % between 1963 and 1964 and world trade 7 % to 8 %.

The world business outlook suggests then in 1964 the stimulus given to the Community's economy by non-member countries will be distinctly stronger than in recent years, but the extent of the eventual rise in Community exports will also depend on supply possibilities and the competitive capacity of industries in the member countries.

In view of the endeavours to remedy economic strains in most Community countries, it can in general be expected that supply will in the main be adequate to cope with any rise in exports. It must be assumed on the other hand that labour costs per unit of production will rise further in most member countries between 1963 and 1964. At the same time the higher cost of raw materials will make it more difficult to offset this rise by bigger profits, as has generally been done so far. True, the margin of profit on home sales has improved in some member countries, and this could after all provide certain

possibilities of compensating for declining export profits. However, this does not increase the incitement to export, particularly if, as expected, business in the Community remains lively or even speeds up. It also seems hardly possible that prices for exports to non-member countries can be substantially raised, especially as the stimulus of extra external demand will come largely from the United States and Great Britain where the year 1964 at least should bring no material increase in wage costs per unit of output or in the prices of industrial products.

In any case, the effect of all these positive and negative factors is likely to be an appreciable speed-up in the growth of the Community's exports to non-member countries for the full year 1964. The increase in exports of goods could attain 6 % to 7 % (value and volume). The rise in sales to the industrial countries may be still greater, as exports to the United States and the United Kingdom may even rise by more than 8 % above the 1963 figure. For exports to the developing countries, on the other hand, the forecast is that there will be an increase of 4 % to 5 %.

Trend of supply and utilization of goods and services (1)

	1961 (2)	1961 (3)	1962 (3)	1963(3)(4)	1964(3)(5)
	At current prices (\$ '000 m.)	Changes in volume compared with the previous year in %			
Gross Community product	205.7	5.3	5.0	4	4.5
Private consumption	125.0	6.2	6.1	5	4.5
Public consumption.....	28.5	5.6	6.7	5	3.5
Gross fixed asset formation	46.2	9.5	6.3	4	5.5
Balance : Exports (6) minus imports (6)	+ 3.1	+ 2.6	+ 1.2	— 0.1	— 0.6

(1) The aggregates for the Community are computed on the basis of the official exchange rates.

(2) In 1961 prices; average 1961 exchange rates.

(3) In prices of the preceding year; exchange rates of the preceding year.

(4) Estimates by the Commission's staff.

(5) Forecasts by the Commission's staff.

(6) Goods, services and factor income.

In 1964, in the Community as a whole no less than in the majority of member countries, the expansion of domestic demand in monetary terms will be largely determined by a policy aimed at more cautious steering or even strict limitation of this expansion; its underlying growth will again be considerable.

It is highly probable that gross fixed capital formation will expand somewhat more strongly between 1963 and 1964 than between 1962 and 1963. It could grow 10 % in value and 6 % by volume.

Thus it is to be expected that the greater industrial propensity to invest, which became discernible in several member countries from mid-1963 onwards, will continue in 1964 and will lead especially to higher spending on equipment. The more favourable development of certain factors which determine investment will in the main continue in 1964, especially the livelier expansion of exports, a further considerable increase in consumer demand and the effect of labour shortages on investment in rationalization. The more favourable way profits again shaped in some countries in 1963 could also contribute indirectly to more ambitious investment projects for 1964. Against this must be set certain inhibiting influences on investment activity which stem from the policy launched in several member countries of a more or less general limitation of the growth of demand.

If in 1964 weather conditions are normal, investment in building and construction which in early 1963 had suffered severely from the exceptional cold, will certainly grow more than between 1962 and 1963. Quite apart from this, there should be no appreciable weakening in the trend of expansion of building investment in the Community as a whole even if the authorities in certain countries continue to follow a restrictive line when awarding public contracts, paying housing subsidies or issuing permits to build housing. Quite apart from the fact that current new demand will continue to be considerable, the volume of the projects in hand should in itself ensure a considerable expansion of expenditure. In 1964 again the growth of the volume of building investment will in fact depend much less on the development of demand than on possibilities of production. These have improved somewhat, particularly because of the increase in numbers employed in building and construction in 1963.

On the basis of the budget plans available at the time of writing and of the further restrictive measures planned under the stabilization programmes, it is probable that public investment will increase at a lower rate between 1963 and 1964 than between 1962 and 1963.

As for investment in stocks, there is likely to be a more appreciable increase in raw material stocks than between 1962 and 1963. This is due, among other factors, to the hard price trends predominating on world markets.

The expansion of consumers expenditure in 1964 will again impart considerable stimulus to economic activity—and to the advance of prices. The growth of expenditure could however be smaller, though not much smaller, than between 1962 and 1963.

To judge by the budget estimates available, current spending by the public authorities in the Community as a whole will grow somewhat less vigorously than in the previous year. The growth of private consumers' expenditure is also likely to slow down a little, for in Italy and France total wages and salaries are likely to rise less sharply than between 1962 and 1963. In addition, the total for 1964 in the Federal Republic of Germany will still be influenced—by the tendency to slower expansion of wages already observed in 1963. If the weather is normal, however, the volume of wages and salaries in this country will expand, because more hours will be worked in 1964 than in 1963. Transfer incomes also will again be appreciably increased. In Belgium, and particularly in the Netherlands, wage rises—and therefore the expansion of private consumers' expenditure—should be even more vigorous than between 1962 and 1963. Despite the possibility that on balance the expansion of this form of expenditure in the Community as a whole may slow down a little, an easing of prices could mean that the real growth of private consumption between 1963 and 1964 was hardly less than in the previous year (about 5 %).

The slight slackening in the expansion of total demand in monetary terms will probably not be reflected in a corresponding trend in domestic supply. On the contrary, if weather conditions are normal and allowance is made for the exceptional slowdown observed in the early months of 1963, growth in 1964 should even be more vigorous. In particular, a rather stronger expansion of agricultural output is to be expected and construction will also probably advance more strongly than between 1962 and 1963.

Industrial production (as defined in the Index of the Statistical Office of the European Communities, i.e. excluding construction, food, beverages and tobacco) is likely to attain 6 % comparing with an annual growth rate of 5 % between 1962 and 1963. Although the growth rate in the consumer goods industries, which has so far been quite rapid at times, could slow down the recovery already observed in many capital goods branches in the second half of 1963 it is likely to become more intense and widespread. In the basic materials sector, production should again expand appreciably; in iron and steel the stagnation observed in 1963 might well give way to a recovery.

In the services field a continuation of the rapid expansion is to be expected. On the whole the real gross Community product could rise between 1963 and 1964 by about 4.5 %, compared with about 4 % between 1962 and 1963.

All in all the labour market situation will continue to be fairly difficult in 1964 in view of the extremely low total of unemployed at the end of 1963 and the smaller natural increase in the active population. Meanwhile the reduction in the total of hours worked

will be less substantial than in 1963. With this manpower situation, the recruitment of foreign labour both within the Community and from non-member countries will still be of considerable importance.

As to the foreseeable price trend, there are some signs that the very sharp price rises are beginning to slow down in France and perhaps also in Italy, but the forecasts do not suggest that stabilization in 1964 will go far enough. In the Netherlands, moreover there are likely to be appreciably stronger upward price trends, mainly as a result of considerably faster wage rises. In Belgium, too, prices will rise more vigorously than in the previous year. Only in the Federal Republic of Germany is there a chance that relative stability may be maintained, but here too it is by no means impossible that more marked upward trends will again make themselves felt in the course of 1964.

The forecasts on trade with non-member countries point to a further deterioration in the Community's trade balance. However, the deficit will not grow anything like as steeply as between 1962 and 1963. In all probability the balance of current payments will now show a deficit too. The influx of private capital into the Community will also probably slow down in view of expansion in leading non-member countries and the measures taken in the United States to check the export of capital. As a result of all this the Community's overall balance of payments could show a substantially lower surplus than in 1963 or might even reach equilibrium.

C. Economic policy

In 1963 economic policy had to deal with changing problems. At the beginning of the year there was a distinct further weakening in the growth of investment by enterprises, if not an absolute downturn in the trend, and exports to non-member countries were stagnating. At the same time consumption continued to register an expansion which drew its strength from an income trend that led to rises in costs and—to a lesser extent—in prices. In some countries, however, there was a tendency for the expansion of consumption to slow down—particularly in the Federal Republic of Germany, but also at times in Belgium and the Netherlands. Current payment balances in most member countries, especially Italy and France, where the strong upward thrust of mass income and thus of private consumption continued unabated, showed a distinct tendency to deteriorate. This, however, did not affect overall payment balances (except in Italy) since there were higher capital inflows to the Community.

This situation called for a selective economic policy which was not to be exactly expansive, but also not restrictive, in its overall effects, since a restrictive policy would have more or less impaired the expansion of investments, which in any case was in danger. Selectivity ought to have taken the form of ensuring that conditions for investment by enterprises, especially the conditions for obtaining finance from banking institutions or the capital market, should continue to be favourable or, if necessary, should be improved. At the same time, ought to have been set to the expansion of wage incomes—and thus of private consumers' expenditure—and of the current spending and transfer expenditure of the public authorities. Clearly the means of doing this were to be found in the main in the fields of fiscal policy and of incomes policy, in particular wages policy. In the field of credit policy, selectivity ought to have meant discouraging those short-term credits which experience shows are very readily applied to the financing of excessive income increases, and encouraging medium and long-term credit, mainly used to finance investments.

One sector where selective economic policy was specially appropriate was building. In most member countries, largely because of constantly increasing public subsidies to housing, this sector was a source of overheating which influenced the whole wage and price field. Special measures to limit demand were called for.

An ambivalent economic policy of the type described was particularly advisable because any slackening in directly productive investments could in the long run jeopardize balanced economic growth.

A selective policy of this kind was also called for by the cost rises observed: where they were not paid out of profits (but this again has a harmful influence on investment),

these rises could lead directly to higher prices and impair capacity to compete with non-member countries where it was evident that costs and prices were more stable.

Unfortunately this sort of economic policy "mixture" was administered only imperfectly or not at all. This applies in particular to budget policy, especially in Italy and France, where on the contrary the budgets had a highly expansionary effect which was now marked in consumption and transfer expenditure. But in the important field of incomes policy, too, there was practically no progress. Only in building and construction were certain quieter trends achieved in the Federal Republic of Germany.

The consequences are evident. Their complexity was heightened by the fact that, simultaneously with the practically uninterrupted expansion of consumption in 1963, external demand again picked up, especially in those member countries which had remained relatively competitive, and the propensity to invest again showed signs of recovery. Certainly the disequilibrium in Italy and France was more marked, with partial imbalances becoming general, and there was again the danger of the other member countries being faced with a general excess of demand. In this connection developments in Italy and France will undoubtedly have influenced the other member countries not only via intra-Community trade but also psychologically.

In these circumstances there was no choice but to abandon the recommendations for a selective anti-inflation policy and propose a policy of general restriction. At the same time, however, the recovery of world business, of exports and of the propensity to invest within the Community have improved the chances that a policy aimed at a blanket restriction on demand might not lead to a decline in investment and thus adversely affect longer-term economic growth.

The first obvious need was to apply an overall curb on demand in Italy and France, using the resources of budget and credit policy. This the Commission has urged by direct representations to the Governments of the countries concerned and in particularly important statements in Quarterly Survey No. 3/63 on "The economic situation in the Community". These problems were also raised at meetings of the Economic Policy and Monetary Committees on 14, 15 and 22, 23 October respectively. In these discussions the Italian case was evidently the more disturbing, since until then the authorities in that country had only succeeded in applying a few limited measures and not a comprehensive stabilization programme. In France such a programme was decided on and put into operation in September.

In addition to France and Italy, the Netherlands also found themselves obliged—though only in the autumn—to envisage fiscal and credit policies which would curb the

development of internal demand. As a result of livelier exports and the continued boom in building the manpower situation in the Netherlands, far from easing, is suffering from fresh strains. These were one factor leading to the approval of wage increases for 1964, which will force up prices not a little and considerably worsen the balance of current payments, and which, at the same time, might threaten the long-term development of investment.

In view of the rapid expansion of demand, strains and rising prices in some member countries, growing demand from non-member countries and a growing budget deficit at home, it was no wonder that in Belgium, too, the pace of economic growth, which in any case was accelerating and in 1963 led to full employment, speeded up further. There were strains on the labour market and a steeper wage/price spiral. The National Bank therefore began to apply a policy of dearer and tighter credit. Even in Luxembourg, where some parts of the production system had long been greatly under-utilized, strains became so acute that there was a threat of inflationary developments coming simultaneously from the income and the cost sides. Here too, measures had to be taken to limit, in particular, the expansion of building demand.

The establishment of economic budgets has proved its worth as an instrument by which economic trends can be more exactly plotted and proposals for economic policy better formulated. The first provisional forecasts for 1964 were drawn up on the basis of a common skeleton forecast in the spring of 1963, and they were confronted in the Economic Policy Committee at the beginning of July. The resulting memorandum, published as an annex to Quarterly Survey No. 3/1963, still reflected the demand for a selective policy—justified in general at the time—but already pointed out, in the case of Italy and France, that if this policy failed global restrictions would also become necessary. A review of the provisional forecasts early in the autumn clearly showed the changes which had meanwhile taken place and their consequences for economic policy, namely the need for measures to curb demand in France and Italy and, in certain directions, in the Netherlands also. The Economic Policy Committee's memorandum, based on confrontation and discussion of the revised preliminary economic budgets, is printed as an annex to this quarterly survey.

The outlook for 1964 as shown in these forecasts by the Commission's staff, does not permit the conclusion that economic development will be balanced or even move sufficiently towards balance. This could only be achieved if an even stricter stabilization policy were applied, the side effects of which, however, would then modify other elements in the forecasts.

As things look at present, price levels will rise further. A slowdown in France and also in Italy may well be achieved, but on the other hand everything points to a

speed-up in the Benelux countries, and in the Federal Republic of Germany the danger of a resumption of upward price movements cannot be completely discounted. In the Community in general the movement of the price level could again become more harmonious than it was, at least in the first half of 1963. Unfortunately, however, this harmonization will probably be in the direction of a general upward movement which at all events must be considered as still too rapid to be compatible with the aims of the EEC Treaty, particularly with the stability of the level of prices required by Article 104.

At the same time there is a danger that external equilibrium might in the long run be destroyed. This equilibrium is to be understood as a situation in which the Community's current account shows surpluses sufficient to cover the net capital exports required to honour the obligations of the Member States and the Community as a whole in the field of development aid.

As already stated, the Community's trade balance deteriorated by about \$4 000 million between 1959 and 1963; the surplus on the current accounts taken together practically disappeared during the same period. The outlook for 1964 suggests that there will even be a deficit this year. In these circumstances, and just because from the external angle it is important that the Community should be properly fitted into a balanced system of world trade, of payments balances and of development aid obligations on a scale that corresponds to its capacities, the main emphasis of economic policy in the Community must now in fact be laid on internal stability. This means rapid stabilization of the price level, which must then be kept stable. The conflict of aims which has hitherto existed between internal and external balance no longer exists. On the contrary, there is a danger of "over-adaptation" of costs and prices, in other words of a structural imbalance in the Community's external economic relations in a direction exactly opposed to that experienced before 1961.

It is true that these problems are not equally acute for all member countries. For the Federal Republic of Germany there is even a risk that the surplus on current transactions with the outside world may again become too large. However, this will depend mainly on developments within the Community. It is in any case advisable, from this angle, to see the Community—which will have a common commercial policy in the not too distant future, and whose economic and monetary policies are to be increasingly co-ordinated vis-à-vis the outside world as well—as a single whole.

The fact that in 1963 the Community again had surpluses on the overall balance of payments is not incompatible with the above line of thought. These surpluses are attributable to net capital inflows which are in no way to be regarded as normal and lasting. If, in the interests of the international balance-of-payments situation they

must be combatted this must not be done in such a way that a further cost and price inflation would be allowed or even encouraged in the Community, leading to deficits in the balance of current payments; as experience shows, these are never easy to eliminate again.

The best plan is doubtless to combat excessive capital inflows in the front line, i.e. at their sources, where the outflows occur. As stated in the last Quarterly Survey No. 3/1963, this problem is also thoroughly appreciated in the United States—the most important country from which capital is flowing out on too large a scale. The first measures were taken or announced in the third quarter of 1963, moreover with considerable success (raising of interest rates on short-term capital, interest equalization tax). Here perhaps the continuing business upswing in the United States, which should speed up strongly once the tax reduction is implemented, might offer not only the possibility but also a policy reason for now accepting some rise in interest rates on long-term capital.

At the same time circumstances may demand a few appropriate measures to keep the Community countries' exports of capital at a high level or even to increase them.

A special policy thus carried out by both sides from opposite ends doubtless increases the margin for effective action aimed at internal stability within the Community, for such action will not in fact be feasible in most member countries without measures to restrict credit and, in certain cases, to deal with interest rates.

Certainly budgetary policy is of particular moment in the framework of a strict policy of internal price stabilization. In some member countries, in particular Italy, France and Belgium, this would seem to involve reducing present or forecast deficits in cash operations and in any case financing them in a way which does not exert strongly expansionary influence on liquidity at home. The other countries should at least avoid deficits higher than those incurred in 1963 and at the same time financing should be ensured from domestic savings. Within the overall restrictive or, at least, not expansive budget policy, it will be necessary in most member countries to place continuing emphasis on the curbing or extremely cautious guidance of expenditure and of tax reliefs which directly and indirectly increase demand for building.

However, if possibilities in the budgetary field and in relation to the economic outlook for 1964 are realistically appraised—the outlook suggests a revival of investment accompanied by continuing vigorous expansion of wages and consumption—it is obvious that great importance also attaches to credit policy. Moreover this policy is in a position to act much more rapidly, whereas budgetary policy is effective only after a period of time.

In fact measures to restrict credit have already been taken in all member countries except the Federal German Republic, where there was still no need for such action. This policy may have to be made more stringent. In Italy and France in any case it will hardly be possible to avoid continuing and intensifying a restrictive credit policy if the necessary degree of stabilization is to be attained rapidly enough, and in the majority of the other countries it is not impossible that a further tightening of the credit brake will prove necessary.

More or less marked effects on interest rates are, of course, unavoidable in this process, whatever instruments of credit policy are used. Even action on bank liquidity or a direct quantitative restriction on credit expansion without "officially" raising interest rates generates dearer money trends on credit markets. In addition to this, however, raising of interest by the authorities can in particular cases be an indispensable instrument of internal stabilization policy, inter alia because of its psychological impact, and also because interest policy stimulates certain forms of savings.

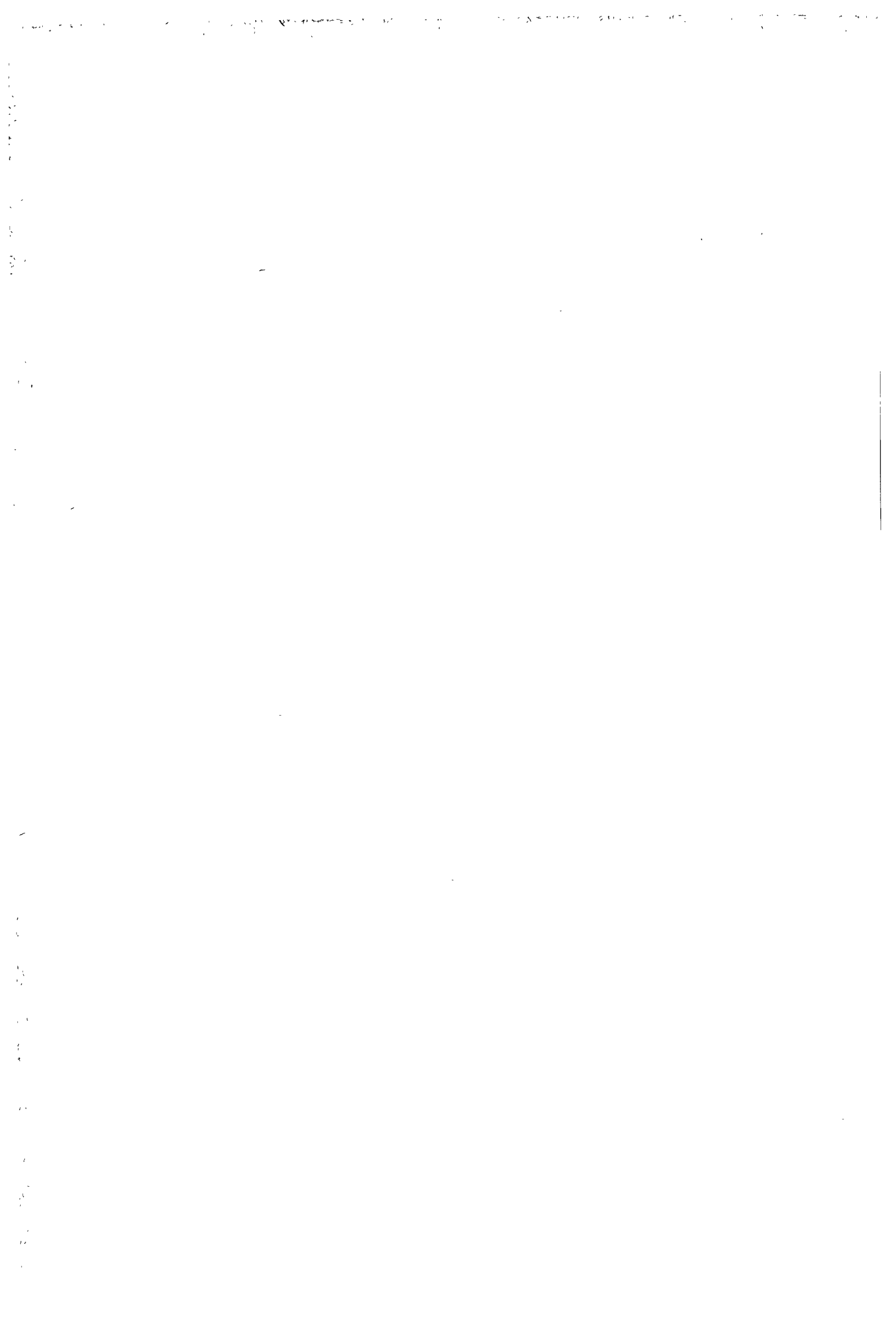
It would in any case seem that from the angle of international capital movements there is already, thanks to the special measures taken at both ends, sufficient room for manoeuvre in connection with interest policy for certain member countries at least to make limited use of this instrument. France and Belgium have already begun to do this and other member countries may follow. For the Federal Republic of Germany it will at least not be advisable to try to exercise pressure on capital interest by such methods as increasing the liquidity of the money and capital markets, since this could accelerate the upward movement of internal demand so much that price stability would certainly go by the board.

The transition to a general policy of keeping a tight rein on domestic expansion does not mean that the various measures that have from time to time been recommended in connection with incomes and wages policy can or should be abandoned. On the contrary, it is only as part of an overall policy that these measures will have any chance of success.

If, on the other hand, demand expands too much and strains on the labour market become too severe, even an organized and institutionalized incomes policy will be deprived of its basis.

It should be noted in conclusion that in view of the cyclical forces making for price and wage rises, a strict stabilization policy or a policy of maintaining internal stability does not now involve the danger of recession or stagnation. The main effect of a general policy of restriction is to eliminate excessive demand, i.e. price rises and undue pressure

on the balance of external transactions. A slight slowdown of real economic growth in relation to the forecasts would in any case be possible. Some temporary reduction in the growth rate of the real national product ought to be accepted in order to obviate the danger of more severe action—which would genuinely imperil economic growth—being needed later.



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

A. Federal Republic of Germany

In 1963, as in 1962, the pace of economic growth slackened a little. According to the monthly Index of the Federal Statistical Office industrial production, which had been 4.5 % higher in 1962 than in 1961, was in 1963 only just over 3 % higher than in 1962. Gross national product (at constant prices) will have expanded by about 3 % (1962, 4.4 %; 1961, 5.4 %).

This loss of pace was partly due to the unusually severe and lengthy winter of 1962-63, as a result of which the decline in economic activity in the first months of 1963 was substantially greater than is usual for the season. Production and income losses were only partly made good thereafter: the main sufferers were building and construction, and the industries depending on this sector.

As in previous years, the loss of pace in a number of sectors was attributable to bottle-necks and in particular the persistent shortage of manpower. The growth of demand was less general in 1963 and this factor, as well, played a not unimportant role in the reduced pace of growth in 1963.

Exports, which rose vigorously in the course of the year, made a very effective contribution to the expansion of economic activity. Investment in equipment, however, increased only a little, since till about the middle of the year businessmen showed very little propensity to invest. Although demand in the building sector remained strong, the growth of investment here too—owing to the losses of output at the beginning of the year—proved appreciably less impressive in 1963 than in 1962. Public consumption again advanced very appreciably. But the expansion of private consumption lagged well behind the advance made in 1962, mainly because wages rose less rapidly while households stepped up their saving considerably.

The disequilibrium between the development of overall demand in money terms and that of real supply from home production and imports tended to right itself as 1963 wore on. The main evidence for this change is the fact that the upward movement of wages lost something of its vigour; the strains experienced on the labour market also eased, at least temporarily. The result was a marked improvement in the price situation. Building costs none the less rose again, and the level of consumer prices, too, was up again, largely because of rises in food prices, rents and services.

The balance of current transactions with other countries showed a definite tendency to recover. The trade balance alone yielded a surplus of \$828 million in the

first nine months of 1963, compared with a surplus of \$631 for the same period of 1962. The surplus on capital account was also larger. The total net gold and foreign exchange reserves of the Bundesbank and of the commercial banks at the end of September were \$271 million up on the corresponding 1962 figure.

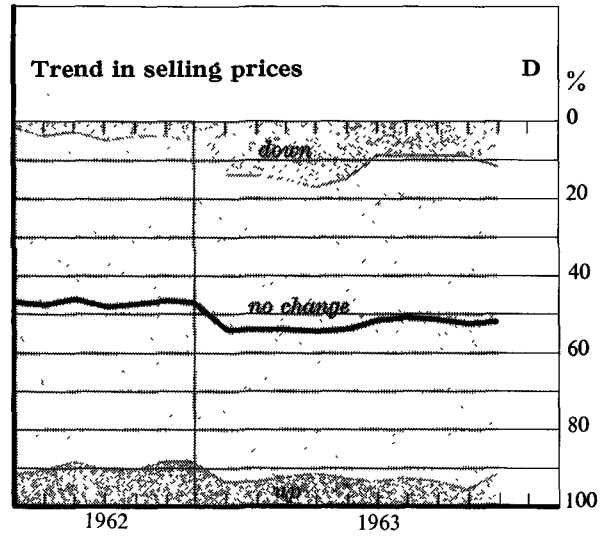
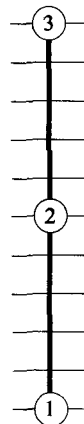
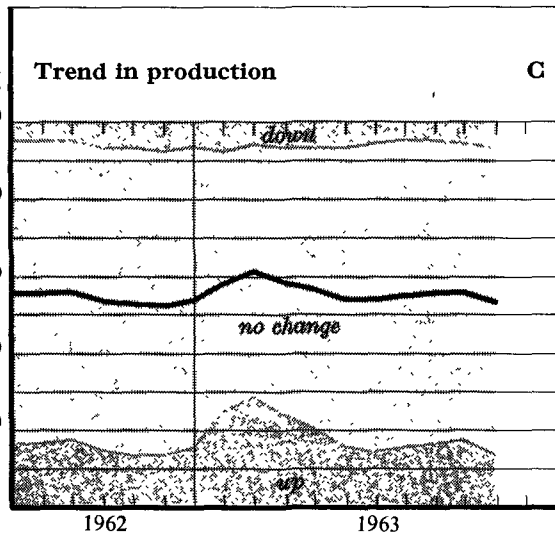
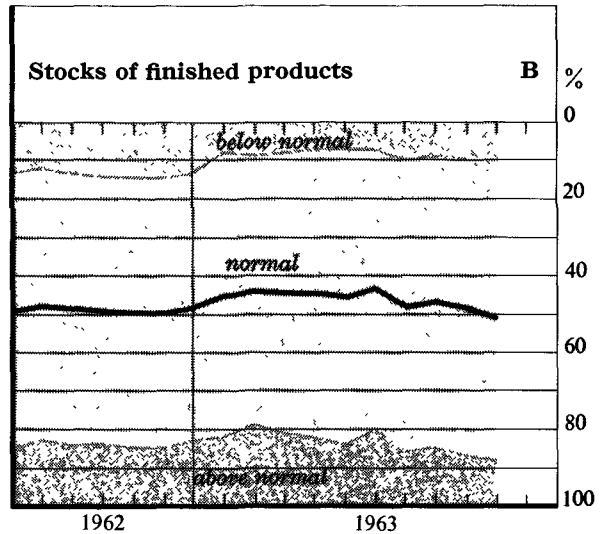
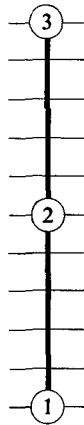
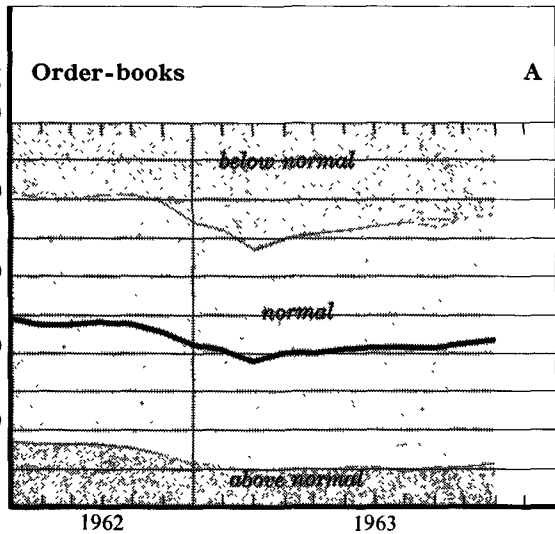
Granted normal weather conditions, more rapid growth is to be expected in 1964. Demand from abroad can be expected to make a particularly vigorous contribution to expansion. Actual investment expenditure by industrial enterprises may well rise appreciably, notably as a result of heavier outlay on equipment. Although the number of building licences issued has for some time been distinctly reduced, it is quite possible that, in view of the backlog and for other reasons, investment in construction will turn out to be substantially greater than in 1963. Public consumption spending will pursue its definitely upward trend. Assuming a constant savings ratio, the growth of private consumer spending—in real terms—might well be more vigorous than in 1963.

Strain is likely to continue on the labour market, since the number of persons in paid employment will increase only slightly (0.5 %—1 %) and since further negotiated cuts in the number of working hours are to be expected. However, an increase in industrial production of some 5 % (no adjustment being made for any disparity in the number of working days between the two years) is well within the bounds of possibility.

Although imports are likely to grow appreciably once again, the tendency for the balance of current transactions to improve will probably continue. Prices—save in building and construction—are likely to remain fairly stable; but the cost of living will again increase somewhat, mainly because rents and certain services will be costing more.

These expectations—particularly the outlook for prices—might well, however, prove off the mark if budgetary policy or the balance of current transactions with other countries were, on balance, to have a substantially stronger impact on the economy than now seems likely. This might necessitate, among other things, firmer measures to curb the growth of demand. Current estimates, however, indicate that by and large there is no need for measures either to curtail the development of demand or to encourage it. But, for the sake of price stability, all available facilities should be mobilized to facilitate imports. The drive to improve the balance of supply and demand in the building and construction sector should be maintained by careful regulation of public expenditure on work that affects the building market.

BUSINESSMEN'S VIEWS ON THE INDUSTRIAL SITUATION



Answers to questions of the EEC business survey, carried out in the German Federal Republic by the IFO-Institut.

Note: The chemical petroleum and metallurgical sectors have only taken part in the survey since January 1963. The results for 1963 are therefore not exactly comparable with those for 1962.

GRAPHS A, B, C and D: The three colours (green, grey and violet) show the percentages of the three different answers. The black curves, the scale for which is given between the graphs, show the figures obtained by adding together the percentages weighted as follows:

- by 0.03 for the answer "above normal", or "up";
- by 0.02 for the answer "normal", or "no change";
- by 0.01 for the answer "below normal", or "down".

1. Balance-sheet for 1963 (1)

Exports, which had made relatively slow progress in 1962, expanded sharply in 1963. Customs returns show that in the third quarter, the year-to-year growth rate for merchandise exports was 11.6 % in value (12.6 % by volume), compared with rates of 0.7 % and 8.4 % (value) in the first and second quarters. For the full year 1963, the growth rate may prove to have been some 7 % to 8 % in value and 8 % to 9 % by volume (3.9 % and 3.5 % a year earlier). Income from services also increased, though not to the same extent as in 1962. The growth of overall exports of goods and services (in terms of national accounting) should therefore show an increase of about 7 % for 1963 as compared with 1962 (volume). The 1962 increase was 4.2 %.

On the other hand, the expansion of fixed asset formation was very modest. It had already been noted in 1962 that managements were less inclined to invest and this trend continued during the first part of the year, with a slight improvement only from the middle of the year onwards. Consequently, investment in equipment generally is likely to have advanced only slightly, by about 2 % (volume) against 5.8 % for 1962. The expansion of investment in building and construction was also very weak. The slowdown was not due to any weakening of demand—owing in large part to the building backlog, this was once again very vigorous—but mainly to the exceptional severity and length of the 1962-63 winter : only a small proportion of the very heavy production losses suffered early in the year could be made good despite the greater efforts of firms in the rest of the year. For example, the number of dwellings completed in the first nine months of the year was 9.5 % down on the corresponding 1962 figure. Investment in construction rose most sharply in the public sector, the rise affecting both public building and public works in the transport sector. All in all, the scale of investment in building and construction must have been a little more than 8 % in value (and some 2.5 % by volume) higher in 1963 than in the preceding year (the corresponding 1962 figures were 13.1 % and 5 %). Taking gross fixed asset formation as a whole, the growth rate may be assessed at about 5.5 % in value and about 2 % by volume (1962 : 11.3 % and 5.4 %).

The contribution to economic activity made by investment in stocks was broadly the same as in 1962. The severe winter served to clear large quantities of pithead coal stocks. A certain tendency for industry to build up stocks of raw materials became apparent as the year went on : this might in part have been a reaction to rising prices on world markets. Stocks at retail and wholesale level also increased again, one reason for this being no doubt the unexpectedly slow growth of demand for consumer goods.

For while the growth of public consumption—mainly in the shape of an appreciable increase in the wage and salary bill and in heavier defence expenditure—was very marked (and higher than the average growth of the other aggregates in the national accounts), the expansion of private consumption, which had been vigorous in 1962, was by and

(1) Data drawn from national accounts are for the Federal Republic including West Berlin.

large quite restrained; for the full year it will probably work out at some 5.5 % at current prices and perhaps 3 % at constant prices (1962 : 9 % and 5.7 %).

This unexpectedly sharp decline of the growth rate is explained only in part by the fact that, as had already been observed for some time, wages were rising more slowly; none the less the level of negotiated weekly wages was in the third quarter fully 5 % higher than a year earlier, and earnings would seem to have improved even more. Since, in addition, transfer incomes improved very substantially and since employment expanded considerably in the course of the year, the year-to-year growth rate of mass incomes for the third quarter works out at about 7.5 %, compared with a corresponding growth rate of almost 10 % for the whole of 1962 over 1961. However, a decline in the amounts withdrawn from their businesses by self-employed persons and, particularly, a very sharp increase in private saving—the savings ratio rose from 9 % in 1962 to 9.5 % or 10 % in 1963—served to strengthen the forces working against the expansion of private consumption. In terms of volume, the growth of consumption was hampered by price increases.

According to the employment statistics of the national labour offices, the number of persons in paid employment at the end of September totalled 21 700 000, a rise of nearly 2 % on the figure for September 1962. This growth was partly due to the continued arrival of a large number of foreign workers, who now totalled 820 000, as against 706 000 at the end of September 1962. Over the same period, the very severe strain on the labour market abated a little, particularly in the first half of the year. The number of unemployed in September, when unemployment is always at its lowest, was 96 000, or about 13 000 more than a year earlier. At the same time, however, the number of vacancies registered at labour exchanges was also a little higher than the year before and was six times as great as the number of unemployed.

Despite a distinct decline in the number of persons in paid employment in industry and mining (in September it was 1.1 % down on the figure for the previous year) and despite obstacles to production early in the year caused by the freeze-up and, in the spring, by the strike of metal-workers, industrial production continued to expand thanks to substantial improvements in productivity. The rate of growth even rose again towards the end of the year. For the full year 1963, however, the rate at which production expanded was probably no more than a good 3 %, as against 4.5 % for 1962 (1).

Agricultural production was again higher in 1963. Although the output of livestock products slowed down distinctly—there was even an actual decline in the number of animals—harvests of grain, hoed vegetables and fruit were better than in 1962.

Once the growth of activity in the services sector is taken into account, the increase in the real gross national product for 1963 over the preceding year probably works out at about 3 % (for 1962 it was 4.4 %, for 1961, 5.4 %). This growth would therefore

(1) Index of the Federal Statistical Office.

be rather less than had been forecast at the end of 1962 (3.5 %). Much of the discrepancy can be put down to the unforeseeable production losses caused by the weather in the first half of the year and to the metal workers' strike.

Imports continued to expand in 1963, though at a reduced pace. Customs returns show that in the first nine months of the year imports of goods were 6.7 % higher in value and 7.7 % higher by volume than a year earlier (1). Expenditure abroad on services also increased again in 1963, although to a far lesser extent than in 1962; in particular, German tourists did not step up their spending to the same extent. All in all, the volume of goods and services imported in terms of national accounting will have grown in 1963 by about 8 %. In 1962 the growth had been 11.4 %.

The quieter pace at which overall demand was growing, coupled with the expansion of overall supply, which was very considerable despite the weather and the metal-workers' strike, contributed to a noteworthy easing of the price situation. During the first nine months of the year industrial and agricultural producer prices remained to all intents and purposes unchanged, despite wide fluctuations in the latter. However, in view of the continued pressure of demand in the building and construction sector, costs here again rose vigorously, even if a little less sharply than in 1962. In the case of housing, the building price index was in August almost 6 % above the corresponding 1962 figure. Consumer prices also rose again, mainly because certain foodstuffs, together with rents and services, were costing more. Consequently, the year-to-year increase in the general cost-of-living index for October was 3.3 %. If the group "foodstuffs, beverages and tobacco" is left out of account, the increase was 3.4 %.

Although, by and large, imports of goods and services rose sharply, the "external contribution" (i.e. the surplus on external trade in terms of the national accounts) was scarcely any lower than the figure to which it had fallen in 1962.

According to balance-of-payments statistics, the current account (including unrequited deliveries and remittances but ignoring the technical changes affecting customs returns referred to in connection with imports) further improved in 1963. The deficit was brought down from DM 1 020 million for the first nine months of 1962 to DM 510 million for the same period of 1963.

While the surplus on trade climbed from DM 2 500 million to DM 3 300 million, the surplus on services fell by DM 300 million. The year showed a very considerable increase in the net inflow of capital (including errors and omissions but excluding changes in the foreign currency position of the commercial banks); this was mainly attributable to heavy purchases of securities by foreign investors. The surplus here was DM 3 600 million for the first nine months of 1963, as against DM 1 700 million for the same period of 1962. The gold and foreign exchange reserves of the banking system (the Bundesbank

(1) Excluding merchandise held in bond, which had been added to the import returns for 1962.

and the commercial banks) increased altogether by DM 3 100 million in the first nine months of 1963, comparing with DM 700 million only for the same period of 1962. The increase in the Bundesbank's reserves was DM 1 600 million and that of the commercial banks DM 1 500 million.

Balance-of-payments trends served to strengthen internal bank liquidity, and this development became particularly marked in the second half of 1963 when it was no longer offset, as in the first half, by the cash transactions of the public authorities. Because of a more rapid increase in expenditure, the total cash transactions of central public authorities in the third quarter resulted in a net deficit of DM 1 800 million (as against DM 1 200 million in the third quarter of 1962), whereas a surplus of DM 1 700 million had been recorded in the first half-year (comparing with a surplus of DM 2 000 million in the first half of 1962).

While, in the first nine months of the year, the expansion of bank deposits only just reached the level attained in 1962, the growth of bank lending continued; the pace tended however to ease, particularly in the second half of the year, partly perhaps as a result of some improvement in the profits accruing to industry.

Supply and use of goods and services

	1961 (2)	1961 (2)	1962 (2)	1963 (3)	1964 (4)
	At current prices in DM '000 million	% change by volume on preceding year			
Gross national product	326.40	5.4	4.4	3	4.5
Imports (1)	59.03	7.7	11.4	8	7
Private consumption	186.59	6.8	5.7	3	3.5
Public consumption	46.42	8.8	11.1	8	5
Gross fixed asset formation.....	80.71	9.4	5.4	2	6.5
Exports (1)	65.81	3.3	4.2	7	8

(1) Goods, services and factor income.

(2) *Wirtschaft und Statistik*, 1963/10.

(3) Estimates by the Commission's staff.

(4) Forecasts by the Commission's staff.

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 Commission's sole responsibility.

2. Outlook for 1964

Broadly speaking, the prospects for economic development in 1964 are fairly encouraging. Granted normal weather conditions, the general tempo of economic expansion should speed up again appreciably.

The contribution of demand from abroad is likely to be particularly substantial. World business conditions are expected to develop favourably in 1964 and Germany's competitive position seems to have recovered distinctly in the past year: not only has Germany's industry been able to deliver merchandise appreciably more promptly, but her export prices as well have in the main been very stable at a time when a number of important customer and competitor countries have had to contend with a distinct upward movement of prices. This is reflected in the flow of orders from abroad, which has now been mounting vigorously for some time. In the third quarter of 1963 these orders were 22 % higher than a year earlier, and also slightly higher than current deliveries, though these were themselves booming, (October 21 % and 10 %).

All in all, exports of goods and services in 1964 in terms of national accounting might easily exceed the 1963 figures by 8 % to 9 %, provided export prices remain unchanged.

Gross fixed asset formation will, in all likelihood, expand considerably faster in 1964. At present, the Commission estimates a growth rate of about 9 % (about 6.5 % in volume).

A slight improvement in the climate of business investment—already mentioned in the last quarterly survey—continued to grow more marked in the third quarter of 1963 and thereafter. The upswing of foreign demand, further rationalization and the easing of the pressure on profit margins are the keys to this development. Consequently, the growth of investment in equipment should pick up again. In any case, the inflow of orders from the home market to equipment industries is still rising; in the third quarter these were fully 8 % above on the corresponding 1962 figure, though they were still about 1 % below actual home sales (October + 10 % and -1 %). In mechanical engineering the corresponding figures for the third quarter were 8.5 % and + 0.5 % (October + 26 % and + 4 %). If this recovery should continue, equipment investment might well increase by some 4 % (volume) in 1964 as compared with 1963.

None the less, managements are still applying very strict criteria in drawing up their investment schemes; since the shortage of labour is expected to continue in 1964, emphasis is mainly on rationalization, and there still seems to be some reluctance to invest in capital widening. This has of course meant that managements were particularly unwilling to invest in building, and in the third quarter the licences granted for industrial or commercial building (measured by cubic feet enclosed) were again down on the corresponding figure for the previous year, this time by 8 %. By contrast, other construction

investment should continue to increase vigorously in 1964 and, if the weather is normal, even more steeply than in 1963. Although housing permits issued in the third quarter were more than 7 % below the corresponding 1962 figure, the very heavy backlog of orders in this sector has not yet shrunk to any appreciable extent; at the end of 1963, orders for some 800 000 dwellings may have been outstanding, whereas the number completed each year has averaged a little less than 550 000 for each of the last three years. According to current budgetary forecasts, public expenditure on construction is also likely to increase faster. The permits granted for administrative building were 5.4 % up in the third quarter on the corresponding figure for 1962. Lastly, an appreciable increase in investment in the transport sector is also to be expected. The overall increase in outlay on construction might well reach about 12 % in 1964. However, as in 1964 there will again be some rise in building prices (all the more since supply remains less elastic than demand) the increase in terms of volume will very probably be only about 8 %.

Despite a drive to curb growing expenditure, public consumption will almost certainly rise again sharply in 1964, although probably not as much as in 1963. The authorities will have to cope with both a heavier wage and salary bill with increased outlay on defence.

Private consumption should also continue to expand in 1964. However, the upward movement of agreed wages might continue for some while to lose momentum: unlike most earlier collective agreements, many of those concluded in 1963 cover a period of more than one year. These agreements, as they now stand, provide for wage increases which are generally smaller for 1964 than those that were granted for 1963. For example, it has already been agreed that pay scales will be raised by 2 % on 1 April 1964 and by 1 % on 1 October 1964 for wage-earners and salaried employees in the public service (including railwaymen), and by 2 % on 1 July 1964 for workers and employees in the metal-working industry. It remains, however, to be seen whether actual earnings will not expand appreciably faster, particularly if the strain on the labour market should again grow more severe in the course of the year. Transfer incomes will again rise sharply. Existing pensions must be increased by 8.2 % on 1 January 1964 (as against 6.6 % in 1962) and the basis for calculation of the new pensions will itself increase even more: a 9.2 % upward readjustment will be added to that of 8.2 % awarded in 1962. Lastly, the figure for amounts withdrawn from their businesses by self-employed persons might show a further increase, since profits are expected to improve. Accordingly, if the savings ratio remains constant, the expansion of private consumption should be a little more vigorous, so that year-to-year growth rates of 5.5 % to 6 % at current prices and 3.5 % to 4 % at constant prices may well be achieved. However, if the savings ratio were again to increase—and this variable is very difficult to forecast—the growth rates would, of course, not be so high. Even so, the rise in the rate of expansion could be slightly larger than between 1962 and 1963.

There is good reason to expect that strain will persist on the labour market, were it only because no substantial improvement can be expected from natural population

trends. The number of young people leaving school in 1964 will be only slightly greater than it was in 1963. In addition, it may again become more difficult to attract additional manpower from abroad. However, if the weather is normal, unemployment (taking the year as a whole) will almost certainly be lower than in 1963. Consequently, the number of persons in paid employment is likely to be from 0.5 % to 1 % higher in 1964 than it was in 1963. Moreover, despite further negotiated cuts in the length of the working week and further extension of paid holidays, the average number of hours worked by each employed person should increase a little if, in contrast with 1963, the weather is normal, and also because 1964 will have more working days than 1963.

In view, then, of the slight increase in the total number of hours worked and of the anticipated improvement in productivity, much of which will be the result of rationalization schemes put through in preceding years—there should be considerable scope for home supply to expand. The results of the EEC Business Survey would seem to bear out this forecast: in October 48 % of heads of industrial enterprises questioned, replied that the production facilities available to them would enable them to produce more if the inflow of orders increased. A year before the percentage giving this answer was only 33 %.

In view of the foreseeable development of demand and the effects of imports, it is reasonable to suppose that industrial production (on the basis of the monthly Index of the Federal Statistical Office, i.e. including building and construction) will increase by about 5 %. The growth rate for the gross national product as a whole (at constant prices) might be a little lower, but in any case will be higher than in 1963.

The expansion of imports is likely to continue, though hardly at a faster rate, since export prices are now rising in a number of the countries which supply Germany. Heads of enterprise might, however, decide to lay in heavy stocks of raw materials in view of the upward trend of world commodity prices.

Since exports will probably increase more than imports, the "external contribution" (i.e. the surplus on the balance of payments as shown in the national accounts) should again increase.

These prospects for the development of overall demand and supply and of productivity and wages augur well for fairly stable prices in 1964. Only on the building markets are prices likely to rise, mainly because the surplus of demand has not yet been met in this sector; but here the increases will probably be less than from 1962 to 1963. Certain autonomous price increases (in particular higher rents) can be expected in 1964 too, and the cost of services will almost certainly continue to drift upwards.

These estimates of price trends are however only valid on condition that the increase in public spending, and particularly Federal spending, does not turn out to be even higher than had originally been planned. For the moment, it is proposed to limit the

growth of Federal expenditure in 1964 to 6 %, a figure which corresponds to the forecasts made by the German authorities for the growth rate of gross national product in terms of money. An increase in outlay of the order of 6 % seems in fact more or less compatible with stable prices; but if this limit is to be respected a brake will have to be put on public demand in the building and construction industry. It would also be advisable to maintain the policy already being pursued with regard to any public expenditure which affects other forms of building activity, notably housing.

Again, if the outlook for prices is to remain reasonably favourable it is essential that the surplus on current account should not increase too much once again. Something should be done now to obviate this danger by adopting additional measures to facilitate imports—including agricultural products; the Treaty of Rome still leaves enough latitude in this respect [e.g. Article 15 (2)]. It goes without saying that in the coming phase of the business cycle any increases in customs duties, even if they were to affect only one major industry, would be highly undesirable from the point of view of both cyclical and price policy. This would apply equally to any tax or other measure designed to improve the present situation of exports.

The current prospects for the development of the economy being what they are, it may be said in general that although the Federal Republic's economic policy for 1964 need not directly seek to curb expansion, it must on no account take an expansionary turn.

Note :

Since the national accounts for the Federal Republic now include West Berlin, and this fourth quarterly survey is essentially a report on the whole year, no special section has been devoted to the economic situation in West Berlin. In the first three quarterly surveys of 1964 the section on West Berlin will once again appear.

B. France

For the French economy, 1963 was characterized by a widespread excess of demand, persistent tightness on the labour market, and a rise in prices which continued gathering speed into the autumn. Economic growth was slightly less than in 1962.

The strength of demand sprang partly from a further vigorous rise in exports, but an even greater contribution was made by sharply rising public expenditure on consumer goods and investment and greatly increased expenditure by households. Expenditure on house-building likewise rose fast, after the loss of pace in the first quarter of the year due to weather conditions. On the other hand, increase in outlay by enterprises on buildings and equipment remained within somewhat narrower limits.

This expansion in demand was favoured by an increase in the availability of money due in large measure—at any rate until the autumn—to a fairly considerable inflow of foreign funds, by a further expansion in credits to business, and by substantial additions to liquidity caused by the cash transactions of the public authorities. The growth in money supply did however slow down somewhat after certain measures in restraint of liquidity and credit had been taken at the beginning of the year and again in the autumn.

Growth of internal supply was checked in 1963 by various abnormal factors. For instance, owing to bad weather, agricultural production hardly reached the level for the previous year. Growth of industrial production was also rather weak at times because of severe frost, strikes and the introduction of a fourth paid holiday week. Hence, although the basic economic trend continued very strongly upwards, the rate of growth of internal supply for 1963 was only 5 %, according to the INSEE index, compared with 6.1 % for 1962. At about 4.5 % the rate of growth of real gross national product will consequently also be less than in 1962 (5.8 %).

Imports continued to soar. The surplus on foreign trade declined further, and in the second half of the year the balance of payments exhibited a distinct tendency to be less favourable.

The disequilibrium between monetary demand and real possibilities of supply, and the sharper rise in costs that went with it, was reflected in a rise in prices, and this gathered more and more speed till in September the consumer price level lay 7 % above the level for the corresponding period of the previous year, with building costs some 12 % up.

In the middle of September the Government therefore decided upon a stabilization programme, which introduced general measures of financial and credit policy intended to slow down the expansion in demand, coupled with immediate and direct intervention measures in the determination of prices. Further steps, including an increase in the bank rate by 1½ %, to 4 %, were taken in the remaining months of the year.

It is not yet certain whether these measures, and in particular the overall restrictive measures, will suffice to restore general economic equilibrium in 1964 without further intensification. Success also seems to depend less on immediate quantitative effects than on how the various groups—especially the two sides of industry—react to the measures.

To judge from the present position of economic policy, overall demand will continue to run slightly ahead of supply possibilities. In any case, external demand will go on increasing very strongly in 1964. Domestic demand also looks like continuing to rise, though its expansion might certainly be rather slower than in 1963. Total expenditure by enterprises and by the State on buildings and equipment might increase at a somewhat lower rate than in 1963. The expansion of public and private consumers' expenditure will presumably also be slightly less than in 1963—provided the budget estimates for 1964 are not exceeded and the growth of incomes, especially of wages, is kept down.

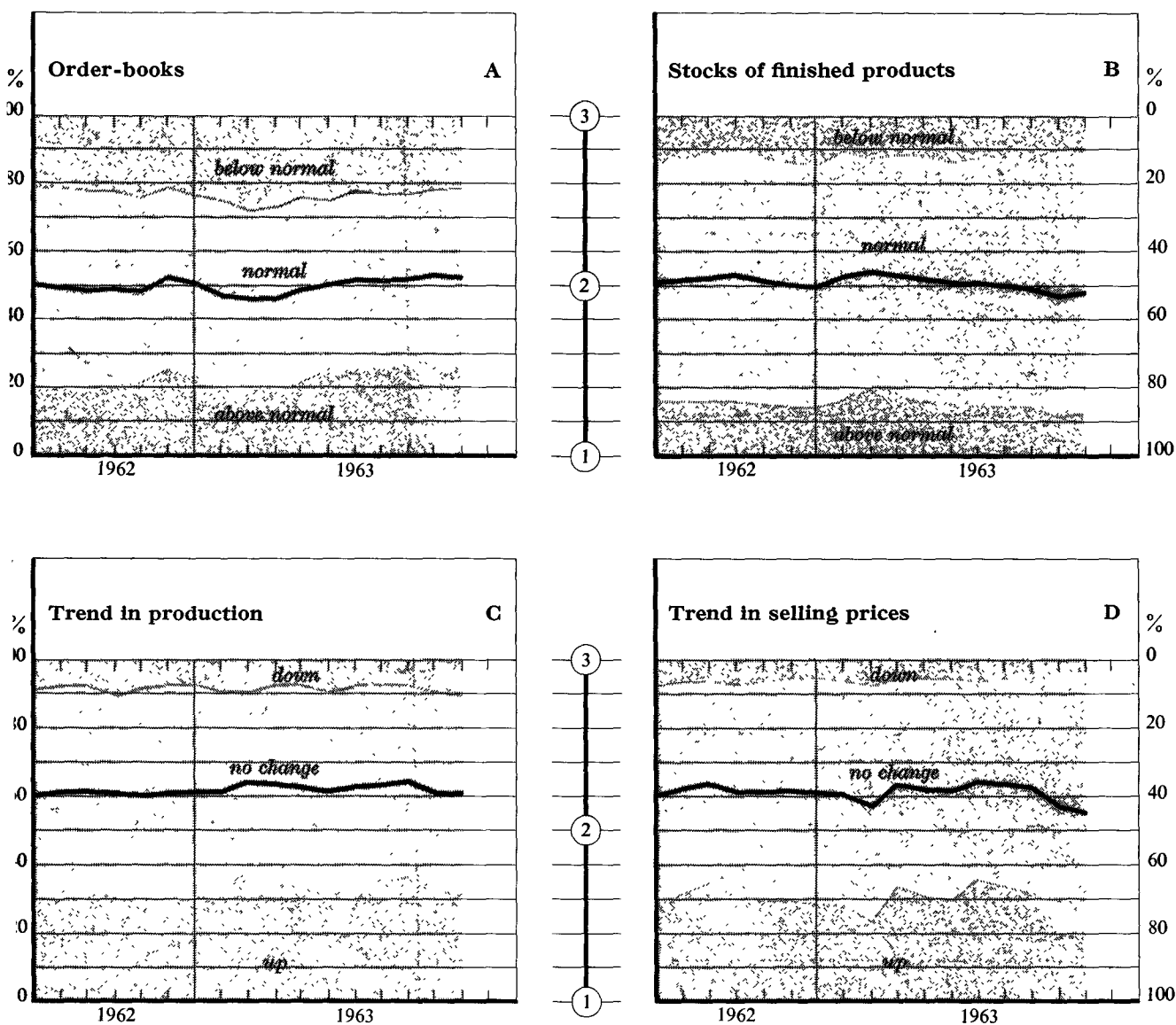
A demand pattern such as this means that no slowdown of overall economic growth should occur in 1964, taking the year as a whole. Real gross national product might even increase by about 5 %, or somewhat more than in 1963.

Since imports will continue to increase substantially, and a slight deterioration in the terms of trade is not out of the question, the tendency towards a decrease in surpluses on external account might continue, though more slowly.

These prospects indicate that inflationary tensions may not completely disappear in 1964. There will probably still be upward pressures on prices, but as long as certain measures of control remain in force, the influence of these pressures is likely to be reflected in the price indices in distinctly attenuated form.

However, the French Government has made it clear that it regards the direct measures only as a temporary solution to help the campaign against the real causes of the inflationary strains. Further steps of this kind will be taken if those already taken prove insufficient. In this connection, more use could be made of budgetary policy to contribute to stabilization.

BUSINESSMEN'S VIEWS ON THE INDUSTRIAL SITUATION



Answers to questions of the EEC business survey, carried out in France by INSEE.

GRAPHS A, B, C and D: The three colours (green, grey and violet) show the percentages of the three different answers. The black curves, the scale for which is given between the graphs, show the figures obtained by adding together the percentages weighted as follows:

- by 0.03 for the answer "above normal", or "up";
- by 0.02 for the answer "normal", or "no change";
- by 0.01 for the answer "below normal", or "down".

1. Balance-sheet for 1963

The year 1963 was characterized by an expansion of overall demand which was far larger than the expansion of supply.

Foreign demand for goods and services increased distinctly faster than in 1962 when, largely as a result of events in Algeria, the increase had been very slight. After the long and unusually severe winter had adversely affected results for the first quarter of the year, merchandise exports (as defined in customs statistics) achieved very high rates of growth: 15.8 % in the second quarter of the year, and 14.1 % in the third (in value). Even though these rates will have fallen slightly in the fourth quarter, it seems that the rise for the year may well be about 10.5 % (1962: 1.8 %). This upsurge can be attributed to some recovery in deliveries to the countries of the franc area, and also to a very considerable increase of sales outside the franc area, especially to the other countries of the Community.

The rise in exports of services may also have been more rapid, albeit probably not as rapid as the rise in exports of goods. Hence, total exports of goods and services—in terms of national accounting, including factor income from abroad—could in 1963 be about 9 % in value and some 8 % by volume greater than in 1962 (1962: 3.3 % and 2.5 %).

The role of domestic demand was even greater in 1963, mainly owing to consumer expenditure. But total expenditure on investment was also substantially higher than in 1962.

In gross fixed asset formation, however, growth was sometimes comparatively slow, and it varied widely from one branch of economic activity to another. During the first months of the year, a certain reduction in the propensity to invest became noticeable in private industry, where capacity had been considerably expanded in the previous years and certain large-scale projects had been completed. This development was not quite compensated by an increase in the growth rate investment by public undertakings, the building industry and trade. Nevertheless, expenditure on industrial and commercial building and on equipment rose by about 8 % in 1963, which is only slightly less than in 1962. Fixed investment by the public authorities—very largely in construction—showed an unusual increase over 1962 (about 19 % in value, compared with 13.4 % between 1961 and 1962). Expenditure on housing also rose faster, under the influence of the great growth in population and of substantially increased Government subsidies.

Aggregate gross fixed asset formation is likely to have increased at about the same speed as in the previous year (11.2 %). However, growth by volume, at about 5 %, will have been distinctly less than in 1962, when it was 7.5 %. This year increases in

prices were perceptibly heavier, chiefly because supply could not keep up with demand, owing to unfavourable weather and to manpower shortages, especially in the building industry.

In terms of the national accounts, investment in stocks has tended if anything to inhibit effective overall demand. Trade and industry have certainly continued to accumulate stocks of raw materials and semi-finished goods, in conformity with development of production; but stocks of finished goods appear to have decreased, under the pressure of the strongly growing demand from ultimate consumers. A distinct reduction in stocks of agricultural products could be observed.

Current expenditure by the public authorities presumably developed rather more slowly than in 1962; this might be connected mainly with the reduction in the armed forces and the change in wage and salary structure in the public service due to withdrawal of French forces from Algeria, expenditure on goods and other services having risen if anything more rapidly than in 1962. Current public expenditure will probably have grown at a rate of about 11 % in value (1962 : 15.5 %) and at about 1.5 % by volume (1962 : 2.3 %).

Expenditure by households, on the other hand, grew at least as fast as in 1962 (11.2 %). While the growth of disposable incomes may have been somewhat weaker, partly owing to the increased burden of taxes and social security contributions, the rate of saving seems to have fallen notably : repatriates from Algeria continued to draw on their savings for consumption purposes, and the propensity to consume was reinforced by the price climate, which was markedly inflationary at times, and by changes in the income structure. For one thing, earned income rose as a result of increased employment and the very vigorous advances in wages; in addition, transfer incomes were raised appreciably. The growth in these two income categories, in which the propensity to consume is relatively high, has been estimated at 13 % (gross). The gain in income from entrepreneurship and capital, on the other hand, was relatively small (about 9 % gross).

Owing to the spurt in prices, the increase in real income of households was in fact very much less. Correspondingly, the growth by volume of private consumption, at 6 % or less, is likely to be distinctly lower than the year before (6.9 %).

While these demands in terms of money continued to expand with undiminished vigour, growth of real supply from domestic production was distinctly slower.

This slowdown is to be explained mainly by the fact that agricultural production will hardly have reached the level attained in 1962. While the output of livestock products was stepped up once more, the severe damage caused by winter conditions and the wet weather at the end of summer will have kept harvests well below the 1962 level.

However, the growth rate of industrial production was also somewhat lower than in 1962. According to the INSEE index (which includes building), it was only about 5 % compared with 6.1 % a year earlier. Of decisive importance in this connection were the serious production losses caused by frost and strikes during the early months of 1963. Later in the year, the index again registered a fairly vigorous and steady expansion of industrial production, interrupted only by the lengthened holiday period, though in various branches of the consumer goods industry expansion was limited by the availability of factors of production.

Owing to the weather, building output suffered a particularly serious set-back in the first quarter of the year. In the following months, however, progress was made as rapidly as the bottle-necks in labour and equipment, which are especially acute in this branch, would permit. In fact, the rate of growth for the full year may even have been about as high as for 1962 (6.3 %).

Finally, if the increased contribution made by services is taken into consideration, real gross national product will probably be about 4.5 % higher than in 1962. Not only is this rate of growth considerably lower than between 1961 and 1962 (5.8 %) but, owing to unforeseeable abnormal influences (strikes, bad weather), it also lies somewhat below the forecast made by the Commission at the end of last year.

Once again advances in productivity (output per man/hour) have made a vital contribution to overall economic growth, the increase in employment having been no more than moderate. Largely as a result of continuing repatriation of French nationals from North Africa, increased immigration of Algerians, and the reduction in military service, the number in paid employment rose, especially in trade and industry, where it was at mid-year 2.5 % higher than in mid-1962, while the corresponding increase between 1962 and 1961 was only 1.4 %. For the first time in years, however, this is offset by a very appreciable decrease in the average number of hours worked per person in paid employment, since a fourth week of annual paid leave was introduced in important branches of industry, including building. Owing to the great demand for manpower, the strains on the labour market not only persisted but even worsened visibly in the second half of the year. Throughout the year, the number of people seeking jobs declined fairly continuously.

Total imports increased about as strongly as in 1962. Merchandise imports gained far more rapidly. According to customs returns, and after deduction of the statistical arrears from the previous year, which were included in January 1962, these imports were, in the first nine months of 1963, about 17 % (by volume) higher than in the corresponding period of 1962. The rate of expansion in the final quarter may well have been as high, and this would mean that the rate of increase for the full year was about 16 % (1962 : 13.5 %). As, however, the changed situation in Algeria means that expenditure on services abroad will have been lower than in 1962, total imports of goods

and services (as defined in the national accounts, i.e. including factor incomes) will show an increase by volume of only some 10.5 % between 1962 and 1963 and in value of about 11.5 % (a year earlier the figures were 10.6 % and 9.7 %).

The growing discrepancy between monetary demand and real supply possibilities, and the consequent faster rise in costs was reflected in a more and more rapid rise in prices, which persisted into the autumn. As the year advanced, foodstuffs gave way to industrial products, and even more to services and building, as the mainspring of this upward movement. In September the index of wholesale prices was 4.6 % above the corresponding level for the previous year, the index of consumer prices as much as 7 % higher. Building costs exhibited extreme increases—more than 12 % in less than a year. From September on, however, the freedom of price formation was drastically limited by the Government's stabilization plan; for instance, any increase in industrial producer prices was rendered subject to Government approval, and arrangements were also made to regulate certain trade margins. As a result, the rise in prices must have levelled off considerably during the remaining months of the year. Nevertheless, the average price level for the year will have increased by more than 5.5 %.

Owing to the fact that imports of goods and services increased more strongly than exports, the "external contribution" (or surplus on external payments, as defined in the national accounts) decreased still further than last year. But whereas in 1962 the deterioration was only in the trade account with the countries of the franc area, in 1963 it related exclusively to transactions with countries outside the franc area. This means that the current account—including unrequited services—will have closed with a distinctly reduced surplus. However, since the net inflow of private capital remained high at any rate into the autumn, and official transfers of capital abroad (mainly advance repayment of debts) were lower than in 1962, the surplus in the overall balance for 1963 will not differ much from that for 1962 (\$ 598 million). The official reserves of gold and foreign exchange rose by \$ 728 million in the first ten months of 1963, i.e. more strongly than in the corresponding period of 1962 (\$ 677 million). However, this may have been offset by some deterioration in the net foreign exchange position of the commercial banks.

Money was in abundant supply at least till early autumn. In the first nine months of 1963 the volume of money was 17 % greater than during the corresponding period in the previous year. The main cause of this—apart from the still quite considerable inflow of foreign exchange and the further expansion of advances to industry—was the greater contribution to liquidity made by the cash transactions of the public authorities. However, the availability of money expanded rather more slowly after a series of measures had been taken, first in the spring and again in the autumn, the main object of which was to limit credit expansion.

The cash transactions of the Treasury were characterized by an increasingly heavy deficit. By the end of September, through an extraordinarily rapid rise in expenditure (20 % compared with the first nine months of 1962), the deficit had already reached

8 300 million francs, whereas at the same time in the previous year it was not more than about 3 200 million francs. Hence, since in the last months of each year outlay normally exceeds revenue, 1963 will probably close with an excess of public expenditure which is not only considerably larger than that of 1962 (when it was 6 100 million francs), but will also pass the 7 000 million-franc mark which has served as a guide since 1958.

For the first time since 1958 a call was made on the capital market to finance the excess expenditure. The market proved very ready to subscribe. Not only the two Government loans, together amounting to 3 000 million francs, but other securities too—in particular those for corporations under public law—were placed; the volume of the issues was much greater than in 1962, and the operation went through completely without friction. The interest level on the market remained almost stable; over the year the average was somewhat lower than in 1962.

Supply and use of goods and services

	1961 (2)	1961 (2)	1962 (2)	1963 (3)	1964 (4)
	At current prices in FF. '000 million	% change by volume on preceding year			
Gross national product	319.67	4.5	5.8	4.5	5
Imports (1)	44.83	7.5	10.6	10.5	9
Private consumption	206.62	5.8	6.9	6	5
Public consumption	43.02	3.4	2.3	1.5	2
Gross fixed asset formation.....	62.39	10.0	7.5	5	5
Exports (1)	49.54	6.1	2.5	8	8

(1) Goods, services and factor income.

(2) Rapport sur les comptes de la Nation de l'année 1962; SEEF, Paris.

(3) Estimates by the Commission's staff.

(4) Forecasts by the Commission's staff.

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 and are established and published under the Commission's sole responsibility.

2. Outlook for 1964

The development of the economic situation in 1964—in particular, whether the inflationary disturbances will persist or stability can be restored—will largely depend on the Government's economic policy.

The measures taken as part of the stabilization plan of 12 September, to which reference has already been made in the Quarterly Survey of "The Economic Situation in the Community" No. 3/1963, gave little assurance that the rate at which domestic demand in monetary terms was expanding would be adequately checked. Supplementary measures were however taken: bank rate was increased from 3.5 % to 4 % on 14 November; further reductions were made in customs duties on a number of items, and direct price controls were introduced for certain services.

In the light of the present situation as regards measures of economic policy, the economic outlook for 1964 is still relatively expansive.

Demand from abroad should continue to rise fairly steeply. The prospects for economic growth are certainly very favourable, not only in the main member countries of the EEC but also in non-member countries—especially the USA and UK. The ability of the developing countries to import might increase; in this field, the credit facilities granted to certain countries by France may well give an additional fillip to French exports. Moreover, demand from franc area countries may increase, especially if political and economic conditions in Algeria settled down gradually. Finally, if the expected further rise in revenue from services is also taken into consideration, it is perfectly possible that in 1964 the total increase in exports of goods and services—as defined in the national accounts—over the year before will be about the same as in 1963 (some 9 % in value and 8 % by volume).

In present circumstances the rate of growth that it will in fact be possible to achieve for exports in 1964 will depend in no small measure on the level of domestic demand and the way in which costs and prices develop. At the present moment it is particularly difficult to say what the prospects are, since they depend not only on the quantitative effects of the stabilization measures but also on their psychological impact.

This applies particularly to the foreseeable development of gross fixed asset formation. On the face of it many factors indicate that enterprises will increase their expenditure on equipment at about the same rate as in 1963, and their expenditure on industrial and commercial building at an even slightly higher rate. In the private sector of the economy—again, especially in industry—a more expansionary tone may be given to planning by the far from unfavourable profit situation in 1963, continuing good conditions for raising medium-term and long-term capital, the high level of capacity utilization (especially in the consumer goods and building industries), and the expectation of a further increase in sales at home and abroad. On the other hand, of course, it is not

impossible that investment may be discouraged by certain difficulties over liquidity, in particular the direct and indirect effects of a tightening of short-term credit. On balance the present situation nevertheless gives reason for expecting a moderate expansion of these classes of investment. At the same time, investments by public undertakings are being made in line with the objectives of Plan IV; no cuts have been made in them even by the stabilization programme. The rise in investment expenditure by the Government might however slow down somewhat, especially since the limited elasticity of building output should be taken into consideration here. On the same grounds, expenditure on house-building might increase less than between 1962 and 1963. All in all, growth of gross fixed asset formation in 1964 is unlikely, at 9 % in monetary terms, quite to attain the rate for the previous year, though the real increase may again be about 5 %.

Investment in stocks may stimulate overall demand rather more than in 1963. If credit policy renders short-term loans scarce and expensive enough, it will affect first and foremost enterprises' arrangements for carrying stocks; but, with harvests normal, a substantial increase in stocks of agricultural products is again to be expected.

Current expenditure by the public authorities will slacken if it is kept within the budget estimates for 1964, which are based largely on a policy of strict moderation in the further wage and salary concessions to be made in the public sector. But even with this proviso current expenditure by the public authorities, with a rate of growth of some 7 % for the year, will be expending faster than real gross national product.

Conditions for an appreciable slowdown in private consumers' expenditure do not yet seem to be adequately assured. Mass income due to increased employment might expand somewhat less than in 1963 since, owing to the smaller growth in the civilian working population, the numbers in employment can hardly increase again so strongly as in the previous year, and a further decline may also take place in the average number of hours worked per person in paid employment. Transfers by the State will likewise increase more slowly, owing to the reduction of assistance to repatriates from Algeria. However, it is questionable whether the influence of developments in the wages sector can suffice to slow down consumers' private expenditure. Credit policy and control of producer prices could inhibit the readiness of enterprises to make further large-scale wage concessions; but it must be borne in mind that there is little likelihood of the strain on the labour market having as yet changed radically. Much depends on whether the two sides of industry can be induced to moderate wage increases. Nevertheless, the present outlook suggests that there may be a brisk increase in wages. Since the income of households from other sources will presumably continue to rise at the same rate, and since there are signs of a fresh decline in the rate of saving, the increase in private consumers' expenditure in 1964 might be of the order of 9.5 %. The increase by volume can then be forecast as about 5 %, especially if prices in certain categories of private consumption (houses, public services) continue to be frozen for some time.

Given this increase in demand, there should be no slackening of economic growth in 1964, as compared with 1963.

The rate of growth of industrial production may even be somewhat greater than from 1962 to 1963 (some 5 %). Naturally, this assumes that production does not in 1964 suffer from major dislocations due to strikes and bad weather, as it did in 1963.

In building output, on the other hand, a slight levelling-off of the annual rate of growth can no doubt be expected, in spite of the large backlog of work, and even if weather conditions are normal, since bottle-necks have been increasing for some time and further progress therefore depends on the development of additional capacity, the supply of manpower and, especially, the stepping up of productivity. The real contribution of this sector to the national product may be about 5.5 %, against a good 6 % in 1963.

Agricultural production will again contribute to the growth of gross national product in 1964, provided weather conditions are normal. The growth by volume could slightly exceed the rate for the previous year (4.5 %), and reach about 5 %.

Domestic production will continue to be substantially augmented by imports of goods and services. These (as defined in the national accounts, and so including factor income from abroad) could be about 9 % by volume higher than in 1963. None the less imports of merchandise may, despite the lowering of duty on industrial goods under the stabilization plan, grow somewhat more slowly than in 1963, as there is a possibility that imports of fuel may stagnate. In contrast to this, imports of services—especially transfer of factor income, which dropped in 1963—will greatly increase.

If imports continue to advance rather more rapidly than exports, and some slight deterioration should occur in the terms of trade, the surplus on external account—or “external contribution” in terms of the national accounts—could again decrease, albeit hardly so much as in 1963. Although there is still a tendency for the balance on current account to deteriorate, the overall balance of payments may still show a surplus, especially as the low level of outstanding foreign indebtedness means that it will not be possible to make advance repayments on the same scale as in the past.

These probable developments in monetary demand and real supply do not suggest that inflationary strains will cease in 1964 unless the authorities further intensify their restrictive measures—and not only in the credit field, but also in connection with the expansion of Government expenditure. For the time being at any rate, cyclical forces will apparently still tend to push prices up, though doubtless more slowly. These forces can however be reflected in the various price indices only in distinctly attenuated form as long as the prices and trade margins of certain goods and services are subject to control, selective price-reducing campaigns are continued, the raising of rents is forbidden, and no upward adjustment is made in the cost of public services. In the early months

of the year seasonal factors could also influence certain prices, such as those for textiles and food. Prices during 1964 are therefore sure to rise more slowly than during 1963; but on average the year can be expected to show an increase in the index of consumer prices of about 4 % to 4.5 %.

The French authorities wish to stress that the measures relating only to the symptoms of inflationary development—such as direct controls of prices and trade margins—are merely emergency steps intended to improve the psychological climate. They are not meant as a substitute for a policy to eliminate the real causes of the situation, and will in any case not remain in force for long. Direct intervention in the price mechanism on the present scale would not, in the long run, be a suitable way of combating inflation; it only holds up inflation for the time being and masks the real dangers.

The measures dealing with the causes of inflationary pressure are therefore all the more important. The general imbalance which still affects the economy can be corrected only by a policy which exerts a sufficiently broad and sharp braking effect on expansion of domestic demand. Only within such a policy will it be appropriate to apply a certain selectivity, checking consumption and favouring investment.

In any case, the admixture of measures must be such that the bottle-necks and the difficulties on the various labour markets are reduced. The problem is all the more urgent since otherwise it will hardly be possible to achieve what is a sine qua non for the success of the Government's stabilization policy—namely, a slowdown in wage increases, which between 1962 and 1963 climbed nearly 10 % per person in paid employment. The easier the situation is on the labour markets, the greater will be the hope, that, as part of an incomes policy, moderation can be instilled into both employers and workers.

In connection with the policy of putting a general brake on the expansion of demand, further efforts should be made in implementing the 1964 budget to slow down actual expenditure by the State even more than planned in the Finance Law. Any additional revenue that accrues should be used to reduce further the excess of expenditure over income (the "impasse"). The potential value of a further reduction of the "impasse" in combating inflation is increased by the fact that although the 1964 budget shows a reduction of about 2 200 million francs to 4 700 million francs in the excess of expenditure over income, this will not be fully effective as a means of restricting demand because more than half the reduction is merely the result of transferring certain extraordinary expenses from the budget to public financing institutions. Finally, the remaining deficit ought to be financed in 1964 by taking up further long-term loans, so far as possible, by increasing short-term indebtedness.

Credit policy should further limit the possibilities of an increase in available funds : in this field there are new opportunities to work towards price stabilization now that

France's surplus in the balance of payments—especially on current transactions—is very much smaller and the risk of increased inflows of capital has been in large measure eliminated both by the steps already taken or being prepared in the USA. One use that can be made of the margin of freedom that has thus been restored to credit policy will be to exert pressure on interest rates. The measures taken by the Bank of France show that it is ready to seize the opportunity.

C. Italy

The Italian economy showed an increasing imbalance in 1963. A slackening of real growth between 1962 and 1963 was accompanied by an acceleration in nominal internal demand.

On the demand side, only the growth of exports of goods and services slowed down further, and this was typical of the changed situation. Overall expenditure on gross fixed asset formation, on the other hand, showed very definite growth, although the growth rate of building activity slackened appreciably. Investment in capital goods, however, rose more rapidly between 1962 and 1963 than during the previous year. But it was consumers' expenditure that showed considerable acceleration, both in the public and private sectors. Private consumption may well have risen between 1962 and 1963 by about 16 % in value and, as prices rose considerably, 8.5 % by volume. It was stimulated by a further very rapid expansion of income from employment and transfer income, and apparently a certain decline in savings, which in its turn probably reflected the changes in income structure and the general inflationary climate.

The development of internal supply was left far behind by the expansion of demand. The real gross national product may have risen by some 5 %, against 6 % between 1961 and 1962. Agricultural production did not reach the previous year's level, chiefly because of bad weather. Building and construction may be only slightly up on 1962. Industrial output, however, again advanced appreciably, by some 8.5 % compared with 9.6 % between 1961 and 1962. There was also a definite rise in the contribution made by the services sector.

Despite sharply accelerated imports to supplement internal supplies, prices again rose considerably, and sometimes at an even faster rate. This was clearly accounted for not only by the imbalance between supply and demand but, "partly as a consequence of this imbalance", also by increased costs, since once again labour costs per unit of output rose appreciably. In October 1963 wholesale prices were 5.6 % up on last year consumer prices 8.1 %, although there had been pronounced rises during that year too (wholesale prices 4.0 %, consumer prices 5.3 %).

In these circumstances the trade gap widened considerably, from \$1 400 million in 1962 to an estimated \$2 500 million. Since, in contrast to former years, net income from other current foreign transactions rose very little and the deficit on capital movements increased sharply, the balance of payments position deteriorated greatly. The

deficit was financed mainly by further borrowing from abroad by the banks and only to a very minor extent through a reduction in official gold and foreign exchange reserves, from \$3 441 million in December 1962 to \$3 254 million in October 1963.

Bank liquidity came under pressure, although Treasury cash transactions in 1963 tended to ease the situation and Central Bank advances to the banks increased somewhat. Stock markets were subdued, partly owing to an increase of private capital exports.

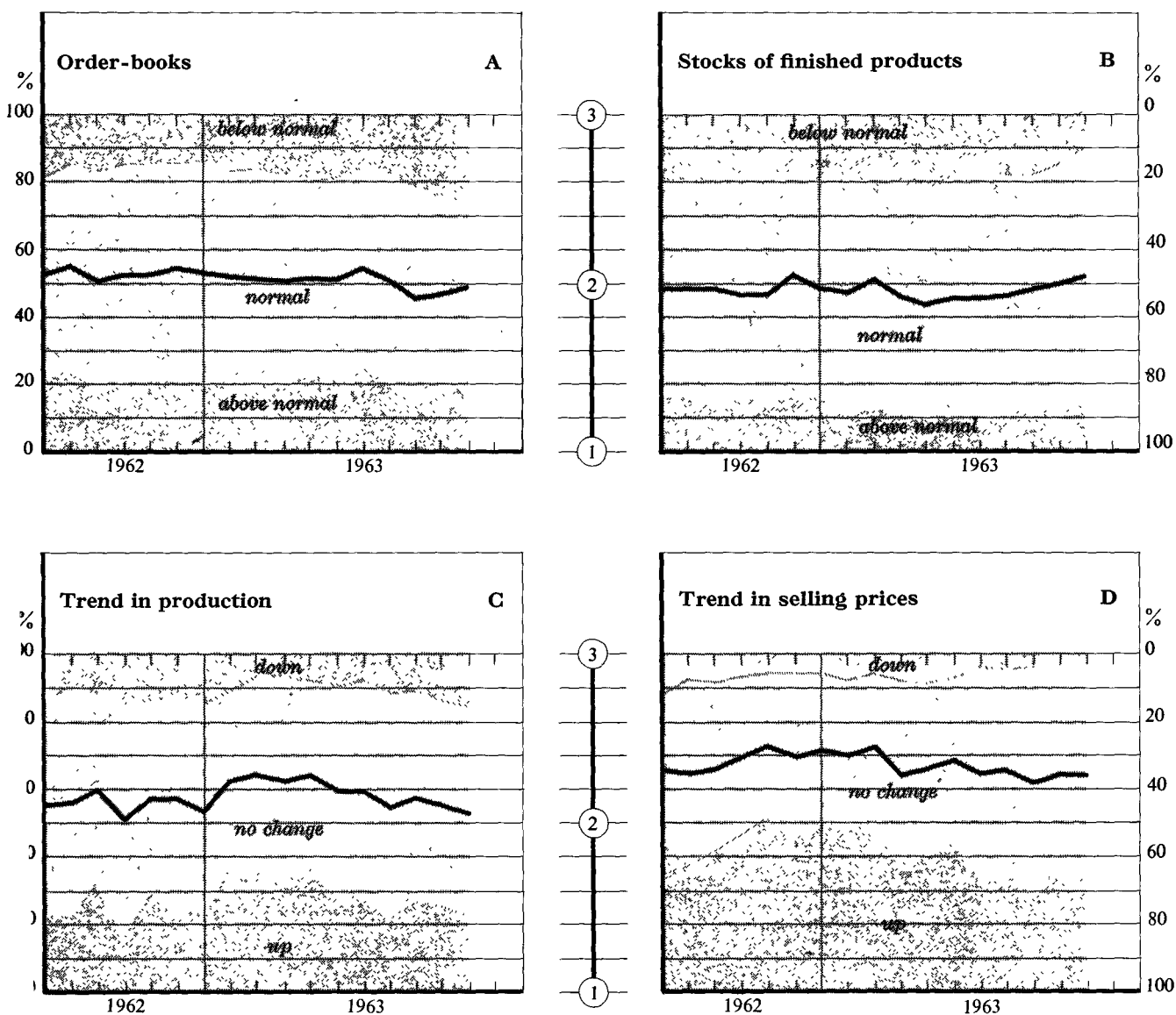
In the autumn the Government took a number of measures, and announced others, to remedy the unsatisfactory development of prices and of the balance of payments. In the Commission's opinion this is a step in the right direction, but it is clearly still not enough to bring about a sufficiently rapid recovery of equilibrium and consequently there would seem to be an urgent need of more drastic measures to restrain the expansion of demand.

In the expansive world economic situation exports will remain at a high level. But there will be above all a further rise in the factors of internal demand, investment and consumption, though the latter may increase rather more slowly than between 1962 and 1963. An increase of about 5 % in the gross national product is perfectly feasible especially if the weather is more favourable than in 1963, and the industrial production index may go up by 7 %.

Everything points to the possibility of another steep rise in prices, though not so pronounced as between 1962 and 1963, and a further substantial deficit in the current balance of payments. If the capital account shows no improvement, and on the assumption that the banks' short-term indebtedness abroad does not rise further, gold and foreign exchange reserves will diminish very appreciably.

The Commission, acting on the opinions of the Economic Policy Committee and the Monetary Committee, has consequently again advised Italy to adopt a policy to curb more energetically the expansion of internal demand. The Commission is of the view that such a policy, which is necessary in order to stabilize prices and the balance of payments, may lead to a slight reduction in real economic growth in 1964; this is acceptable, however, in the interests of more rapid and balanced growth in the future.

BUSINESSMEN'S VIEWS ON THE INDUSTRIAL SITUATION



Answers to the questions of the EEC business survey, carried out in Italy by ISCO-Mondo Economico.

GRAPHS A, B, C and D : The three colours (green, grey and violet) show the percentages of the three different answers. The black curves, the scale for which is given between the graphs, show the figures obtained by adding together the percentages weighted as follows :

- by 0.03 for the answer "above normal", or "up";
- by 0.02 for the answer "normal", or "no change";
- by 0.01 for the answer "below normal", or "down".

1. Balance-sheet for 1963

A feature of the Italian economy in 1963 was that demand more and more outpaced internal supply.

A significant factor in this situation and in the relatively sharp increase of costs in Italy was that the growth in exports of goods and services between 1962 and 1963 distinctly slackened still further, until for the first time for five years it was below that of total demand. Goods exports (according to customs returns) increased in value between 1962 and 1963 by some 8 % (as against just under 12 % between 1961 and 1962). In volume the increase was considerably smaller, as export prices rose by a full 4 % between 1962 and 1963. If, however, the seasonally-adjusted growth of exports in 1963 was scarcely slower than in the previous year, it must be remembered that growth in 1962 was adversely affected by certain exceptional factors.

The slower growth of exports was due mainly to a fall-off in exports of agricultural products and food preparations; but in terms of volume it also to a greater or lesser extent affected other classes of goods, particularly cars.

Once again, exports to the other member countries in general progressed more rapidly than to non-member countries, but in comparison with previous years the difference in growth rate narrowed considerably. Exports to eastern Europe, however, accelerated appreciably.

Exports of services expanded probably only a little less quickly than in 1962, at least in terms of value, although there was no significant increase in remittances from Italians working abroad, in contrast to the large increases of previous years.

In terms of national accounting, total exports of goods and services may have risen between 1962 and 1963 by about 9 % in value and some 4.5 % by volume (between 1961 and 1962 : 12.2 % and 11.8 %).

Taken over a year, internal demand again grew very rapidly and in terms of value may even have accelerated. This may be true even of total expenditure on gross fixed asset formation, and it certainly is so of expenditure on plant and equipment. Here, investment seems on the whole to have increased considerably and even more rapidly than last year, probably mainly as a result of rationalization measures and the expectation of further price increases, although on the part of large firms there was no great propensity to invest. The upward trend during 1963 was also clearly very vigorous. Demand for building and construction continued at a very high level; but the banks' reluctance for some time past to advance money for building projects and apprehension in face of certain Government steps to control rents have probably had a damping effect in this sector. But, mainly as a consequence of the growing shortage of labour in the northern industrial areas, it is unlikely that investments in housing or commercial and industrial building

will have achieved anything like the growth observed between 1961 and 1962, which admittedly was unusually large. The volume of public works seems once more to have failed to come up to the previous year's level.

On a rough estimate, based mainly on developments in the first seven to eight months and on prospects up to the end of the year, gross fixed asset formation may have risen between 1962 and 1963 by 15 % in terms of value and a good 7.5 % by volume (1962 : 14.6 % and 8.9 %).

As opposed to 1962 and despite a run-down of stocks of agricultural products, total investment in stocks appears to have expanded somewhat; the inflationary price climate may well have played a part here.

There was an even more marked acceleration in the growth of consumers' expenditure, which in 1963 was again by far the most important factor in the expansion of demand. Mainly owing to a further considerable rise (of about 25 %) in expenditure on staff, public consumption probably increased very rapidly in terms of value; by volume it may be up 5 % (1962 : 4.5 %).

The increase of private consumers' expenditure was undoubtedly very considerable as well as being more rapid than between 1961 and 1962. It is estimated at 16 %, as against 12.2 % between 1961 and 1962. On account of the steeper rise in prices, to which reference will be made later, the rise by volume was smaller; it did reach, however, 8.5 % as against 6.7 % between 1961 and 1962.

The sharp increase in consumers' expenditure was based mainly on a further very considerable expansion of total wages and salaries. The propensity to save, moreover, declined, being affected by the strong upward trend of prices and the uncertain economic climate. Among the factors tending to swell total wages and salaries, besides a definite, though perhaps rather slower rise in the number of workers in paid employment (about 3 %), special mention must be made of the continuing drift of labour from the land to industry and the very substantial increases in wages and salaries. Inclusive of family allowances, agreed minimum wages in trade and industry rose between 1962 and 1963 by some 9.5 % and 10 % respectively (1962 : 5 % and 8.2 %). For salaried employees the corresponding pay rises can be put at about 12.5 % in trade, at 14 % in industry and 26.5 % in the public service (1962 : 5.3 %, 7.5 % and 13.5 %). Effective wages and salaries may have risen even more. Increases in cost-of-living bonuses under the existing sliding-scale arrangements were decidedly greater, both absolutely and relatively, in 1963—especially in the first half of the year—than in the last eleven years and played an important part in the upward trend of nominal wages and salaries. Transfer income also rose considerably.

In private consumers' expenditure there seems to have been a further sharp rise in the proportion of dearer goods. Per capita consumption of meat has risen fast, though

it is still very low by comparison with other member countries. Registrations of new cars in the first nine months were 50 % up on last year.

On the supply side, agricultural output may well have been lower than in 1962. Livestock products were again adversely affected by a shortage of fodder owing to bad weather but even more by a shortage of labour. The production of olives, fruit and potatoes rose substantially, while the harvest of wheat, sugar beet, wine and many kinds of vegetables was much less plentiful than in 1962 as a result of the weather.

Industrial production, on the other hand, again showed a considerable year-to-year growth rate (about 8.5 % as against 9.6 % from 1962 to 1963). Seasonally adjusted, this reflected in general a somewhat more rapid development in 1963 than in 1962. There seems to have been a marked recovery in the autumn after a particularly slack period in the summer. The output of food products, cars and rubber manufactures expanded at a higher than average rate and even faster than in 1962.

Building and construction (contribution to the national product at constant prices), which rose between 1961 and 1962 by over 6 %, will probably have only just exceeded the 1962 level, owing partly to strikes and the already mentioned shortage of labour in certain areas. The contribution of the services sector may possibly have increased by some 5 %.

All in all, the increase to be expected in the real gross national product is 5 % (1962 : 6 %).

There has been an almost equal advance in productivity. The total numbers in employment seem to have risen only moderately. The movement of workers from the land to other sectors, which has gone on for some time, remains in evidence. Unemployment continued to shrink appreciably, according to ISTAT sample surveys by about 15 %. Scarcity of labour, which had previously been confined to certain categories of skilled workers in some areas, has now become more serious and widespread.

Imports of goods and services have risen decidedly faster than production. This was mainly because production in general did not keep pace with the unusually rapid increase of internal demand, and agricultural output in particular, as has been pointed out, even fell away. In some cases, no doubt, the decline in Italy's competitive capacity also played a part. The additional incentives provided by the EEC customs tariff reductions of 1 July can have made hardly any difference to the situation, since they were very slight in the case of Italy in view of the reductions made independently at the end of August 1962 for reasons of price policy. Imports of goods (according to customs returns) may well have shown a year-to-year growth rate of not less than 23 % by volume and 24 % in value (between 1961 and 1962; 15.4 % and 16.0 %). Part of the growth rate from 1962 to 1963 can be explained statistically by the particularly rapid increase in the second half of 1962, but the 1963 rate was also extremely high.

Food products, cars, textiles, machines and products of the iron and steel industry showed the highest growth rates, both by comparison with 1962 and in the course of 1963. Imports from other member countries (about 30 % up in terms of value) and from industrial non-member countries expanded rapidly, as well as those from developing countries.

Imports of services, mainly expenditure on freights and foreign travel, rose equally quickly. Total imports of goods and services may be said to have risen by about 23 % in terms of volume (between 1961 and 1962 : 15.4 %).

Although the volume of supply increased considerably again and imports were only very slightly dearer, prices continued to soar. In October wholesale prices were up 5.6 % on a year before, consumer prices 8.1 % and—especially important for the operation of the sliding wage scale—the cost-of-living index 9.4 % (October 1961-62 : 4.0 %, 5.3 % and 6.8 %). No doubt building prices also rose steeply once again. The basic trend of prices remained sharply upwards during the whole year. The drop in food prices in the spring and during part of the summer was of a seasonal nature. The prices of services and industrial products continued their rapid rise, certainly until the autumn.

Prices of raw materials, which between 1957 and mid-1962 had fallen, have since then either risen or at least remained static. Moreover, wage costs per unit of output have further increased considerably. As a result of the generally very vigorous expansion of demand the higher costs were largely passed on in prices.

The deficit on trade has increased extremely sharply. By the first half of the year it was already almost as high as for the whole of last year, and the 1963 figure may well be about \$2 500 million, as against \$1 400 million in 1962. As net income from services and unrequited transactions at best increased very slightly in contrast to 1962 and the deficit on capital account expanded sharply—inclusive of the large expansion in exports of Italian bank-notes—there will probably be a very considerable deficit in the overall balance of payments, which in 1962 still showed a surplus of \$50 million.

Only a very small part of this deficit was financed from official gold and foreign exchange reserves, which thereby fell \$187 million in the first ten months of 1963; the major part was supplied through short-term borrowings of the banks from abroad, with a consequent weakening of their net foreign exchange position (almost \$800 million in the first eight months of 1963). Only in the autumn of 1963 did the banks cease further borrowing abroad, at the instance of the monetary authorities, and in September and October the banks' net foreign exchange position showed the first improvement for a long time.

The trend in the balance of payments led to a contraction of internal bank liquidity. The effect was relatively slight on account of the borrowing abroad just mentioned. Two factors working in the same direction were the sharp raising of minimum reserves (1)

(1) Including cover for bankers' drafts in circulation.

in the first nine months of 1963 by over Lit. 360 000 million, against an increase of barely Lit. 130 000 million the previous year (during which free liquid resources of some Lit. 200 000 million had flowed into the banks after a reduction of the reserve ratio), and a further increase of notes and coin in circulation. On the other hand, rediscount credit and advances of the Banca d'Italia had grown more quickly during this period by (Lit. 90 000 million against an increase of Lit. 33 000 million last year). But in contrast to 1962 the Treasury's cash transactions had a highly expansionary effect on liquidity. The Treasury's balance at the Bank of Italy in the first nine months of 1963 decreased by nearly Lit. 370 000 million (December 1961 to September 1962 : Lit. 198 000 million), as the deficit on the Treasury's cash transactions increased considerably, mainly as a result of the rapid increase of expenditure on staff, and at the same time fewer new Treasury Bills were issued. But on the whole bank liquidity decreased. There was a distinct rise in the ratio of credit, the extremely rapid expansion of which slowed down somewhat from May 1963 onwards, to resources ("mezzi di provvista").

The sale of Treasury Bills dwindled, in part on account of the new regulations on minimum bank reserves in the autumn of 1962 and also owing to the general sharp tightening of the credit market. In the first nine months of 1963 the value of long-term securities placed was only Lit. 940 000 million (in the same period of the previous year : Lit. 1 224 thousand million). Net interest on Government securities rose from 4.9 % to 5.5 % in the ten months up to October 1963.

Supply and use of goods and services

	1961 (2)	1961 (2)	1962 (2)	1963 (3)	1964 (4)
	At current prices in Lit. '000 million	% change by volume on preceding year			
Gross national product	22 022	8.3	6.0	5	5
Imports (1)	3 760	15.4	15.4	23	15
Private consumption	13 305	7.7	6.7	8.5	6.5
Public consumption	3 175	4.9	4.5	5	4
Gross fixed asset formation.....	5 099	12.3	8.9	7.5	6
Exports (1)	3 908	16.3	11.8	4.5	9

- (1) Goods, services and factor income.
- (2) Italian Central Institute of Statistics (ISTAT), Rome.
- (3) As estimated by the Commission.
- (4) Commission forecasts.

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

2. Outlook for 1964

At the time of writing it was particularly difficult to make any forecast of Italy's economic development in 1964. On the one hand there was no doubt that drastic measures were urgently needed to restore internal and external balance; but these measures would produce a sufficiently speedy and radical effect only if they brought about a slow-down, albeit limited, of real economic growth. On the other hand, in the special political circumstances—the forming of a new Government—there was no sufficient indication of the orientation of future economic action or of its intensity, except that it was proposed to give priority to the solution of cyclical problems.

In these circumstances the Commission has made its appraisal on the assumption, which at the time of drafting the report was not an unrealistic one, that the stabilization policy already begun will be intensified but will be dominated by the desire to maintain a fairly high rate of growth in real terms.

On this view the expansion of demand in 1964 will no doubt continue at a considerable rate, though it will certainly be slower than in 1963.

The prospects of expansion in world business activity will no doubt benefit Italian exports of goods and services. Further advantages are to be expected from recent measures to promote trade (simplified procedure for refund of turnover tax on exports, increase of export credit funds) and from the next harvest, which should be better. If, furthermore, the expectation of a slower growth of domestic demand and a corresponding stabilization of prices were to be fulfilled, a year-to-year growth rate for exports of goods and services of some 11 % in value and 9 % by volume would be quite within the bounds of possibility.

Domestic demand will certainly continue to expand appreciably. Gross fixed asset formation will be encouraged by the prospects of improved foreign demand and of continued growth in consumer expenditure. Other stimulating factors will be the pressure to rationalize on account of the steep rise in wage costs which has been going on for some time, and the implementation, mentioned in the last quarterly survey, of Government decisions to step up housing schemes and to promote investment by additional income tax relief and more advantageous tax treatment of depreciation. On the other hand, a further slowdown of public works is to be expected and certain limits seem to be placed on physical growth, at least as far as investment in building is concerned, by the rather severe shortage of manpower which has been experienced for some time in certain areas. The contraction of margins for self-financing by firms, combined with tightness on the capital market, will probably also act as a brake on growth. Last but not least, the effects on investment of a tighter credit policy must be taken into account.

In these circumstances the growth of gross fixed asset formation may be slower than in 1963, both in value and by volume.

After a very rapid expansion over the last few years, public expenditure may well show a smaller increase from 1963 to 1964. It is also expected that the growth of private consumers' expenditure will be more moderate. First it can be assumed that the increase in cost-of-living allowances will be smaller. Secondly, equality of pay for men and women was largely applied by the end of 1963. But the Government's stabilization measures should have an effect upon wages; this, however, is a difficult hurdle. Even assuming that the underlying trend of consumption slackens, the rate of increase from 1963 to 1964 will still be high (some 11 % in value and 6.5 % by volume), because the rise in wages and salaries continued to the end of 1963 and because there is no expectation of an early change in the propensity to save, which is at present rather on the decline.

The development of demand, which doubtless could promote a rapid expansion in most sectors, will not be the only factor determining the growth of home supply. More important will be the weather, in the case of agricultural production and building, the availability of skilled labour and, last but not least, the ability to compete with supply from abroad. As for the latter factor, it is quite probable that in some sectors, for example textiles, demand and elasticity of production would in themselves allow of a more vigorous expansion of production, but that demand is directed rather strongly towards the cheaper imports.

It can be predicted however that, if serious labour disputes are avoided, the growth of industrial production will be only slightly slower from 1963 to 1964 than from 1962 to 1963 and may well reach about 7 %. The year-to-year growth rate in building and construction (contribution to the national product at constant prices) may be 2 % and therefore somewhat lower than in 1963, while the services sector's contribution may rise by some 5 % in terms of volume. Assuming that agricultural production is normal, an overall 5 % increase in the national gross product is feasible.

In these circumstances imports of goods and services will again increase very sharply (some 15 % by volume), though certainly much less so than from 1962 to 1963.

The rise of prices, however, will not be halted; on the contrary, on a year-to-year comparison at least, a rather heavy increase is again to be reckoned with, although it will be distinctly smaller than from 1962 to 1963. The upward trend may well persist throughout 1964, although the rate may slacken appreciably; for many items it is becoming less and less possible to raise prices owing to the growing pressure of imports.

The tendency for the trade deficit to increase will probably continue in relationship with the general development of prices; it will certainly be extremely difficult to prevent a further increase of the deficit in the balance of current payments. Even if the deficit on capital account remains approximately at the 1963 level, there will again be a very large deficit in the balance of payments. If it is allowed that the short-term foreign indebtedness of the banks cannot further be substantially increased, the deficit in the balance of payments will result in a very considerable reduction of official gold and foreign exchange reserves (end of October 1963 : \$3 200 million), which in any case have already been burdened with a mortgage by short-term borrowing (\$1 000 million net).

The main field in which radical reorganization measures are needed is that of budgetary policy; a severe anti-cyclical policy would limit expenditure and increase revenue so that considerable cash surpluses would be accumulated. In any case it seems indispensable that Government cash transactions at least should aim at substantially reducing the cash deficit. And, above all, the remaining deficit should be financed in such a way that there is no further increase of liquidity in the economy.

Non-inflationary financing of the State's cash deficit presupposes, however, a normally operating capital market. Accordingly, there appears to be an urgent need for immediate measures to restore confidence among business circles and again attract savings more strongly to long-term domestic investment. Obviously a further increase in the relevant interest rates would have a favourable effect here.

The question suggests itself whether the monetary authorities should not now also make more direct use of interest rates as an instrument of policy, in conjunction with quantitative liquidity policy, which of course again affects interest rates indirectly. A policy aimed at preventing rises in interest rates would not be compatible either with the inflationary expansion of demand or with Italy's balance-of-payments position. In view of the measures taken—mainly in the United States—against the outflow of private capital, as well as the raising of interest rates in France and Belgium, it seems unlikely that a conventional restrictive credit policy would be counteracted by an excessive inflow of capital from abroad. Certain unavoidable inflows—for example through direct borrowing abroad by Italian firms—would be possible only on a limited scale, and would even be acceptable in so far as they put a brake on the reduction of official foreign exchange reserves. A too rapid shrinking of reserves could provoke undesirable psychological reactions, with excessively restrictive and above all one-sided effects on the domestic situation. It seems clear that considerations of the balance of international payments should no longer prevent a country whose balance of current payments has so gravely deteriorated from using the most effective means of restoring equilibrium.

The measures taken in Italy up to the time of drafting this report do not seem adequate to restore internal and external equilibrium as promptly as could be desired.

Most of these measures, for instance the decision to cut down the budget deficit by Lit. 80 000 million (i.e. 10 %) and to refrain from using increased tax revenue for additional expenditure, have already been discussed in the last Quarterly Survey (No. 3/1963). In the meantime further measures have been taken (extension of permission to make direct sales of farm products; larger-scale granting of licences to trade in meat; freezing or reduction of rents in certain cases; controlled price of bananas cut by about 6 %; steps to promote a higher output of meat, sugar and olives and an improvement in quality).

It goes without saying that the opinion formed up to now of the attempts at stabilization cannot be materially altered thereby. More drastic general restrictive measures, especially of budget and credit policy, are still needed.

Moreover, the Commission is not alone in this view; it is shared by the Community's co-ordinating bodies primarily concerned with these matters: the Economic Policy Committee and the Monetary Committee. The opinion of the Economic Policy Committee will be found in the Annex; that of the Monetary Committee, must still be considered as confidential.

The point on which all these recommendations are most insistent is the need for restraining the expansion of demand. It would be erroneous in the present situation to count on the early and complete success of measures to promote the development of production. Such measures are for the near future to be commended only on condition that they do not immediately encourage an expansion of demand, which they obviously will do if the State offers inducements in the form of subsidies or tax reliefs. Furthermore, it must be remembered that as a rule the effects on production are felt only after a relatively long time and probably too late having regard to the need for rapid stabilization.

The temporary and moderate slowdown in the growth of production which could result from drastic curbing of the expansion of nominal demand not only seems justifiable because of the urgent need for stabilization; it would also help to remove certain bottlenecks and distortions in the pattern of production factors, such as have resulted in the past from a very rapid real growth of the economy bringing about profound structural changes. If an appropriate policy is adopted—one which applied judiciously would not entail any danger of recession—the forecast for 1964 will have to be modified accordingly: there should be a slower growth of the economy in real terms, a stronger trend towards price stabilization, and perhaps an improvement in the balance of transactions in goods and services.

A new Italian Government has been formed since the present report was drafted. Shortly before this, the parties represented in it had agreed on a basic programme of economic policy, the broad lines of which were to be incorporated in the new Government's

programme. It was too late to deal more precisely in this report with that part of the programme which is concerned with cyclical trends. It would seem in this sphere to go farther in the desired direction than previous stabilization measures since it calls for a temporary "freezing" of current Government spending and also takes up matters of wage policy. It is not clear, however, from the basic programme at what level or growth rate Government spending is to be stabilized.

D. The Netherlands

In contrast to developments in most other Member States economic growth in the Netherlands was a little more rapid from 1962 to 1963 than it had been from 1961 to 1962. This is expressed in the year-to-year growth rate of the gross domestic product in real terms which was 4 % as against 3.3 % in 1962. The speed-up is reflected even more clearly in the gross national product, which however is affected by factor income from abroad: it was 4 % as against 2.7 % from 1962 to 1963. Industrial production (on the basis of the Central Statistical Office index) probably rose by nearly 4 % from 1962 to 1963 (3.8 % from 1961 to 1962).

Doubtless the pace quickened even more than these figures suggest; allowance must be made for the unfavourable weather conditions in 1963 which caused production losses, especially in the building industry and agriculture.

The growth of demand gathered pace throughout the year. The increase in exports was appreciably greater than from 1961 to 1962, and internal demand was also more buoyant. Gross fixed asset formation increased by some 9 % in value and about 5 % by volume. Investment in plant and equipment, which had shown a weakening trend until the spring, made a noteworthy recovery. Investment in building and construction moved definitely upwards, not only in value but also—although less vigorously—by volume, especially as the number of persons employed in this branch increased considerably. Employment rose to such an extent that tightness on the labour market, instead of being relieved, as had been expected towards the end of last year, became more acute from the middle of the year onwards.

The vigorous expansion of overall demand led to a rapid increase of imports, amounting to about 8 % by volume as compared with 5 % for 1962 over 1961. The surplus on current account was smaller than in 1962. Nevertheless the overall balance of payments will still show a slight surplus, partly owing to the fact that the authorities prohibited foreign issues on the capital market.

Economic development in 1964 will be greatly influenced by this autumn's decisions to raise wages considerably more than had been originally expected. The resultant increase of costs and rise in internal demand may impede the expansion of exports. Since however, as a result of improvements in the world economic situation, potential foreign demand is likely once again to rise considerably, it is probable, that despite the above-mentioned factors, exports will increase by at least 5 % in volume.

Home demand, however, will rise more rapidly. In the first place, private consumption will probably expand more than from 1962 to 1963, because of the substantial wage increases. As a result of the new collective agreements and the increase in the numbers employed, total wages and salaries are likely to rise by about 14 %, as against 10 % from 1962 to 1963. Secondly, the increased propensity to invest is likely to continue its stimulating effect on equipment investment, especially since increased costs offer a strong incentive to rationalization. This, plus considerable progress in building and construction, will probably lead to a substantial rise in overall expenditure on investment in fixed assets.

Despite measures to increase the supply of labour it is hardly likely, as a result of expansion in demand, that tightness in the labour market will slacken to any significant extent. Nevertheless, it will be possible to increase production more quickly than in 1963, though this will be in part only an apparent gain, reflecting the losses suffered during the winter of 1962/63. Industrial production may increase by about 5 %, and the gross national product at constant prices by about 4.5 %.

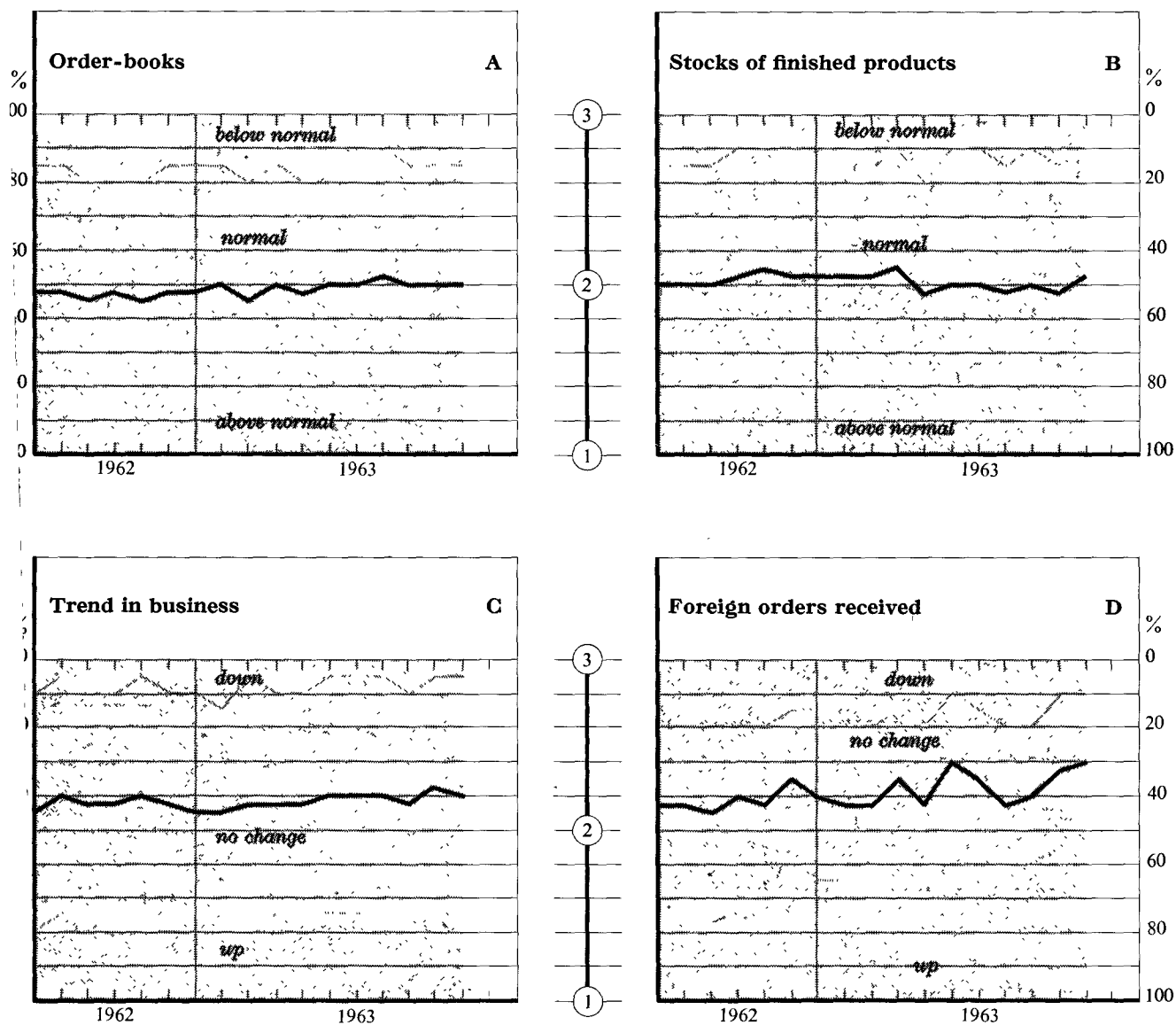
Imports will expand a little faster. The balance of trade is likely to deteriorate and the current account will probably even show a deficit.

Consumer prices can be expected to rise more strongly than in 1963. It will hardly be possible to avoid some of the rising wage costs being passed on in prices, as a otherwise too strong a contraction of profit margins may cause a decline in investment in 1965, which in turn might compromise long-term economic growth. Economic policy must aim, however, to prevent the onset of a wage-price spiral and to ensure that the external disequilibrium is no more than transient. This necessitates applying a certain brake, both on the budget and on credit policy. The Government has already taken action on these lines, but this should be intensified the moment the internal imbalance shows any sign of worsening. An effort should, however, be made to prevent any serious deterioration in the conditions for financing directly productive investments.

1. Balance-sheet for 1963

In 1963 foreign demand made a large contribution to the growth of overall demand. According to customs returns, merchandise exports increased by almost 9 % in value over the previous year, as compared with 5.6 % for 1962 over 1961. In volume the

BUSINESSMEN'S VIEWS ON THE INDUSTRIAL SITUATION



Source : Business survey of the Centraal Bureau voor de Statistiek.

Note : The survey includes construction but not paper, petroleum, non-metallic minerals.

GRAPHS A, B, C and D : The three colours (green, grey and violet) show the percentages of the three different answers. The black curves, the scale for which is given between the graphs, show the figures obtained by adding together the percentages weighted as follows :

- by 0.03 for the answer "above normal", or "up";
- by 0.02 for the answer "normal", or "no change";
- by 0.01 for the answer "below normal", or "down".

increase may have been a little less marked, since export prices, which last year had declined by 1 %, almost regained the 1960 level during 1963. The increase in volume may be around 8 %, as against 6.9 % last year.

Exports went ahead particularly in the spring; they slackened a little in the second half of the year, as by that time endeavours to make up for the winter set-backs had almost spent themselves. An improvement in the economic situation throughout the world and greater elasticity of the productive apparatus (mainly caused by higher productivity) as well as a slowdown in the expansion of private consumers' expenditure during the year, all contributed to the vigorous expansion of exports.

Though most branches shared in this, it was particularly lively in the case of certain farm products, transport equipment (mainly military), chemicals and products of the iron and steel industry.

Exports of goods to the other Community countries rose by about 18 % in value, which is well over the increase, from 1961 to 1962 (9 %). However, deliveries to non-member countries, which had increased by 2.4 % last year, showed virtually no growth. Exports to the EFTA countries possibly did not even reach the 1962 level.

Exports of services increased at a slower rate (5 %) than goods exports, while factor incomes showed a markedly better development than in 1962. According to the national accounts total exports rose by about 8.5 % in value and nearly 7 % by volume from 1962 to 1963 as against 6 % and 6.5 % respectively from 1961 to 1962.

Internal demand, too, was more buoyant than in 1962.

Despite the exceptionally severe winter which caused a heavy set-back to building and construction, total expenditure on gross fixed asset formation attained a higher growth rate than from 1961 to 1962 (9 % in value as against 7 %). In terms of volume the increase was 5 % as against 4.2 % from 1961 to 1962. Gross fixed asset formation by enterprises (including housing) increased by more than 4 % as against 2.5 % last year. The reason for this is probably that firms spent more on plant and equipment (a rise of 11 % in value, as against 9 % from 1961 to 1962). The slowdown in the growth of these investments which has been noticeable since the beginning of 1962 seems to have come to an end after the 1962/63 winter and to have given way to a revival which gained momentum in the second half of the year. In the first place, expansion of demand remained very vigorous, especially demand from abroad and from private consumers; secondly the shortage of labour became more acute. Finally, profit expectations seem to have been temporarily brighter because of an optimistic view of progress in productivity and the expectation of continued moderation in wages policy. The combination of these factors seems to have stimulated the propensity to invest. There may also have been certain special factors such as the prospect of long-term expansion for the Netherlands economy opened up by the discovery of large deposits of natural gas.

The increase of private investment in building (housing, industrial and commercial) for the whole of 1963 will probably amount to nearly 4 % by volume despite the heavy set-back at the beginning of the year. The growth of public investment slowed down a little; nevertheless it was still substantial. After a 16 % increase in value (12 % by volume) from 1961 to 1962, these investments are likely to increase by 14 % in value in 1963 (9 % by volume), largely because of stoppages in the first quarter.

In connection with the upward move of production and the price trends in the world market, investment in stocks has probably risen somewhat more rapidly than from 1961 to 1962.

Private consumers' expenditure expanded more quickly than in the previous year and has probably increased by at least 8 % in value over 1962, as against 7 % from 1961 to 1962. At the same time, however, consumer prices also rose again: the growth in consumption is therefore likely to have been about 5 % by volume, as against 4.2 % from 1961 to 1962.

Household expenditure began to rise rapidly in the autumn of 1962; the trend continued (seasonally corrected) until early in the spring of 1963—although the pace gradually slackened; it picked up again in the fourth quarter. The main cause of this development was that disposable household income continued to rise substantially. The number of employed persons increased and wages and salaries went up again. It is true negotiated wages rose by barely more than 3.5 % on average—though even this is rather more than the 2.7 % originally intended. But in addition, indirect wages rose; there were the effects of certain decisions taken in 1962 (to offset rent increases); and finally the wage drift, so that in the private sector there was probably an increase of gross income of about 8 % per person employed. In the public sector wages and salaries were raised by an average of about 8 %. All in all, the total sum of wages and salaries probably rose by about 10 %—11 %. There were also the tax reductions of July 1962 and the rise in social benefits. Finally, income from sources other than paid employment probably increased more rapidly than it did from 1961 to 1962.

The 10 % rise in Government spending on consumption is largely a result of the increase in civil service pay; by volume the increase is likely to be about 3 %.

Not only nominal overall demand but internal supply as well rose more rapidly than in 1962.

The number of persons in paid employment rose somewhat less than in 1962 (2 % as against 2.5 %). Reserves of manpower declined further after the exceptionally severe winter, and large numbers of young workers were rapidly absorbed. Building and construction and the various services accounted for most of the rise in the number of persons employed.

Industrial production increased substantially, thanks mainly to improved productivity. The number of persons employed in industry rose only slightly. In the first quarter of 1963 industrial output was severely handicapped by the effects of the severe winter, but from April to December it was running at nearly 5 % above the figures of a year earlier, despite a certain amount of social unrest in the autumn. From the second quarter onwards the pace definitely quickened. Expansion over the whole year may therefore have reached about 4 %, as compared with 3.8 % from 1961 to 1962.

Output in building and construction suffered particularly from the bad weather conditions at the beginning of the year. However, most of these losses were made up in the subsequent months, thanks largely to a very marked increase in the number of workers employed. From 1962 to 1963 the volume of building and construction work completed therefore probably rose by about 4 % as against 3.5 % from 1961 to 1962.

While farm output is unlikely to have increased noticeably over the previous year, the product of the services sector rose more quickly than in industry, largely because of an increase in the numbers employed.

Thus from 1962 to 1963 the gross national product at constant prices probably increased by nearly 4 %, which would be almost exactly in line with the forecasts published a year ago in these surveys. From 1961 to 1962 the increase of the gross national product had been only 2.7 %. If the effects of the exceptionally severe winter of 1962/63 and the unfavourable turn in income from abroad in 1962 are taken into account, the growth rate for domestic production can be put at about 4 % as compared with 3.3 % in 1962. Since working hours were again shortened, productivity in general (output per man-hour) possibly rose by about 2.5 %; in industry alone it increased by more than 3 %.

Imports of goods and services rose even more quickly than internal supply. In terms of national accounting, merchandise imports probably increased by 10 % in value and 9 % by volume over the previous year, as compared with a 4.5 % and 5 % increase respectively from 1961 to 1962.

Imports had begun to pick up towards the end of 1962 and this trend was clearly maintained in 1963. Purchases of raw materials rose more quickly, because of the accelerated rate of expansion in production and the upward movement of world prices; purchases of consumer goods, especially durables, also rose very appreciably. From the middle of the year renewed investment activity led to a marked expansion in imports of equipment goods.

Imports of services and transfers of factor incomes to abroad also rose, though less rapidly than merchandise imports. In terms of national accounting total imports of goods and services rose by about 9 % in value and 8.5 % by volume, as against 6 % and 6.5 % from 1961 to 1962.

Despite the very rapid increase of supply, the price level rose again. On a monthly average consumer prices were more than 3 % higher than last year (from 1961 to 1962 the increase was close to 3 %). Notwithstanding certain price rises attributable partly to agricultural policy decisions (sugar, bread, milk and butter), food prices on the whole rose a little more slowly (by about 3.5 % from 1962 to 1963 as against 4.5 % from 1961 to 1962), whereas prices for other products on the average moved upwards more quickly. Prices for industrial products, which from 1961 to 1962 had risen only very moderately, went up by about 1.5 %. In addition, prices for services rose a little more quickly (by about 4 % as against 3.5 % from 1961 to 1962) but this was partly because of the increase of controlled rents in September 1962. At the beginning of December prices for some goods and services were officially "frozen".

The trade balance deteriorated appreciably in 1963. The deficit increased by about Fl. 300 million. Part of this was doubtless made good by an improved balance of services and a greater surplus on factor incomes. The current account for 1963 is therefore likely to close with a surplus of approximately Fl. 400 million as against Fl. 650 million in 1962.

The overall balance of payments for 1963 may show a modest surplus, after a deficit of about Fl. 180 million in 1962. Private capital movement is likely to show a relatively high surplus, more especially since the Government, partly in an effort to favour the issue of its own loans, granted no licences for foreign issues in 1963. The surplus on private capital transactions no doubt made up the deficit caused in public capital movements by large advance repayments of foreign debts (to a total of about Fl. 250 million). The net gold and foreign exchange reserves of the Central Bank were higher by Fl. 350 million towards the end of September than they had been at the end of December 1962. Probably the commercial banks once more increased their net foreign assets.

In 1963 the country's internal monetary situation was marked by a further and very considerable increase of liquidity, contributed to by the net foreign exchange purchases of the Central Bank and an expansion of credit, whereas Treasury transactions had less effect in increasing liquidity than in 1962. Notwithstanding the expansion of liquidity, the money market was under strain from time to time and the Central Bank counteracted this through its minimum reserve policy. In the course of the year, however the capital market also came under strain. Although companies raised less money by share or debenture issues than in 1962, and although—in contrast to the previous year—no more foreign issues were allowed in this market, interest rates tended to rise, the more so since the Government and regional authorities (especially municipalities) made heavier calls on the capital market than in 1962. One symptom of strain was that certain difficulties were encountered in placing the most recent Government loan in October (Fl. 400 million).

The demand of industry for finance seems to have risen appreciably as a result of higher turnover and a certain tendency to increase stocks of raw materials; from the spring

onwards a greater propensity to invest also contributed to this development. Not only did short-term loans increase considerably at times, but demand for medium-term and long-term finance must also have risen substantially.

To prevent excessive demand from increasing still further the Central Bank decided in October to reintroduce the measures to control bank-credit which had been suspended at the beginning of the year when Bank-rate was lowered from 4 % to 3.5 %. From September to December 1963 bank advances were not to exceed by more than 4 % the average amount outstanding in the first six months of 1963. In addition the Government decided to limit, for the period from November 1963 to October 1964, the loans issued on the capital market by regional authorities to 91 % of the total issued from July 1962 to June 1963.

Supply and use of goods and services

	1961 (2)	1961 (2)	1962 (2)	1963 (3)	1964 (4)
	At current prices in '000 million florins	% change by volume on preceding year			
Gross national product	44.80	3.1	2.7	4	4.5
Imports (1)	22.51	7.1	6.6	8	8.5
Private consumption	25.69	4.7	4.2	5	6
Public consumption	6.21	3.8	6.3	3	1.5
Gross fixed asset formation.....	10.85	6.1	4.2	5	7
Exports (1)	23.26	4.4	6.6	7	5

- (1) Goods, services and factor income.
- (2) Nationale Rekeningen 1962, CBS.
- (3) Estimates by the Commission's staff.
- (4) Forecasts by the Commission's staff.

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 and are established and published on the Commission's sole responsibility.

2. Outlook for 1964

The very tentative forecasts for 1964 made in the last Quarterly Survey must be considerably modified. Renewed tightness on the labour market and changes in the internal economic situation have led to agreement between the two sides of industry on wage increases in 1964 much larger than was envisaged in the overall economic projections. The Government approved these greater wage increases subject to certain conditions and at the same time announced, and partly put into effect, a policy which will nevertheless keep the expansion of internal demand within certain bounds.

Internal demand will without doubt expand more vigorously than in 1963, mainly because of the quicker rise of wages, while the growth of exports may slow down perceptibly.

Even though economic trends throughout the world—not only in the industrialized, but in the developing countries as well—remain expansive, there is little likelihood of Netherlands exports deriving the same benefit from this as in 1963. In the first place the impending increase of wage costs will adversely affect the country's competitive position, which had recently improved a little; though production costs are rising in other countries as well, it is improbable that on the average they will do so to the same extent as in the Netherlands. Secondly, certain competitor countries have adequate production capacity to meet the new expansion of world demand, while in the Netherlands capacity is now more taken up by internal demand. Though orders from abroad are still developing satisfactorily at the moment, they must be expected to increase at a slower pace in 1964. However, in view of very considerable defence contracts the growth rate for goods exports from 1963 to 1964 is still likely to reach 5.5 % in value and 5 % by volume.

A further contraction of profit margins caused by higher wage costs is not yet likely to have any significant effect on gross fixed asset formation. In the first place, many firms have already fixed their capital expenditure programmes and secondly, the outlook for the development of demand over the coming years is at present favourable. In addition, endeavours to meet rising production costs by increased rationalization will probably be intensified. For these reasons it is not likely that the revival of equipment investment will subside at an early date. Though it is possible that the measures of credit policy adopted may have a braking effect, this may be compensated by higher profits in 1963, by the lowering of company taxes in January 1963 and by the greater elasticity of supply in industrial and commercial building.

Demand will continue to be very lively throughout the building and construction sector, especially as capacity will rise owing to certain measures taken to increase labour supply.

Altogether, therefore, equipment investment by enterprises (including housing) may increase by 13 % in value and 7 % by volume from 1963 to 1964. In the case of public investment, on the other hand, the effects of the braking measures decided on in October 1963 will probably make themselves felt; nevertheless, it may still be expected to increase by 8 % or 9 % by volume.

Thus total expenditure on capital investment will again increase very vigorously and more so than from 1962 to 1963. An approximate 7 % growth by volume is considered possible. If the set-back to the building and construction industries at the beginning of 1963 are taken into account, such a rate would not be very different from that of the previous year.

Private consumers' expenditure will expand especially vigorously; as a result of the very rapid increase in household income its growth will probably quicken appreciably. Allowing for the fact that prices will probably rise more steeply, the expansion of private consumption may still reach at least 6 % by volume.

The number of persons employed will rise by at least 2 %. The average wage will be substantially increased as a result of the recent labour-management agreement. A first 5 % increase, planned to take effect on 1 January in most sectors, will be followed by a similar increase in April. Where collective agreements provide for an increase in holidays with pay (not more than two days) this must be offset by a smaller rise of wages. Furthermore, the rigid system of absolutely binding agreed wages was abandoned in the most recent agreement; certain firms are allowed to exceed the maximum wages fixed. For this reason the rise of agreed wages, which from 1962 to 1963 had been only about 2.5 %, may reach 8 % or 9 % from 1963 to 1964. The wage drift will also tend to push up the total income from wages and salaries. The total in the private sector may rise by at least 15 %. Pensions and family allowances, too, will probably be increased by 12%. Finally, salaries and wages in the public sector will be raised, certainly by an average of more than 15 %. Other incomes on the other hand are not likely to rise much more; given a very energetic price policy, they may even decline slightly.

Government spending on consumption may rise at a slightly quicker pace. The overall growth rate will probably be 13 % in value and 1.5 % by volume.

Internal supply is also likely to expand more rapidly than in 1963, but not as much as demand. In the first place the number of persons employed will increase once more, as a result of natural population growth and because of the measures taken to increase the supply of labour. Secondly, it is possible that the advance in productivity will again exceed that of the preceding year; industrial output per man-hour may increase by about 4 %. The impending increase in paid holidays will, however, to some

extent check the advance of production, but more overtime will be worked as a result of the tax reliefs announced.

Industrial production is likely to expand by about 5 %; assuming weather conditions more favourable than those of 1963, output in building and construction may even rise considerably more. There will also be a noteworthy rise in value added in the services sector. If agricultural production is normal, the gross national product at constant prices may therefore rise by more than 4.5 % from 1963 to 1964.

Imports will certainly receive a vigorous stimulus from internal demand. Imports of finished consumer goods will be particularly high. But there is little chance of a further speed-up in imports of raw materials, and imports of investment goods will probably continue at the same growth rate, at least during the first six months. Altogether, goods imports may well increase by more than 9 % by volume from 1963 to 1964. Purchases of services will also increase rapidly.

With these prospects in view there can be no doubt whatever that the level of prices will rise more rapidly than over the past years. In addition to the effects of the measures already announced (increases in indirect taxation and rents) there will be an appreciable increase in the prices of industrial goods and of services. The development of raw material prices is likely to accentuate this trend.

At the same time the balance of trade may notably deteriorate and for the first time since 1957 there is likely to be a considerable deficit on current account.

It is not likely that the balance of payments will again help to increase internal liquidity. Though the proposed budget for 1964 provides for "neutral" financing of the Treasury deficit (Fl. 1 700 million), it is possible that the increase in tax revenue will be less marked, despite the raising of certain indirect taxes, because of the growing share of national income in the hands of persons in paid employment.

In 1964 the authorities responsible for economic policy in the Netherlands will have to take pains, in view of the great increases in costs and in demand arising from the agreed wage increases, to avoid any aggravation of the domestic imbalance, to mitigate it and at the same time to maintain external equilibrium.

As to the first point—internal equilibrium—it is clear that this will not exist in 1964—at least not if there is internal price stability. However, in the Netherlands the extent to which prices will rise does not depend only on market forces, that is to say the supply and demand situation and cost trends, but also on the price policy of a government which can intervene more directly than most other member governments. If price

policy is strictly directed towards preventing, where at all possible, increased wage costs per unit of production from affecting prices, then another problem will arise: profit margins—and absolute profits—may come under such pressure that it will be hard to avoid a set-back in investment. While this would not yet affect the 1964 results, it would be evident by the end of that year and make itself fully felt in 1965. A strict price policy combined with the agreed wages policy would in fact perceptibly depress the overall savings rate because the employee's savings rate is considerably lower than that of the entrepreneur.

Having regard to the rapid population growth, it is not quite certain whether, if this trend continues, full employment can be ensured over the coming years. In particular it is more than doubtful whether in the long run investment can develop sufficiently to bring about a more rapid increase of real income per head than in the neighbouring Member States, which is certainly necessary if economic tension is to be avoided in the Common Market.

Taking this longer view, the authorities will be obliged to allow part of the cost increase to be passed on in prices. It is true this will mean deliberately neglecting one of the most important economic objectives of the EEC Treaty: the obligation to pursue a policy of stable prices will not be respected. On the other hand it must be remembered that—at the present rates of exchange—despite the 1961 revaluation of the guilder and despite the price increases which have taken place so far, the level of prices in the Netherlands is still lower than in the other Member States. The idea of a further alteration in the rate of exchange, which suggested itself in view of the problems described, was abandoned because such an abrupt and general adjustment would aggravate the threat to the current account even more than rising costs and consumer demand will do already. In fact, the rise of costs may be differentiated according to the possibilities and limits of the various branches, especially the exporting ones. Some foreign exchange earning branches of the services sector, such as shipping, would be far harder hit by a currency revaluation.

As it is, the policy now decided on—substantial wage rises and some increase in the level of prices will make it difficult in the foreseeable future to obtain once more the surpluses on current account which are needed in view of the obligation, which the Netherlands share with all other developed countries, to export a certain amount of capital in the form of development aid.

In these circumstances the policy of exerting an overall influence on demand by means of budgetary and credit policy will have to be one of applying the brake. The expansion of internal demand in particular must be restrained so that further wage increases, which might be claimed in view of rising prices, become *de facto* impossible. Unfortunately it is in the nature of things that any policy to contain the overall expansion

of internal demand must in the first place hit investment. Therefore, some caution seems called for.

In fact the authorities have already taken this line since they have decided to reduce by 5 % for a period of six months investment spending by the Government and public enterprises, to limit the issue of loans by regional authorities (and thus their ability to incur investment expenditure), to curb credit expansion and to increase certain indirect taxes and rents. In general, it is to be expected that price rises will act as a brake on the expansion of real demand—provided that the expansion of nominal internal demand in monetary terms is checked. It is possible that in order to ensure this more emphasis may have to be put on measures of budgetary and credit policy. But in view of the pressure of rising costs on margins for self-financing, credit for immediately productive investments should as far as possible be spared.

On the other hand it is very important even in the short term that internal supply should be increased. The Government has taken or announced measures to ensure this, such as a cut in military service, incentives to women to take up work (through a speedier assimilation of their wages to those of men) and tax reliefs for overtime pay. In this context it should also be pointed out that the wage increases themselves may well have the effect of increasing labour supply in the Netherlands.

In addition, there is a series of specific measures intended to establish a better equilibrium, especially on the supply side, in the building and construction branch, where the strain is greatest. These are : greater wage increases than in other branches (in order to attract labour), and encouragement to make the best use of capacity by technical arrangements, by changes in construction planning and by spreading it over a longer period. As for the demand aspect, building permits are to be made dependent even more than hitherto on the capacity of enterprises in the industry.

To sum up, it may be said that this policy—especially if intensified where necessary—certainly seems calculated to meet the requirements of the new situation. Perhaps it could be supplemented by more inducement to save. At any rate, in certain circumstances even the wage decisions should not be applied too strictly. Rather should an effort be made to follow attentively the developments caused by those decisions and where necessary adapt them in due course to general economic requirements. A proper degree of flexibility seems in practice to be called for in this field in view of the Netherlands' great economic dependence on foreign trade.

E. B. L. E. U.

Belgium

Economic expansion continued in 1963 at a pace similar to that of 1962. The real gross national product rose, as it had done between 1961 and 1962, by about 4 %. Industrial production was probably up about 5.5 %.

Between 1962 and 1963 the economic climate improved appreciably. Disregarding certain special factors which favoured growth in 1962 and hampered it in 1963, expansionary forces were clearly stronger in 1963 than in the previous year. This applies particularly to foreign demand which, seasonally corrected, had practically ceased to grow in the second half of 1962 but advanced vigorously in 1963. The expansion of internal demand, which was clearly apparent as early as the autumn of 1962, continued in 1963, although after the middle of the year there were times when some deceleration could again be noted. The year-to-year growth rate of private consumption in real terms was the same as in 1962 (4 %), but the increase in gross fixed asset formation was a little speedier—about 3 % as against 1.5 %.

The price level rose rather faster than in 1962, as there was not only full employment but also increasing shortages, especially of skilled workers, a situation which tended to push up production costs. Building costs again rose particularly sharply.

Probably the deficit on trade will have increased slightly from 1962 to 1963. As the balance of services is also likely to have deteriorated, and the surplus on capital transactions was no more than moderate, the overall balance of payments in 1963 may show only a small surplus, whereas 1962 closed with a relatively high surplus.

It is expected that economic expansion will continue in 1964. Industrial production may well rise about 5 % and the gross national product may again increase by about 4 %.

It is true that extra stimulus from foreign demand may be weaker than in 1963, because certain special factors will cease to operate, but the growth of internal demand may be expected to continue quite rapidly. Spending on gross fixed capital formation may grow faster and private consumers' expenditure should increase at least as rapidly as between 1962 and 1963.

Prices will continue to rise. There seems every likelihood that tightness on the labour market will persist, that unit costs—which in 1963 began to climb again after a fairly long pause—will rise still further, and that the supply and demand situation will allow the increased costs to be passed on in the form of higher prices.

For some time now the Government has been endeavouring to moderate the expansion of demand, particularly in building and construction, and to increase the elasticity of labour supply. It is also seeking closer contacts with management and labour to convince them of the need of giving due consideration to the impact on prices and growth of any action they take that has an effect on incomes. In addition, certain measures of credit policy to steady the economy have been introduced. It is important that, if necessary, this policy should be tightened up in good time and that the Government, in the way it administers expenditure and its financing should be even more circumspect in the way they affect internal demand. Those who direct Belgian economic policy must continue to bear in mind the need to influence the relationship between consumption and investment to the advantage of the latter.

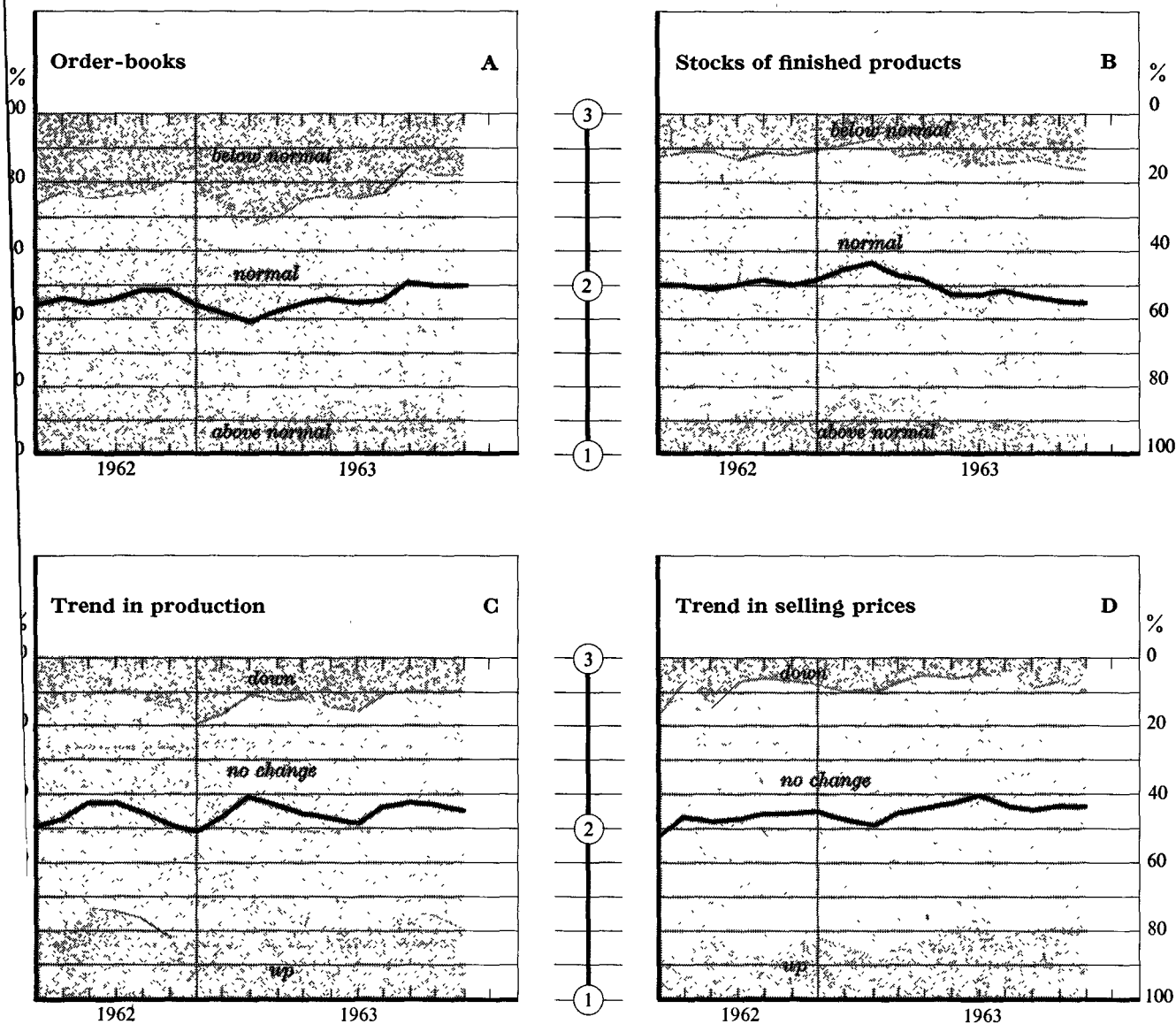
1. Balance-sheet for 1963

In 1963 exports of goods and services—influenced especially by the improved competitiveness of the Belgian economy and the favourable trend of demand in the principal buying countries—again made a decisive contribution to the expansion of overall demand.

Exports of goods increased by about 11.5 % in value, thanks to a brisk revival following the slowdown in growth which began in the summer of 1962 (figures by volume are not available). Although only a little higher than the previous year's rate this figure of 11.5 % conceals a more favourable economic development when account is taken of random factors (strikes at the beginning of 1961, the severe 1962/63 winter) which pushed up the growth rates of exports for 1962 and depressed them in 1963.

In fact exports again expanded strongly in the third quarter of 1963 (+ 16.8 %) after their already vigorous growth in the second quarter, when they were up 13.7 % on the same period of the previous year. It is true that deliveries of military equipment contributed considerably to this expansion but there was also a more than average rise in exports of foodstuffs, textiles and minerals.

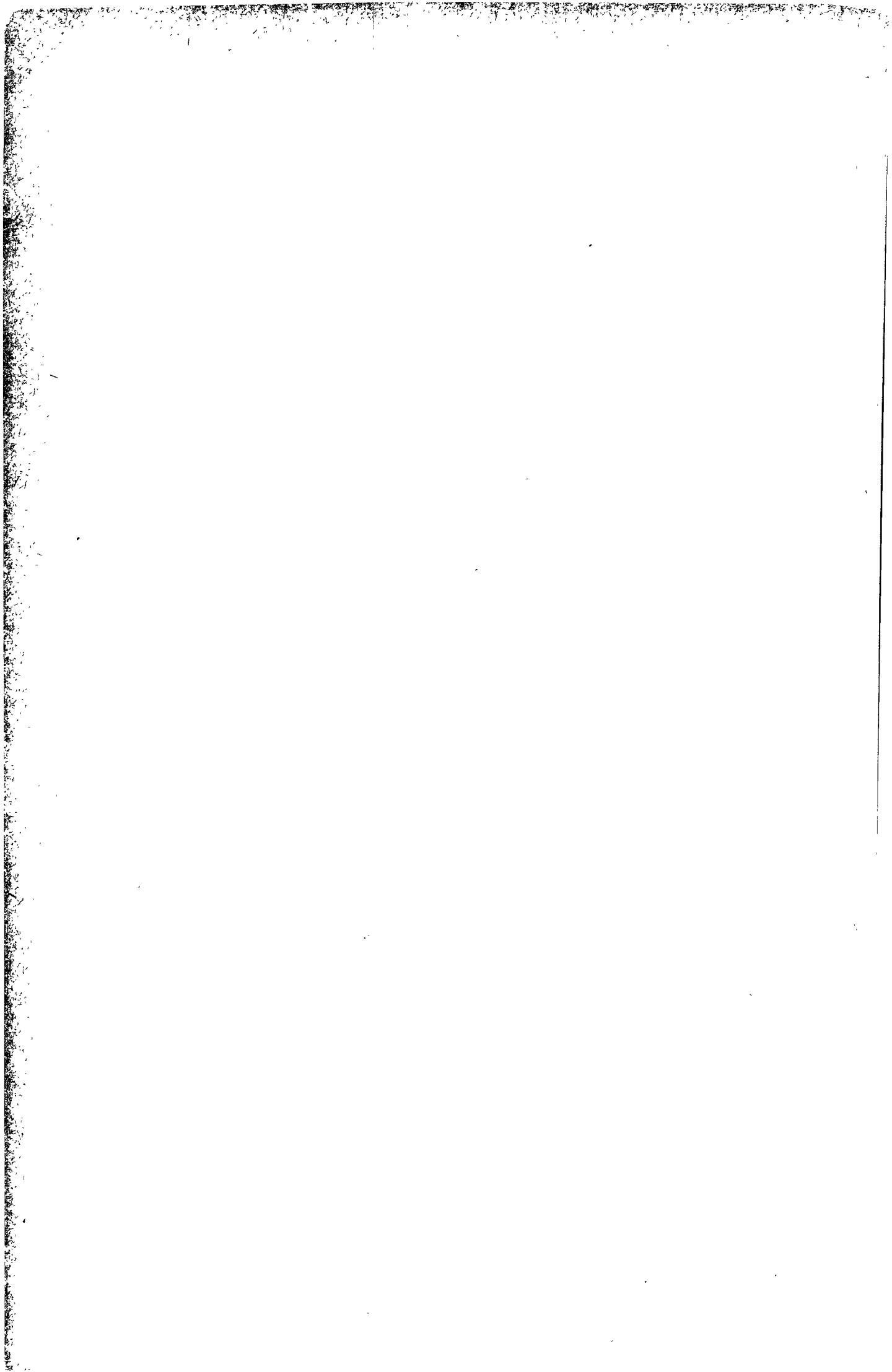
BUSINESSMEN'S VIEWS ON THE INDUSTRIAL SITUATION



Answers to the questions of the EEC business survey, carried out in Belgium by the National Bank.

GRAPHS A, B, C and D : The three colours (green, grey and violet) show the percentages of the three different answers. The black curves, the scale for which is given between the graphs, show the figures obtained by adding together the percentages weighted as follows :

- by 0.03 for the answer "above normal", or "up";
- by 0.02 for the answer "normal", or "no change";
- by 0.01 for the answer "below normal", or "down".



Deliveries to EEC member countries, particularly France and Italy, again rose more rapidly than those to non-member countries. In fact about 50 % of the increase in Belgian exports was accounted for by these two member countries. The changing trend in trade with non-member countries observed since the middle of the year was not vigorous enough to bring about any material improvement in these exports on a comparison of annual averages.

Exports of services, including factor incomes, certainly grew more vigorously than from 1961 to 1962. However, the partial figures at present available show that, as in the preceding years, the growth rate was lower than for exports of goods.

In all it can be estimated very provisionally that exports of goods and services (in terms of national accounting) increased about 9 % (value and volume) as against 8 % (value) and 9 % (volume) between 1961 and 1962.

Internal demand as a whole also showed very distinct expansionary trends.

Gross fixed asset formation by firms probably grew somewhat faster than between 1961 and 1962 as a result inter alia of higher rationalization investments and a fairly brisk revival in purchases of transport equipment. In 1963 again the establishment of foreign firms in the country was another factor stimulating investment. Investment by firms may well have risen by 6.5 % between 1962 and 1963, compared with about 4 % between 1961 and 1962. Allowing for higher prices the volume of these investments was probably up about 4.5 % (as against 2 % between 1961 and 1962).

On the other hand the heavy set-back to housing construction caused by bad weather in early 1963 put a brake on the annual growth of gross fixed capital formation as a whole. With increasing labour shortages it was impossible to make up completely the housing losses of the first quarter. Public investments, although also adversely affected to some extent by these factors, were probably about 10 % up by volume in 1963 on 1962—a relatively high growth rate, even if a little lower than that of the previous year.

Total gross fixed asset formation probably increased a little more between 1962 and 1963 than between 1961 and 1962. The nominal growth can be put at nearly 8 %. Taking into account the fairly steep rise in prices, particularly in building and construction, growth in terms of volume was probably no more than 3 %. However, this compares with only about 1.5 % between 1961 and 1962.

The production trend appears to have been favourably influenced in 1963 by investment in stocks. It is true that after the winter of 1962/63 certain tendencies to

run down stocks of finished goods became evident in industry, but the build-up of stocks of raw materials and semi-products certainly became stronger in the second half of the year.

Public consumption rose faster than between 1961 and 1962, mainly owing to higher salaries in the civil service. By volume, however, the increase in public consumption was probably below that of 1962.

Private consumers' expenditure gave a strong stimulus to total internal demand. The underlying trend for household spending to expand, which began to be apparent in the second half of 1962, continued during the whole of 1963 apart from a temporary slow-down in the early months. In view of the probable speed-up in purchases of durables and services, the growth of private consumers' expenditure can be estimated at about 6%, as against 5 % between 1961 and 1962. In terms of volume, however, growth was probably only slightly higher than in 1962 because of the somewhat faster rise in prices.

The expansion of private consumers' expenditure ran roughly parallel with an accelerated rise in total disposable income. However, the savings rate probably rose slightly.

Total wages and salaries rose by about 9 %, compared with 8 % between 1961 and 1962. This was due to a further increase in employment, but particularly to a considerable rise in pay rates accentuated by generalized application of the sliding wages scale in the course of the year. Transfer incomes and all other non-wage incomes also probably increased more rapidly than in 1962.

From available figures it appears that employment rose at the same moderate pace as in 1962. It may therefore be supposed that about two thirds of the expansion of internal supply is attributable to productivity advances, which were particularly rapid in industry. A large share of the extra supply of labour seems to have been taken up by the services sector. The increase in labour potential was moreover favoured by a greater influx of foreign workers than in 1962. The wholly unemployed, who in 1962 already were only a very small proportion (2.2 %) of wage-earners, naturally made only a relatively small contribution to meeting industry's increasing demand for labour. In any case their number again declined; the average in the first ten months of the year was 33 000 as against 48 600 in 1962. In October 1963 the proportion of unemployed had dropped to 1.7 %. Strains on the labour market, particularly shortages of skilled workers, have clearly become more acute.

There was nevertheless a distinct rise in internal supply. Labour shortages appear to have affected mainly construction and coal-mining.

According to the IRESP index, industrial production was up 8 % in the second quarter and 5 % in the third over the corresponding levels of 1962. Growth for 1963 as a whole compared with 1962 was probably about 5.5 %. This compares with 4 % between 1961 and 1962 if the random factors which swelled the 1961/62 figure to 5.5% are disregarded.

The distinct improvement in the business situation towards the end of the first quarter of 1963 was doubtless largely due to the very rapid expansion of demand for consumer goods which favoured production in the corresponding industries. But a gradual revival in purchases of certain investment goods and semi-products also contributed to raising the overall level of industrial production. However, business remained slack in iron and steel. After a decline in the first quarter, the average order-book position, in terms of working time represented, continued to improve throughout industry and, in September, had recovered to where it stood twelve months earlier.

Agricultural production went up about 2 % although harvests were adversely affected particularly as regards quality by the unusually bad weather. Activity in the services sector probably increased somewhat more rapidly than between 1961 and 1962.

On the whole it may be estimated that by volume the growth rate of the gross national product in 1963 was roughly the same as in 1962 (about 4 %). The slight improvement on the forecasts made towards the end of 1962 was in all probability due mainly to the stimulus of external demand.

Imports of goods and services made a larger contribution to the increase in total supply in 1963. Taken as a whole, purchases of goods abroad rose appreciably faster than in the previous year. In terms of value their year-to-year growth rate was 11.5 %, as against 7.9 % in 1962 (estimates by volume are not yet possible). The third quarter of 1963 saw a certain strengthening of the underlying expansionary trends so that the year-to-year growth rate was 19.5 %, as against 11 % in the previous quarter. This development almost certainly reflects the expansion of consumption, higher imports of industrial equipment goods and stockbuilding in several branches. Purchases from non-member countries on the year's average increased at much the same pace as in 1962, while the growth of imports from member countries was speedier.

In contrast to the position on the export side, imports of services increased rather more vigorously than imports of goods. Provisional estimates show total imports of goods and services (in terms of national accounting) to have been about 9.5 % to 10 % greater in value and by volume than in 1962, when the corresponding growth was 7 % in value and 8.4 % by volume.

The rise in prices in the first eleven months of 1963 was appreciably faster than in the corresponding period of 1962. The retail price index went up 3.2 %, compared with

1.3 % between December 1961 and November 1962. In the comparison of monthly averages for the periods mentioned the rise in 1963 was 2 %, as against 1.4 % in the previous year. Boom conditions have made it easier to pass on part of the higher production costs to the consumer : in some cases it has even been possible to widen profit margins. Higher prices for certain foodstuffs, due in particular to unfavourable supply conditions and to certain agricultural policy measures, were another factor making for an increase in prices. After a period of relative stability, wholesale prices on the year's average went up somewhat faster than retail prices for the first time since 1960. Price rises affected not only home-produced manufactures and agricultural products but also imported goods.

The trade balance seems to have deteriorated slightly between 1962 and 1963. In 1962 the deficit was Bfrs. 11 500 million. This was aggravated by a decline in the surplus on services—to which certain extraordinary transfers by the Government certainly contributed. As a result current transactions showed a smaller surplus than in 1962. It is possible that the overall payments balance for 1963 will also show a surplus—albeit a very small one—as capital movements were in balance or even a little on the credit side.

After declining slightly in 1962, official gold and foreign currency reserve rose appreciably. The increase in the first ten months was \$162 million, as against a fall of \$40 million in the corresponding period of 1962. However, this improvement is largely attributable to the further increase in the Belgian Treasury's foreign exchange indebtedness since the end of the previous year. As a counterpart to this the net foreign exchange position of the banks deteriorated somewhat.

Since the end of 1962 the trend on money and capital markets has been towards higher interest rates. This followed a long period in which high liquidity and, in relation with this, the policy of the monetary authorities, had worked in the direction of cheaper money. Doubtless the difference between Belgian interest rates and those of some other countries, the vigorous economic expansion and, finally, certain effects of the tax reform have contributed to this change of trend, even though the last-mentioned factor became less significant in the course of the year. In this connection it was a question not only of an adjustment of interest rates in connection with passing on to the borrower the higher capital yields tax, but above all of increased public inclination to hoard or to invest abroad. This trend was not without effect on bank liquidity and the Treasury had difficulty in finding on the internal market means to cover the higher deficit.

In fact the Treasury's financing requirements went up appreciably as a result of the expansion of certain current expenditure caused by the particularly severe 1962/63 winter and a sharp increase in actual investment outlay. This can be seen in the trend of Government indebtedness (exclusive of transactions with the International Monetary Fund), which increased by Bfrs. 19 000 million in the first eleven months of 1963 as against Bfrs. 15 300 million in the same period of 1962.

Supply and use of goods and services

	1961 (2)	1961 (2)	1962 (2)	1963 (3)	1964 (4)
	At current prices in Bfrs. '000 million	% change by volume on preceding year			
Gross national product	601.2	3.2	3.9	4	4
Imports (1)	214.8	6.6	8.5	9.5	7
Private consumption	413.1	3.1	4.0	4	4
Public consumption	71.4	1.1	6.2	5.5	3.5
Gross fixed asset formation.....	113.8	3.1	1.5	3	5
Exports (1)	214.3	7.6	9.2	9	7

(1) Goods, services and factor income.

(2) Comptes nationaux 1953-1962, Institut national de Statistique.

(3) Estimates by the Commission's staff.

(4) Forecasts by the Commission's staff.

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 and are established and published on the Commission's sole responsibility.

As a result of the spurt in economic activity and the difficulties of firms in finding the necessary funds on the capital market, demand for credit from the private sector became more and more lively in the course of the year. A rise in bank-rate (from 3.5 % to 4 %) with effect from 18 July was mainly aimed at adapting the various official interest rates to the new situation in the money market, at restraining the increase of money in circulation and at preventing a deterioration of the situation on the foreign exchange markets. On the other hand a second rise in bank-rate on 31 October (from 4 % to 4.25 %) was mainly intended to check demand for short-term finance and channel available funds towards longer-term internal uses.

2. Outlook for 1964

Assuming the developments described elsewhere in this survey as regards the world economic situation and the economic trend in the other Community countries—and given normal weather and no material changes in Belgian economic policy—it may be expected that economic growth in 1964 will continue at roughly the same pace as in 1963.

Although some elements of demand which increased very strongly in 1963 will probably expand less in 1964, total nominal demand may well grow somewhat faster.

A somewhat quieter trend is probably to be expected, particularly in exports. It is of course true that the influence of the improved world economic situation which began in 1963 will continue to be felt in demand from non-member countries and even become stronger in 1964. It is not to be expected, however, that the particularly high growth rate of Belgian exports to member countries attained in 1963 will continue. Even though the expansion of exports to the Community countries as a whole will certainly remain vigorous, some slowdown in the growth of deliveries to France and Italy is nevertheless quite possible as a result of stabilization measures in these two countries. In general, a tendency towards a slightly restrictive economic policy in the Community may have a damping effect on the growth of Belgian exports. Furthermore, such special factors as deliveries of military equipment will probably be less in evidence in 1964 than in 1963.

On balance all these trends and influences may produce a growth of a full 8 % in value and volume of goods exports between 1963 and 1964. On the other hand the progress of exports of services will probably not differ to any marked extent from that in 1963.

Internal demand will continue to show strong expansive trends. In the first place gross fixed asset formation will continue to grow in 1964. There is some probability that fixed investment by firms will increase as much as between 1962 and 1963—if not even more : in many branches of industry increasing labour shortages and the need to curb mounting production costs are an incentive to rationalization. At the same time the outlook for further expansion of sales is quite bright. The trend of permits for industrial construction supports the assumption that there is a considerable propensity to invest and the corresponding building activity for its part is a dynamic investment factor. In addition, there will be a further distinct rise in expenditure on housing construction. In terms of volume, and always assuming normal weather conditions, there will probably be a slight rise—after a decline which has lasted two years. Public investments will also increase again but doubtless less briskly than in 1962 and 1963, when they grew particularly fast. Two factors which may limit the rate of growth are that certain programmes will on grounds of economic policy be spread over a longer period, and that fresh cost rises may occur.

On the whole therefore gross fixed asset formation may rise between 1963 and 1964 by about 8 %—9 % in value and 4 %—5 % by volume. This would be the most vigorous growth for three years. It must be remembered, however, that this speed-up reflects to some extent the almost complete stoppage of building work in the winter of 1962/63.

Whereas in terms of value public consumption will expand less strongly in 1964 than in 1963, the growth of private consumers' expenditure may even be slightly faster.

The increase of private consumption by volume, assuming a sharper rise in prices, may however be rather less marked than in the previous year. It may still be appreciable, however, as it will be favoured by a further rise in the total of wages and salaries which largely because of the manpower shortages, will maintain at least the same pace as in 1963.

The increase in numbers in employment will still be only moderate despite further recruitment of foreign workers.

In view of the probable trend of demand as a whole and of demand for the various classes of goods, and in view of the estimated supply elasticity, it can be assumed that the expansion of industrial production will be only slightly less brisk than between 1962 and 1963 : the growth rate may reach 4.5 % to 5 %. Increased employment and a possible improvement in productivity should suffice to ensure this even though in certain branches the unfavourable effects of labour shortages will again be clearly felt.

The production of investment goods should expand more rapidly under the stimulus of increasing external demand. The expansive trend might nevertheless slow down a little in branches producing durable or semi-durable consumer goods, which advanced with particular vigour in 1963.

The growth rate of the gross national product in 1964 will in all probability reach about 4 %. This forecast is based on the figure quoted for industrial production, and, on the assumption that expansion in services will be comparable with 1963 and that agricultural production will develop normally.

In volume imports may increase somewhat less rapidly than between 1962 and 1963, the more so as 1963 was marked by such special factors as imports of military material and relatively large raw material purchases. In any case imports of goods will probably show an annual growth rate of a full 7 % by volume. The current payments account will hardly change materially, i.e. it will remain more or less in balance.

In 1964 the level of prices will probably again be higher than in the previous year. Even if in the course of the year prices do not rise as quickly as in 1963 the annual rate of increase will probably reflect the high level already reached towards the end of 1963. A slowdown in the rising trend of food prices, which was very strong in the second half of 1963, is possible. The upward trend of prices for industrial products and services will probably continue. It is also likely that the steep rise in building costs will be reflected even more in rents. These, however, are not included in the retail price index.

In Belgium as elsewhere the authorities responsible for economic policy are now increasingly faced with the problem of maintaining balanced growth, i.e. of fulfilling the

conditions for internal financial stability and stability of the price level. It does not seem so much the case that the speedier growth of external demand observed in 1963 contributed to certain strains first noted in that year and which, given the prospects described above, will also tend to be a feature of 1964. It is rather the expansion of domestic demand which has perhaps become too lively. True, it is not the expansion in directly productive investment but the development of private consumer incomes and expenditure in particular which has become quite rapid. Here, with the speedier expansion of wages and salaries in industry, there can be no doubt that public consumption and transfer payments have played a part. In addition, public investment in certain sectors has become a further factor causing strain, particularly where it coincided with the general expansion of private spending.

After a certain period during which its competitive position improved, mainly because wage costs rose only moderately, Belgium now seems to have entered a new phase of rising unit costs and prices. It is true that this trend is in no way comparable in scope with what is going on in some other countries, but it is nevertheless evident that any such development involves the danger of an acceleration which could jeopardize Belgium's internal stability and in time also affect external economic relations, the more so if stabilization policy in the other countries is successful.

In these circumstances a moderately restrictive policy would certainly seem judicious, and there should be no hesitation in curbing even more drastically the expansion of internal demand should this prove necessary—a possibility which cannot be entirely ruled out in 1964.

Very properly, therefore, the Government is endeavouring to make closer contacts with management and workers to ensure that account will be taken of the impact of wage policy on production costs. In this connection it is particularly important, in view of the manpower shortages, to keep the trend towards shorter hours within limits compatible with the requirements of economic policy. Highly relevant here are direct measures to ease the labour market situation such as encouragement to immigration of foreign workers and the employment of more women and also pensioners in industry. These measures have already been set in motion by the Government and should certainly be intensified.

It is, however, also necessary that in its own sphere the State should avoid anything which may over-stimulate business and price trends. Thus the more prudent course of certain public investments is commendable. But endeavours should also be made to curtail the general stimulus imparted by the State budget to internal liquidity and directly or indirectly to internal demand. The Treasury deficit must certainly be reduced—both by curbing the expansion of spending and strengthening that of current revenue—and

financed in a way involving no inflationary dangers such as are unavoidable when recourse is had to foreign credits.

The authorities responsible for credit policy have already shown that they are prepared to make use of the weapons in their armoury. If necessary more severe measures will have to be taken, and here—to the extent that a choice is possible in Belgium—the first cuts should be in those short-term credits which more or less directly help to meet cost and price rises. Disadvantageous effects on productive investments of a further small rise in interest rates need not then be feared, since the new tax legislation should at least offer a continued inducement to such investments. Somewhat higher interest rates may also stimulate long-term savings and their investment at home—a highly desirable development in the interest of sound financing of both private and public investment. In Belgium particularly, international balance-of-payments considerations in any case no longer justify failure to use the most effective instruments of a policy of internal price stability.

Grand Duchy of Luxembourg

Although only moderate, the expansion of production in 1963 was all the more noteworthy as it occurred after a period of two years during which the gross national product at constant prices ceased to increase (1961) or even declined a little (1962). In volume the rise was probably about 0.5 % between 1962 and 1963, and the index of industrial production may have gone up by about 1 %.

Demand for steel in terms of volume improved somewhat compared with 1962. Probably, however, the situation on world iron and steel markets once again caused a fall—albeit a moderate one—in the selling prices of Luxembourg's iron and steel products. For this reason the value of exports was probably no more than maintained at the 1962 level.

Nominal internal demand developed quite strongly, with investment expanding more vigorously than consumption. Wage and price rises became more rapid and here more acute labour shortages (particularly in the building trades), higher import prices and certain agricultural policy measures played a part. The expansion of demand was therefore appreciably smaller by volume than in value.

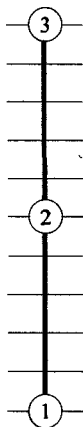
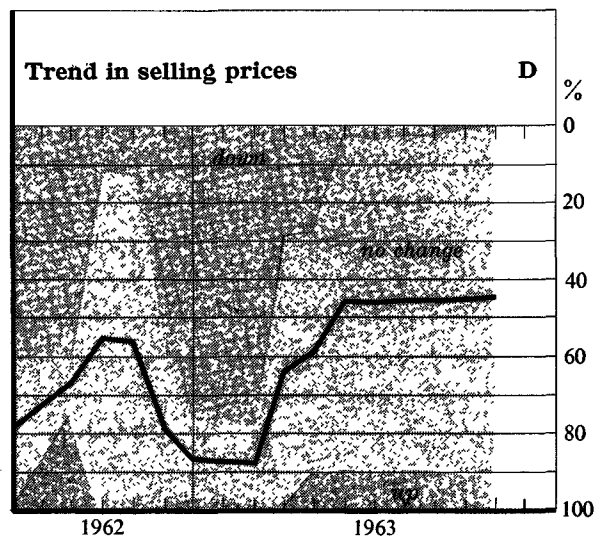
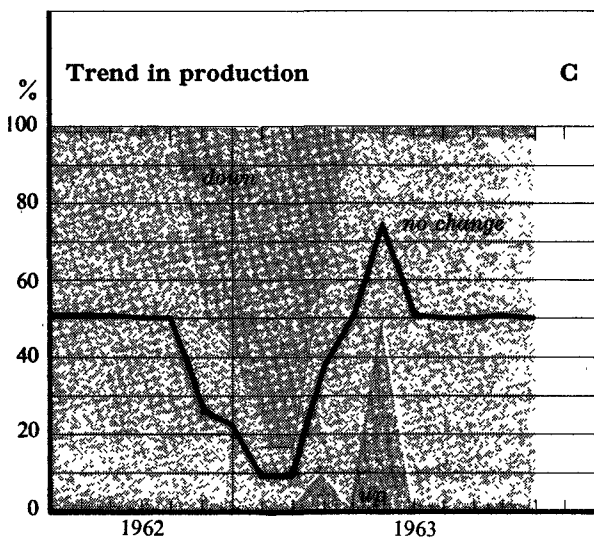
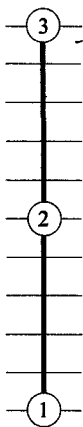
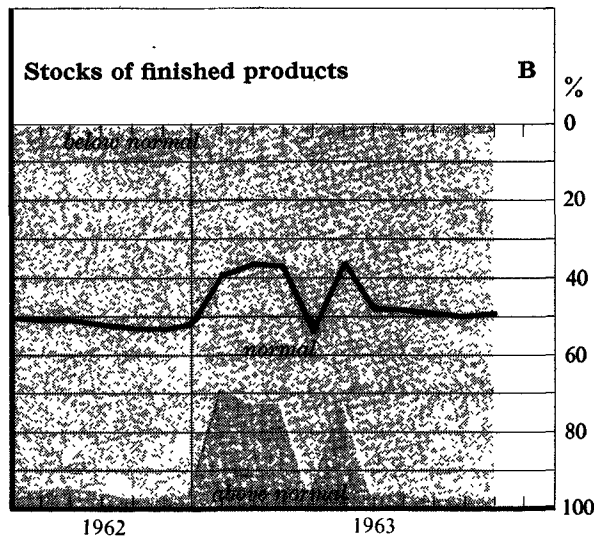
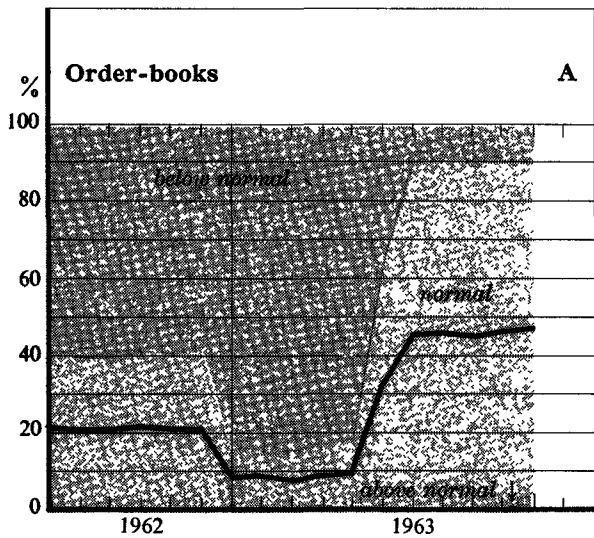
The outlook for 1964 is not exactly bright, nor is it unfavourable. A somewhat more speedy expansion of exports and of private consumption (by volume) can be expected. At the same time, however, a slight decline in fixed asset formation by firms is to be feared because of smaller investments in the iron and steel industry. The gross national product at constant prices will probably increase somewhat more rapidly than in 1963.

In view of the tightness on the labour market, which is likely to continue, and the danger of further price and cost increases, a more vigorous stabilization policy will have to be followed in 1964 if the threat of serious imbalances is to be avoided.

1. Balance-sheet for 1963

Between 1962 and 1963 foreign demand in terms of volume probably increased a little, after declining between 1961 and 1962. In terms of value it may not have changed very much, in view of the pressure on export prices for steel. Exports of goods were favoured by a revival of quantitative demand for steel products, although in the annual comparison this revival was only limited, as new orders flagged after the spring. Exports

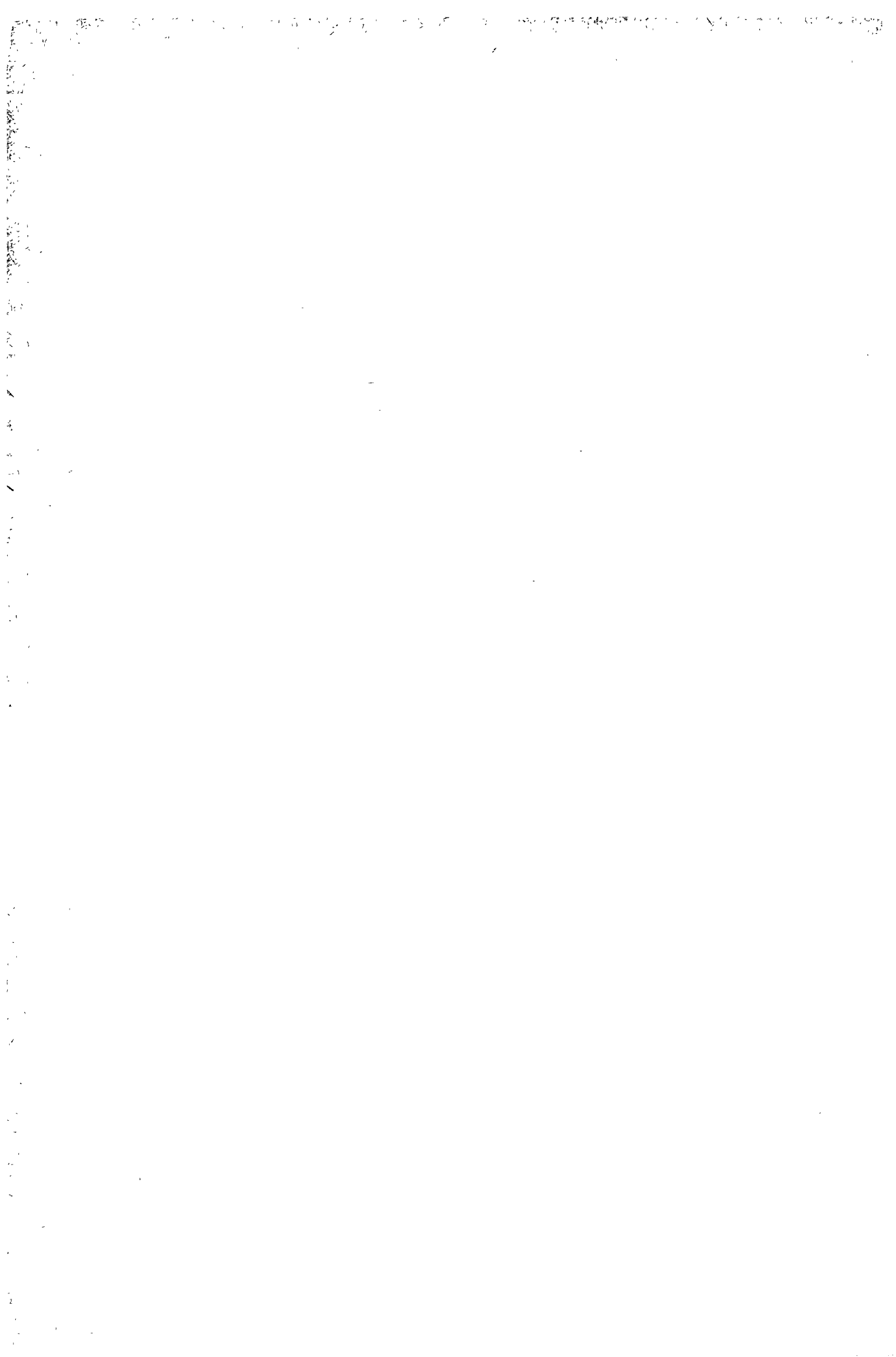
BUSINESSMEN'S VIEWS ON THE INDUSTRIAL SITUATION



Answers to the questions of the EEC business survey, carried out in Grand Duchy of Luxembourg by STATEC.

GRAPHS A, B, C and D: The three colours (green, grey and violet) show the percentages of the three different answers. The black curves, the scale for which is given between the graphs, show the figures obtained by adding together the percentages weighted as follows:

- by 0.03 for the answer "above normal", or "up";
- by 0.02 for the answer "normal", or "no change";
- by 0.01 for the answer "below normal", or "down".



of iron ore fell further. Sales of agricultural and chemical products on the other hand went up faster than in 1962, but in any case these items account for less than 10 % of total exports. In contrast to the previous year, sales to Community countries as a whole progressed less favourably than exports to non-member countries, which, however, had earlier suffered a particularly severe set-back.

In 1963 the development of fixed asset formation was marked by higher investment spending by foreign firms setting up new enterprises in Luxembourg. In terms of value investment in the steel industry probably continued at the 1962 level, although in volume there may have been a slight decline. Investments in building and construction may even have fallen in value between 1962 and 1963. In this sector prices have risen very steeply, so that in terms of volume quite an appreciable decline may have occurred, after a slight increase between 1961 and 1962. The unfavourable trend of building investment is attributable to the severe 1962/63 winter and to greatly aggravated labour shortages. All in all, therefore, gross fixed capital formation was probably up on 1962 a full 7 % in value, but only slightly—about 1 %—by volume.

Private consumers' expenditure also expanded at roughly the same pace in 1963 as in 1962. In value the increase may well have been about 4 %. However, the real growth of consumption in 1963 probably did not exceed 1.5 %, since consumer prices rose more rapidly.

The increase in consumers' expenditure is to be attributed to a fresh rise in household incomes. It is true that in 1963, for the first time since 1958, the numbers employed in the manufacturing and building industries, on the year's average, were lower than in a preceding year. The drop was 2 % and is accounted for mainly by the employment of fewer foreign workers. In addition the more subdued climate in steel slowed down any increase in actual earnings. In other branches, however, there were substantial increases in total wages and salaries. In building they may have been more than 10 % per worker. The automatic operation of the sliding wage scale in May and September and the new minimum wage regulations also helped to push up earnings. To this must be added very considerable wage and salary increases in the public sector. Finally, incomes in agriculture and certain services may well have risen more sharply than in 1962.

Public consumption expenditure increased appreciably, and more strongly than between 1961 and 1962 owing mainly to higher salaries in the civil service.

After declining by 4.3 % between 1961 and 1962, industrial production may have risen by about 1 % between 1962 and 1963 (1). Since the year-to-year growth rate in steel was probably only 0.5 %, growth in the other branches of industry may have been about 2.5 %. (Between 1961 and 1962 steel fell 3.9 % and the other branches 5 %).

(1) According to the national index.

However, the particularly marked improvement in the underlying production trends in early 1963 seems to have again given way to a static situation in the second half year.

While activity in the services sector has probably again increased, agricultural production is unlikely to have been much above the 1962 level. In all, the gross national product at constant prices, which declined by a full 1 % between 1961 and 1962, may have risen 0.5 % between 1962 and 1963.

The increase in imports, which was relatively strong between 1961 and 1962 (6 % in value), slowed down between 1962 and 1963 (2 % to 3 % in value; 1 % by volume). The growth of the volume of imports was checked by sharper price rises abroad.

Since the beginning of 1963 the price trend has been definitely upwards. The cost of living probably rose by 3.7 % between December 1962 and November 1963, compared with a mere 0.6 % in the first eleven months of 1962. The main cause was dearer food, which again was partly due to the Government's agriculture policy measures. But prices for some other products and services also rose.

On the money and capital markets liquidity was again high. Industry probably made smaller calls on the capital market in 1963 than in 1962. Despite a fall in tax revenue the Treasury did not have recourse to the public capital market. The last Government loan was issued in October 1962.

2. Outlook for 1964

Total demand should continue to expand in 1964, with possibly a slight acceleration.

In the first place external demand may rise further and at a slightly increased pace. True it is unlikely that conditions in steel will improve sufficiently in 1964 to warrant the expectation of a considerable increase in Luxembourg's exports of these products. Furthermore, the order-books of steel firms throughout the whole of 1963 were even below the corresponding 1962 levels. However, internationally the investment situation seems to be picking up and this certainly offers improved prospects for steel sales. The coming completion of the Moselle canal should improve transport conditions and thus stimulate deliveries of Luxembourg's iron and steel products. Finally, output in the new industries could help to boost Luxembourg's exports in 1964.

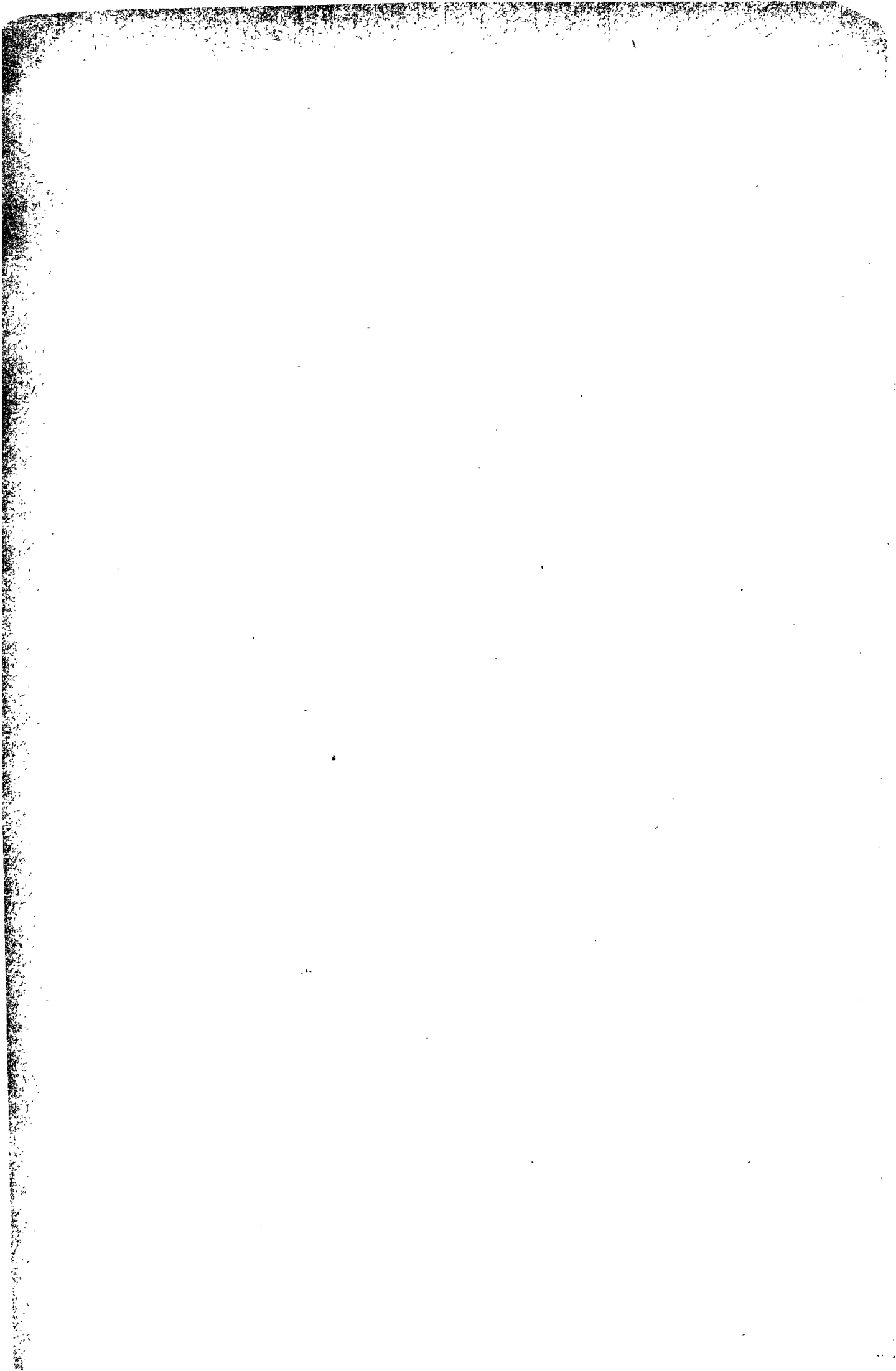
The development of domestic demand will be adversely influenced by a decline in gross fixed asset formation : the smaller investments in iron and steel plant will mean a decline in total investments by firms, although outlay on plant in other branches will continue to grow fairly vigorously. Building investment will probably also show a recessive trend, since housing may again be affected by manpower shortages and the resultant increased costs, and public investments will probably fall appreciably.

Against this, however, private consumption should continue to expand fairly rapidly. The growth rate by value can hardly be expected to change materially. As price rises may tend to slacken a little in the course of the year, the growth of consumption by volume may well be slightly higher than in the previous year.

The expansion of public consumption will probably slow down in terms of value; by volume, however, it is likely to increase faster, mainly as a result of a speedier growth of the numbers of public servants employed.

This outlook suggests a possible growth of about 1 % to 2 % in industrial production between 1963 and 1964. Allowing for a new advance in the services field and a slight expansion of production in agriculture, the real gross national product may be up about 1.5 % on 1963. It is likely that total employment will indeed rise slightly in 1964; nevertheless tightness on the labour market will probably not ease to any appreciable extent.

From the angle of short-term economic policy the 1964 budget and certain credit policy measures seem to aim especially at checking excess demand in the building market as a whole, which is overstimulating expansion in other sectors particularly in respect of wages. In addition, measures were recently taken to encourage immigration of foreign labour and to tighten up price supervision. In 1964 this policy may create the prerequisites for equilibrium, granted a readiness to intensify it in good time. This last condition applies especially to measures to increase the elasticity of labour supply, particularly as Luxembourg's neighbours will also step up their efforts in this direction.



EUROPEAN ECONOMIC COMMUNITY.

Opinion of the Economic Policy Committee on problems arising from the present economic situation in the Community

20 November 1963.

1. The Economic Policy Committee met on 14 and 15 October 1963 under the chairmanship of Professor Müller-Armack and studied problems of economic policy revealed by an analysis of the recent trend in the Community and the outlook for 1964. The Committee had at its disposal a revised version, drawn up by the experts from the member countries, of the preliminary economic budgets for 1964. The Committee would like to express its satisfaction at the promptness with which the initial 1964 forecasts were brought up to date.

2. On the basis of this information the Committee finds that in general the outlook for demand in 1964 is expansive. The favourable forecasts of the world business trend for 1964 justify the expectation that the recovery in Community exports to non-member countries noted since the beginning of spring will continue. Furthermore, and in view particularly, of the recent improvement in order-books in the capital goods industries, the trend of investment by enterprises will doubtless be more dynamic than in 1963. Consumers' expenditure seems likely again to increase appreciably in 1964.

3. There are even grounds for fearing that expansion of demand may be too speedy in several member countries, where grave problems of economic balance may continue to make themselves felt. If these problems are not solved the internal balance of the Community will be threatened. So far in 1963 the rise in prices has been rapid in France and in Italy, although in the latter country it has tended to abate in recent months. Moreover, the trend of the Italian balance of payments may give cause for concern if the rise of costs and prices is not checked in the near future. In the Netherlands the talks on the recent large wage claims suggest that there is a possibility of a disturbance of economic balance in 1964. In the Grand Duchy of Luxembourg, by the combined effect of rising production costs and the operation of the sliding scale, the competitive position of industry is becoming more difficult at a time when the growth of economic activity is al-

ready relatively weak. On the other hand, the balance of the German and Belgian economies does not seem likely to be threatened during the months ahead, although in fact this is a dubious forecast depending on the absence of excessive demand stimulus particularly from the other Community countries.

4. In the opinion of the Economic Policy Committee, developments in recent months show that the policy of combating inflationary trends mainly by selective measures pursued until September in France and put in hand in Italy has not been sufficiently effective. In view of the persistence in these two countries of inflationary tendencies, now accompanied by a decline of confidence, it is doubtful whether balance could have been restored even by strengthening the selective policy. This being so, the Committee refers to the opinion which it issued in its report of 9 July 1963 on the preliminary economic budgets for 1964 and emphasizes the need for greater recourse to global measures to restrict the growth of demand in those member countries where inflationary trends are likely to be prolonged or to become more vigorous. The Committee considers that such an attitude is indispensable not only in the interest of these countries but also in that of the Community as a whole and of those member countries where the prospects of maintaining internal stability are relatively good.

5. The Committee has noted the measures recently adopted by the French Government; in its opinion this overall programme follows the right lines. Nevertheless it wonders whether the effects of the global measures in this plan will actually suffice to halt the present price rise in a relatively short time. More energetic action to balance all budget operations would certainly enhance the possibility of achieving this aim. The French authorities should also ensure that the arrangements made or being planned should be completed by appropriate action in the field of incomes. To judge by its recent trends, the balance of payments is shaping in a way which is no longer an obstacle to more drastic overall restrictive measures, should these prove necessary, and which at least permits the hope that the measures in the credit field will be more effective.

6. In the opinion of the Economic Policy Committee the measures announced by the Italian Government in recent weeks do not yet seem adequate to cope with a situation which, because of the risks connected with the deterioration of the balance of payments, is more serious than in France. To redress the situation it would first be necessary to put an end to the expansive budget policy pursued in the past, to tighten credit restrictions and to adapt incomes policy to present realities.

7. As to the special problems which have recently arisen in the Netherlands, the Committee points out that a steep rise in wages could lead to a difficult situation: the need to act on global demand in order to avoid economic imbalance would doubtless have an unfavourable impact on investments and, consequently, on the longer-term possibilities of bringing the level of wages nearer to that in other Community countries without disturbing external balance.

8. In the Federal Republic of Germany and Belgium, where the prospects of maintaining internal stability are better than in the other member countries, some caution, which should in particular be reflected in budget policy, is nevertheless called for as regards the future expansion of overall demand. Furthermore, in the Federal Republic a slowdown of demand in the building and construction sector appears desirable, especially in public building and in housing. Such a policy making for greater internal stability would certainly be a useful contribution to the efforts of the other Community countries towards stabilization.

