

EUROPEAN
ECONOMIC
COMMUNITY
COMMISSION



DIRECTORATE-
GENERAL
FOR ECONOMIC
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**THE ECONOMIC SITUATION
IN THE COMMUNITY**

3

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QUARTERLY SURVEY

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**Commission of the European Economic Community
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EUROPEAN ECONOMIC COMMUNITY

COMMISSION

The Economic Situation in the Community

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I. THE ECONOMIC SITUATION IN THE COMMUNITY

Economic expansion in the Community continued in the second quarter and, as far as may be seen from the incomplete statistics at present available, in the summer months also. In the second quarter at any rate there was a speed up which can be attributed only in part to endeavours to make good production lost in the first quarter through the very harsh winter weather, but which also reflects the fact that the underlying trend has grown stronger.

This can be seen in the Community's exports to non-member countries: in the second quarter of 1963 exports of goods were 7 % higher in value than a year earlier after being down 2.5 % in the first quarter compared with 1962. In addition to the impact of the special factor mentioned this clearly reflects the improvement which has meanwhile occurred in the world economic situation.

In domestic demand, the total of investment expenditure again advanced considerably. The increase in outlay on investment in building and construction was particularly strong as weather returned to normal and the building industry, by stepping up the number of workers, was able to increase the elasticity of its supply. The trend of investment by enterprises in capital goods remained hesitant, but the underlying tendency no longer seems to be recessive.

Finally, consumers' expenditure grew very strongly. Public consumption in general continued its relatively rapid expansion and the growth of private consumers' expenditure in most member countries in the second quarter was clearly

more rapid than the slow advance of the first. This was essentially due to increased employment and further considerable rises in wages and salaries.

In fact numbers in employment have definitely increased, the rise occurring less in industry than in construction and certain service sectors. In Italy, Belgium and even in the Netherlands the number of unemployed fell below the level of a year earlier, but remained slightly above it in France, where some of the Algerian repatriates are proving difficult to employ, and also in the Federal Republic of Germany. Despite the considerable increase in employment the easing of labour markets did not in general continue. In some countries there is even a tendency for new strains to emerge.

The lively expansion of demand and greater material possibilities of stepping up production resulted in a vigorous increase in domestic supply; the rise in agricultural production was, it is true, inhibited by unfavourable weather conditions (a period of rain), but industry was able to step up output considerably. The production index of the Statistical Office of the European Communities (excluding construction, food, beverages and tobacco) was 6 % higher in the second quarter than in the same period of 1962, whereas the corresponding year-to-year growth rate in the first quarter had been only 2 %. The expansion of output in the building sector was particularly vigorous.

Supply from domestic sources was supplemented by somewhat more rapidly rising imports from non-member countries. The value of imported goods was about 11 % higher in the second quarter than in the second quarter of 1962 (figures for volume are not yet available). However, in view of the expansion of exports, which also rose more rapidly, the Community's trade balance did not deteriorate further. True, the deficit in the second quarter at about \$755 million was \$340 million heavier than in the same period of the previous year, but in the first quarter the corresponding deterioration had been \$530 million. There was probably a considerable surplus on current account; the overall balance of payments registered an increased surplus; here, however, heavier inflows of long-term and short-term private foreign capital were a contributing factor. The total official gold and foreign exchange reserves of the member countries rose by about \$625 million in the second quarter, as against \$388 million in the first.

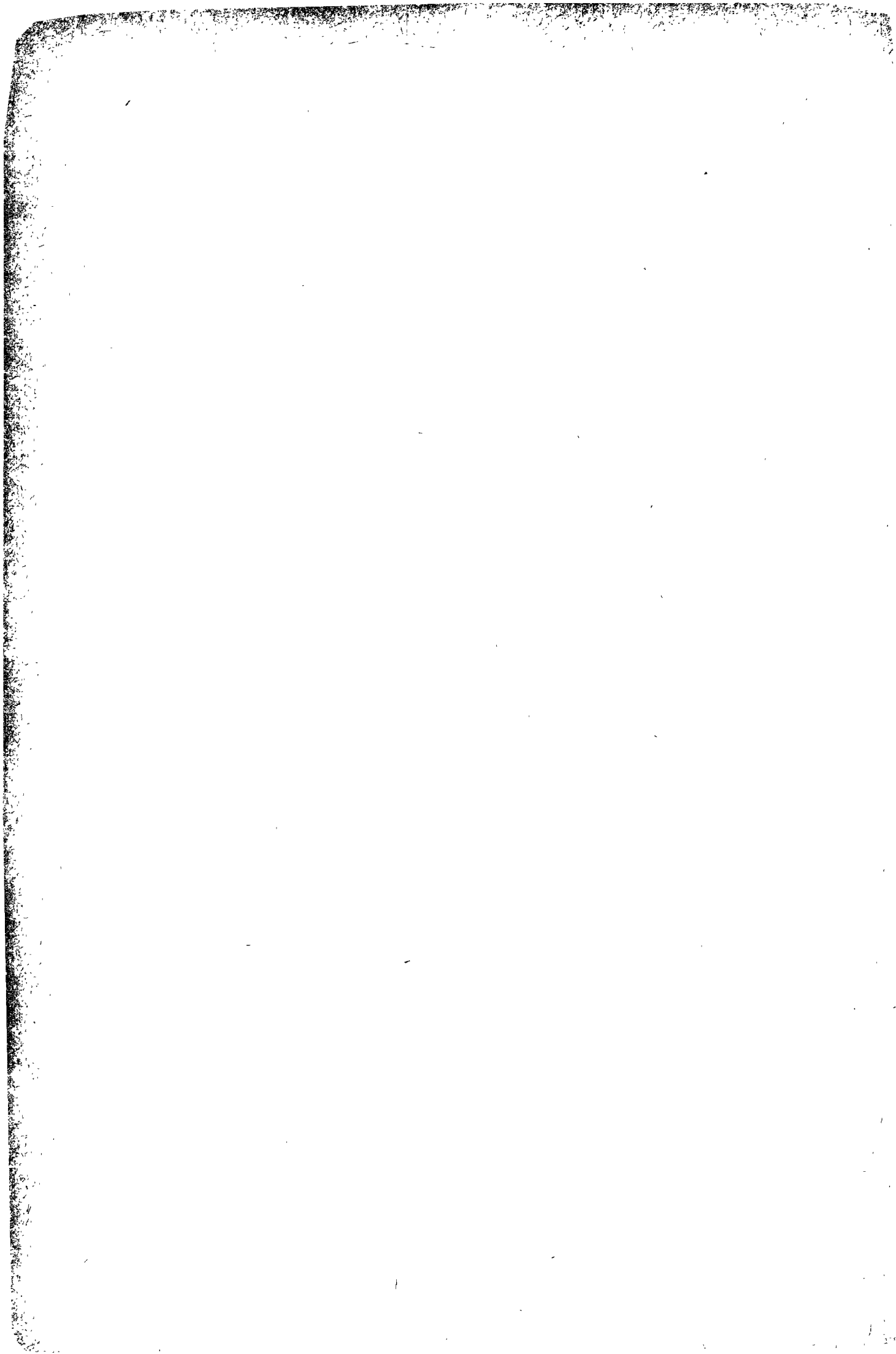
Although a considerably speedier expansion of intra-Community trade—in the second quarter this was 20 % higher than in the same period of the previous year, as against a 9 % year-to-year growth rate in the first quarter—contributed, along with increased production and imports, to more balanced conditions, the price level in member countries did not yet attain general stability. In France and Italy particularly

the upward push of prices continued, albeit less strongly in the latter country. In most of the other member countries the forces working for stability continued to dominate the situation, but even in these countries the longer term upward trend has not yet come to a complete halt.

In all probability economic activity in the Community will continue to expand until the end of the year, and no major changes are to be expected in the trends of the various elements of demand. In accordance with the longer-term trend, the dip in the production curve during the holiday period was again sharper than in the preceding year, and this will probably be offset by a correspondingly rapid pick-up in the autumn. In these circumstances the growth in the real gross Community product between 1962 and 1963 could be a good 4 %, which would be quite in line with the forecasts so far published by the Commission.

The first estimates for 1964 point to a continuation of economic expansion. In view of the tendency for business activity in the world to improve, the Community's exports should continue to increase—perhaps even somewhat faster than in 1963. Investment prospects are more favourable than hitherto. Given normal weather, building investment especially will show an appreciably speedier growth than in 1963, especially if the improvement in the labour situation in this sector continues; expenditure on capital goods could also expand more vigorously, at least in some member countries. In fact the climate of investment again seems to be improving. As against this the growth of expenditure by households on consumer goods is likely to be less pronounced than in 1963. This would be due mainly to some slowdown in the growth of wages in various member countries.

The pace at which demand expands in the Community—in particular the growth of private consumers' expenditure, but also to some extent investment demand—will in any case be influenced in part by the economic measures that France and Italy are having to adopt—not least in the interest of co-ordination in the Community—in order to combat the continuing upward push of prices, for these include stronger action to curb the overall growth of demand. In certain circumstances an effective stabilization policy, might for a while somewhat slow down the now very rapid expansion of production in these countries. But in view of the improved world economic situation and the continuing—and perhaps even somewhat more rapid—expansion in the other member countries, there is little likelihood that growth in France and Italy could be interrupted as a result of such a policy. The slowdown would moreover be only temporary and would create the basis for a subsequent period when the pace of expansion would again be more rapid and development more balanced. Both countries have in fact already adopted new stabilization measures.



A. Recent developments

1. Demand

After the vigorous upswing in the spring, which was partly due to endeavours to make good as much as possible of the ground lost in the winter months, the underlying upward trend of total demand became clearer as the year went on.

External demand—as reflected in actual Community exports of goods and services to non-member countries—which had declined very sharply in the early months of the year, partly as a result of the unfavourable weather, picked up vigorously in the second quarter. Customs returns show that exports of goods were up 7 % in value on the corresponding quarter of 1962, after being 2.5 % lower in the first quarter of 1963 than a year earlier. The first and still incomplete export figures for the summer months point to continuing growth, even at a somewhat slower rate, as efforts to make up lost ground no longer play a part.

The pick-up in the trend of exports is probably due in large measure to the more favourable way world business is shaping : economic activity in the leading industrial countries outside the Community was marked by a strengthening of the upward trends.

Thus expansion in the United States gathered some momentum in the second quarter. The real gross national product, after adjustment for seasonal variations, was 0.9 % higher than in the first quarter and the year-to-year growth rate was 3.2 %. In July industrial production reached a new peak at 126.5 (1957-1959 = 100) compared with 120 in July 1962 and 119 in January 1963. In contrast to the first quarter, expansion was mainly based on greater fixed investment, particularly construction. Private consumption and net exports also made important contributions. The growth of investments on stocks slowed down a little, for the rapid stockpiling of steel came to an end in the second quarter. The Community's exports to the United States already clearly mirror the continuing economic expansion in that country. Whereas in the first three months of this year they were still down 6 % in value on the corresponding period of 1962, in the second quarter they showed a growth rate of 8 %. This is due mainly to a reversal of the trend.

In addition the increase in exports to the EFTA countries was also very vigorous. In the second quarter they were up 9 % in value on the level of the corresponding period of 1962, after a year-to-year growth rate of only 1 % in the first quarter. Here, however, the special factors mentioned (delivery delays in winter and subsequent efforts to make up leeway) exerted an influence for part of the time. Be that as it may, it seems that the underlying trend was also more definitely upwards than before.

Deliveries to Switzerland and the United Kingdom in particular increased appreciably. In the United Kingdom this increase was closely connected with the business revival which began in the second quarter: the adjusted real gross national product, which had still been declining in the first quarter of this year, rose in the second quarter by almost 4 %, a change mainly attributable to a distinct pick-up in private consumer demand and further advances in export trade. The gross national product was 2 % higher than in the corresponding period of 1962. Industrial production showed a similar development: in July the index reached 120 (1958 = 100), compared with 109 in January of this year and 116 in July 1962. This strong expansion was doubtless one reason why the Community's exports to the United Kingdom in the second quarter were 9 % higher than in the corresponding period of 1962 (after a year-to-year growth rate of only 3 % in the first quarter).

The Community's exports to the developing countries were also materially higher than in the first three months of the year. In the second quarter they were up 6 % in value on the corresponding period of 1962, after having been down 6 % in the first quarter. It is true that this was partly attributable to the fact that the growth of exports between the first and second quarters of 1962 was very poor, but there was without doubt also an element of genuine expansion. A growth rate of 9 % was achieved in trade with the associated countries and territories. The Community's sales to the overseas countries of the Commonwealth were also at a high level, whereas exports to Latin America continued to be considerably lower than in the corresponding period of 1962.

Not only external but also internal demand picked up in the second quarter, though here the recovery was not quite so marked.

Expenditure on gross fixed asset formation grew considerably faster. The effort of the building industry to make up for lost output was a decisive factor, and in most member countries this contributed to a vigorous expansion of expenditure on construction. Furthermore, an additional acceleration of the growth of expenditure seems to have set in, largely because of the increase in numbers employed in this branch. In the Federal Republic of Germany, the Netherlands and France the expansion of building investment between the first quarter and the second was in any case materially higher than can be explained merely by endeavours to make up for lost output. In public investment, which mainly takes the form of expenditure on construction, the distinctly expansive trend continued in most member countries.

On the other hand the trend of expenditure on equipment remained hesitant in all Member States. There can however be no doubt that a change has occurred and it is no longer possible to speak of a continuous slackening trend in domestic demand for investment goods. Even though the figures available on sales of capital goods still indicate no pick-up, the flow of new orders in several member countries is again considered to have

improved. This applies particularly to investment in the consumer goods industry and in construction, where there is no doubt that the climate of investment has improved.

Changes in the stock position probably exerted somewhat more influence on demand, production and imports than in the first quarter. On the one hand business surveys in most member countries indicate depletion of the stocks of a number of manufactured goods, which led to more orders being placed with industry. On the other hand a pick-up in the formation of stocks of many raw materials and semi-finished goods seems to have got under way. This also applies to fuel stocks, which were greatly depleted last winter. Pithead stocks again declined, partly under the influence of a prolonged strike in the French coalfields. In mid-1963 they stood at about 12.6 million tons, as against about 20.7 million a year earlier.

The increase in consumers' expenditure has continued. This applies first to public consumption, which continued to expand relatively fast in all member countries. In particular, however, the growth of private consumers' expenditure in the Community as a whole clearly speeded up in the second quarter, after the slowdown in the early months of the year. In fact the income of households has grown vigorously, especially as a result of greater employment, of further increases in wages and salary, which have in some cases again been quite extensive, and of the continuing rise in transfer incomes. In most member countries the increase in consumer spending corresponded more or less to that of disposable incomes. In France the former was perhaps somewhat more rapid than the latter. Only in the Federal Republic of Germany, where the expansion of wages in any case flagged a little, was the increase in incomes not reflected in a corresponding rise in private consumer demand; here the savings ratio has evidently risen.

Purchases of consumer durables and certain textile goods expanded with particular vigour; purchases of durables had suffered in the early months of the year because of the relatively sharp rise in spending on heating and food.

2. Production

In the second and in the early weeks of the third quarter the continuing and perhaps slightly faster underlying expansion of overall demand, coupled with the efforts of enterprises to make good lost production after the unusually cold winter, caused the growth of supply from internal Community sources to speed up once again.

The preliminary figures on harvests are still incomplete and uncertain, but they suggest that agricultural production expanded relatively little. As a result of the damage done by the hard winter and the rainy period in the summer, the wheat harvest was smaller than in 1962. On the other hand animal products increased, even though the damage to pastures in the severe winter was still affecting milk production.

However, industrial production again grew at a distinctly faster pace. According to the seasonally adjusted index of the Statistical Office of the European Communities (construction and food, beverages and tobacco not included), output increased by fully 4 % between the first quarter and the second, after declining by some 2 % between the fourth quarter of 1962 and January-March 1963. In the second quarter the unadjusted index was 5.8 % higher than a year earlier, whereas in the first quarter the year-to-year growth rate had been only 2.3 %.

Examination of the various sectors shows that production in the most important basic material industries did not, it is true, expand to any great extent; only chemicals reported a considerably higher output in the second quarter—in most member countries about 10 % above the corresponding period of 1962. In the capital goods industries also the development of output remained weak. But the production of consumer goods on the other hand expanded more rapidly, with textiles and in particular motor vehicles setting the pace.

The trend was specially expansionary in construction. In all member countries except Luxembourg output was 8 % to 10 % higher than in the second quarter of 1962.

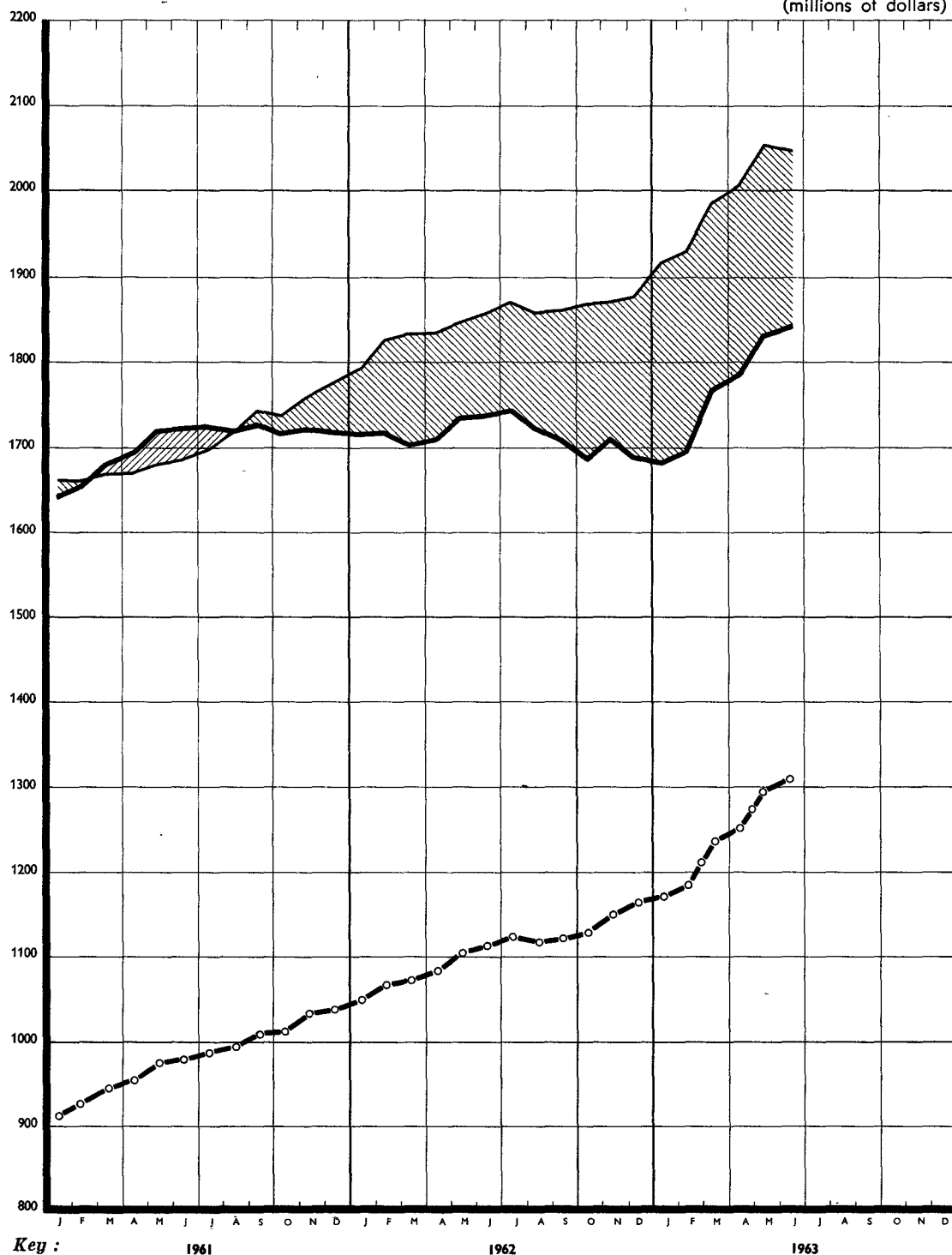
Some branches of the services sector showed trends similar to those in industrial production. The considerable expansion continued, for example in retail business—which was somewhat hesitant only in the Federal Republic of Germany—and in tourism and transport, particularly inland waterways.

The new advances in the output of goods and services were clearly reflected in the way the labour market developed in the second quarter, when the total number in paid employment increased considerably in all member countries except Luxembourg. It is worth noting, however, that the total of persons in industry rose hardly at all in the Netherlands, and in the Federal Republic of Germany was even down almost 1 % on a year earlier. In France the numbers working in industry rose more sharply than at any time in recent years as employment was found for further repatriates from Algeria. In the member countries as a whole a relatively large share of the additional workers seems to have been absorbed by the building industry. This is certainly the case in those countries for which figures are already available, the numbers employed being about 5 % higher than at the same time last year in the Federal Republic and France, and in the Netherlands even more than 10 % higher.

The number of unemployed continued to decline everywhere; it was particularly low in Benelux and the Federal Republic of Germany. In France the trend was distinctly downward. In Italy the fall was again particularly marked—but this was to some extent explained by continuing emigration and the higher school-leaving age, which have temporarily halted the increase in the domestic labour force.

FOREIGN TRADE

(millions of dollars)



Key :

- Exports to non-member countries.
- Imports from non-member countries.
- Intra-Community trade (based on import returns).

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

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

In general these labour market figures indicate that the lessening of strain expected in some countries has not occurred. Only in the Federal Republic of Germany did certain easier trends continue. In France and the Netherlands on the other hand, the labour market seems, despite the considerable increase of numbers in work, to be getting rather tighter. In Italy the shortage of skilled workers has become distinctly worse.

3. The balance of the markets

Even though it can be said that for the Community as a whole the development of imports of goods and services from non-member countries continued to contribute to a satisfactory balance, the detailed pattern of imports nevertheless reflects certain differences which have emerged in the essential business situation within the Community. This is evident from the fact that in most member countries there was hardly any speed-up in the rate at which imports of goods from non-member countries expanded—despite the making good of certain delays which occurred in the winter of 1962/63, relatively high fuel purchases, heavier investment in stocks of raw materials and, finally, relatively large imports of defence material (particularly by the Federal Republic of Germany). Imports by Italy and France on the other hand continued to expand with exceptional rapidity, clearly showing that in these two member countries demand was, perhaps still is, tending to outrun supply.

It was largely for this reason that the growth of the Community's imports of goods from non-member countries quickened somewhat. Customs statistics show that in the second quarter they were about 11 % higher in value than a year earlier (1). In the first quarter the year-to-year growth rate had been 7.5 %.

Within this development of imports, purchases from the United States of America and from the EFTA group of countries rose particularly strongly. In each case they were up 16 % (in value) on the second quarter of 1962; this may be compared with year-to-year growth rates of 9 % (United States) and 8.5 % (EFTA) in the first quarter. Among EFTA countries, the United Kingdom was able to export 24 % more (in value) to the Community than in the second quarter of 1962. Imports from the developing countries as a whole showed a year-to-year growth rate in value of 6 %, as against 9 % in the first quarter. Imports from the Near East and the primary producing countries of Asia and the Pacific were especially buoyant, while those from the countries and territories associated with the Community were considerably below the level of a year earlier, probably

(1) Figures for volume are not yet available.

because of the hesitant imports of foodstuffs. Imports from Latin America were 2 % higher than a year previously.

The increase in the pace of growth in trade between the member countries was considerably higher than the speed-up in the Community's external trade. Customs returns (on the basis of imports) show that in terms of value intra-Community trade was 20 % higher than a year earlier, after a year-to-year growth rate of a "mere" 9 % in the first quarter.

Apart from the permanent effect of the progressive dismantling of trade barriers in the Community and of increasing economic integration, this speed-up was attributable in the main to the same decisive factors as in the case of external trade : efforts to recoup trade delayed in winter, the business recovery, replenishment of stocks and certain divergences in the level of economic activity which have emerged between the various Community countries.

Thus in the second quarter purchases by France and Italy—the two member countries in which, by contrast with the others, demand is tending to outrun supply—from the other Community countries were 30 % and 34 % up on a year earlier, and the trade balance of these countries with other member countries deteriorated further. The decline was particularly marked in Italy, where the seasonally adjusted figure for deliveries to the rest of the Community showed hardly any advance at all. Conversely there was a quite pronounced improvement in the trade balance of the Belgo-Luxembourg Economic Union and even more in that of the Federal Republic of Germany, mainly as a result of higher exports to France and Italy. In the Netherlands the balance remained practically unchanged, a vigorous increase in exports being offset by a corresponding rise in imports.

The differing price trends that have for some time been apparent within the Community were again in evidence. In the Federal Republic of Germany, the Netherlands and Belgium the trend towards general price stabilization continued, while in Italy and France the rise was again considerable, although in Italy the pace of the rise did in fact slacken. The diversity was reflected mainly in a further rise in the price of manufactures in Italy and France, whereas in the other member countries their prices remained practically unchanged. Similarly prices for services in these two countries have risen more sharply than in the others. In Belgium the prices paid for crop products fell back, after the hard winter, sufficiently for the level of consumer prices to be stabilized for a time. In the Federal Republic of Germany and the Netherlands the fall even forced the level down, but in France and Italy consumer prices continued to rise, albeit at a slower rate in the latter country. Luxembourg also still showed rising price trends.

The marked deterioration of the Community's trade balance in the early months of this year did not continue in the second quarter, mainly because exports were livelier. The deficit (on the basis of customs returns) was about \$755 million, or some \$340 million

more than in the corresponding period of the previous year; in the first quarter the difference had still been \$530 million (1).

The surpluses on the Community's current transactions probably again rose a little. Capital transactions too seem to have showed a higher surplus, mainly under the influence of a greater influx of private capital: not only has the import of long-term private capital risen but also that of short-term capital, chiefly because Italian banks have borrowed more from banks abroad. Official gold and foreign exchange reserves therefore rose more sharply in the second quarter (by \$625 million, against \$388 million in the first quarter), and in the months of July and August also the rise in reserves was on the whole considerable despite larger repayments of public debts to non-member countries, most of them before the due date.

The development of internal liquidity in the Community continued to be influenced by balance-of-payments surpluses. However, in the Federal Republic of Germany in the second quarter—as already at the beginning of the year—the banks experienced a net reduction in liquidity, as the transactions of the public authorities withdrew from circulation much larger amounts of capital than the funds which flowed from the balance-of-payments surpluses (which have begun to rise once again). In the Netherlands the seasonal factors which lead to strain were offset by appreciable liquidity trends. The continuing balance-of-payments surpluses in France, particularly on capital transactions but also the rapid expansion of State expenditure, resulted in continuing—albeit slower—expansion of the funds available, the more so as credit tended on the whole to expand more strongly again. In Italy the reduction in liquidity due to the deficit on current payments was partly offset by the increase in the external indebtedness of the banks. A continuous rise in advances and the cash transactions of the public authorities tended—as it had done previously—to provide the economy in Italy with a greater margin for manoeuvre. In Belgium the increase in Bank rate in July (from 3.5 % to 4 %) was probably due not so much to the need to counter strain on the money and capital markets as to the wish that a rise in interest rates set in motion mainly by the tax reform should be confirmed.

The cash situation of the public authorities continued to be influenced by a considerable increase in expenditure, while in several countries the growth of tax revenue slackened. In Germany the overall cash transactions of the federal authorities closed for the second quarter with a slight deficit. In view of the considerable payments to abroad, cash transactions again tended to reduce liquidity at home. In France two supplementary budgets had already been agreed and the expenditure they involved was mainly to be covered by increased tax yields. Nevertheless, the actual "impasse" in France is tending

(1) Excluding purely statistical adjustments to import figures made in France and the Federal Republic of Germany in the first quarter of 1962.

to rise and it must also be remembered that the expansion of revenue is not immune to inflationary pressures. In Italy the vigorous rise in expenditure continued. Even though in this country at the beginning of the summer total revenue was growing rather more rapidly, later in the year the gap between income and expenditure probably widened again. In Belgium a considerable increase in indebtedness occurred in the second quarter, but thanks to the rather more favourable development of fiscal revenue in the summer, the State was able to halt this development.

B. Outlook

Between now and the end of the year trends are unlikely to undergo any material change. Overall economic activity can be expected to continue its growth at roughly the pace observed at the end of the second quarter and in the summer months.

As regards exports to non-member countries, all available figures suggest that they will continue to expand appreciably, even though the year-to-year growth rate might be somewhat lower than in the second quarter, which was still marked to some extent by efforts to make up leeway. Increased external demand can be expected to follow the economic revival in the leading industrial countries; in addition, the Community's capacity to compete seems on the whole to have been quite well maintained recently. The loss of competitiveness which Italy and, possibly, France have suffered could be offset by a further relatively favourable trend which seems to have developed in the Federal Republic of Germany, the Netherlands and Belgium.

In the non-member countries economic expansion should continue, particularly in the United States, and be bolstered especially by an increase in private investment in fixed assets. This assumption is supported not only by incoming orders for durables, which have been 5 % above sales in several months since January 1963, but especially by the considerable increase in new building orders in the second quarter. However, as the expansion of private consumption might slow down somewhat and investment in stocks will also be on a reduced scale, the growth of the gross national product will probably be slightly more modest than in the first half of the year. In any case, however, the Community's exports to the United States will again increase.

In the United Kingdom also expansion will continue, the more so as the budget measures should help appreciably in this respect. In this connection mention should be made of heavier public investment and of tax reliefs, which provide an indirect stimulus to private consumption (this will in any case be boosted by the appreciable increase in employment and by the rises in wages). Furthermore, continuing economic growth in the Community and the United States, and the more favourable business turn in the Commonwealth countries, point to a further rise in British exports. In certain other EFTA countries also economic growth is picking up, in Norway and Austria for instance. In others, however, the slower trends are continuing. But the present expansion of Community exports to this group of countries should continue.

Finally, in view of the recent improvement in the purchasing power of the developing countries, a more favourable turn in Community supplies to these may well be expected.

The expansion of internal demand will probably be a little less brisk than in the second quarter, when endeavours to make up for lost output played a role in some branches. However, growth will still be considerable, and delays which doubtless occurred in the summer as a result of the trend for the seasonal dip in the production curve to become deeper will probably be offset by a correspondingly stronger expansion in the following months.

As to the probable development of the individual elements of domestic demand, a slight speed-up in the adjusted trend of expenditure on gross fixed asset formation is to be expected. Particularly because of the way orders have been coming in lately, there is no longer any danger of a further weakening of purchases of capital goods by enterprises—a slight pick-up is more likely. In view of the higher numbers employed in construction, expenditure on investment in this sector, the expansion of which is largely dependent on supply elasticity, will advance quite strongly.

In contrast to this the expansion of private consumers' expenditure might slow down a little in the coming months. The wages bill will probably increase a little less quickly, not so much because of the trend in employment, which will continue to expand at a fair rate, as of the reduced pace at which wages are rising or can be expected to rise in certain member countries. The effect of this will be felt throughout the Community, even if wages and salaries continue to rise quite considerably in France and Italy. Moreover, the constant rise in the level of prices to consumers will have an inhibiting effect on the rise in the volume of consumption in these two countries.

In view of this probable development of overall demand, domestic supply of goods and services should expand at much the same pace as in the second quarter of 1962. In the fourth quarter industrial output will in all probability be up about 6 % on the corresponding level of the previous year.

Imports from non-member countries will make a further distinct advance. True, imports of energy products will be smaller than in the first half of the year, but it is to be expected that the build-up of raw material stocks will continue for some time yet. Imports of farm products might also rise should the harvests of certain important items turn out in 1963 less favourably than in 1962. To this must be added that import trends in Italy and France will continue to move upward fairly sharply.

In view of the improved outlook for exports the Community's trade balance is, however, unlikely to deteriorate again; it may well tend to remain at the present level.

From now till the end of the year the tendency for prices to rise will persist. True, the factors making for stabilization of prices will gain in importance in some member

countries. In France, too, the direct price policy which is part of the new anti-inflation programme can be expected to exert some influence on the indices. But once the moderating seasonal influences on prices in the "stable" member countries have waned, certain effects of dearer services on the consumers' price level will continue to be felt. In France and Italy the basic price trends will moreover continue upwards, even if perhaps less sharply, especially as the full effects of an intensive anti-inflation policy can be expected only after a certain time-lag.

The present state of the Community's economy and the developments expected up to the end of the year justify the assumption that in the main the forecasts for the full year 1963 will be realized. It is true that for the reasons mentioned the growth of real fixed asset formation will again have to be put a little higher than the figures published in the last Quarterly Survey (2/1963), figures which had been adjusted slightly downwards. On the other hand real private consumption will expand at a slightly slower pace. The growth of the overall gross Community product in real terms might be a good 4 %.

Trends in the supply and use of resources : goods and services (1)

	1961 (2)	1961 (3)	1962 (3)	1963 (3)(4)
	In \$ '000 million	% change by volume on preceding year		
Gross Community product	201.3	5.4	4.9	4
Private consumption	122.2	6.3	6.1	5
Public consumption	27.8	5.2	6.6	5
Gross fixed asset formation	45.3	9.7	6.0	4
Exports (5) minus Imports (5) in \$ '000 million ..	+ 3.1	+ 2.6	+ 1.3	+ 0.5

(1) Exclusive of the Grand Duchy of Luxembourg because the statistical material needed for a forecast on this country is still lacking. Since Luxembourg's share in the total Community product is less than 0.5 % the consequent error is not of great importance;

Combined figures for the Community based on the official exchange parities.

(2) 1961 prices, 1961 exchange rates.

(3) Prices and exchange rates of the preceding year.

(4) Commission forecasts.

(5) Goods, services and factor income.

On the basis of all the available material on current and future developments in the world and within the Community it can be said with considerable confidence that the Community's economic expansion will continue in 1964.

External demand in 1964 could be a rather more dynamic element than in 1963. In this connection the same factors will operate as from the spring of 1963 onwards: continuous expansion of world business, increased capacity of capital goods industries to deliver as a result of the moderate trend of internal demand and of greater productive capacity, and further improvements in competitive capacity in part of the Community.

As regards the economic situation in the United States, which is important for the Community's exports, all the signs are that expansion will continue unabated in 1964. This presupposes, however, that the planned tax reduction enters into force at the beginning of the year. The programme of reductions, as slightly altered by Congress, provides for cuts of \$10 600 million over a two-year period beginning 1 January 1964; this would mean a somewhat higher net stimulus to the economy than was envisaged in the Administration's bill. These tax reductions, which concern both company profits and the incomes of households, should favourably affect investment and consumer demand.

In the United Kingdom too, expansion will probably continue in 1964. The already considerable growth of industrial output indicates that fixed capital investment by enterprises could again make a considerable contribution to the growth of the national product in the final months of 1963. Economic development should again receive some stimulus from exports too. In contrast to the United Kingdom the remaining EFTA countries show as a group hardly any signs of a material speed-up in overall growth for 1964.

Despite the probable cutback in the American foreign aid programme—from which American exporters themselves will be by far the greatest losers—the tendency noted in 1963 for the foreign exchange position of the developing countries to improve can be expected to continue. The cuts in aid will affect actual expenditure only later, and they could be more than offset by the developing countries' foreign currency earnings from increasing exports.

All in all the Community's exports to non-member countries should grow rather faster between 1963 and 1964 than between 1962 and 1963, even though this growth will certainly still continue to be quite modest.

Internal demand as a whole will continue to grow in 1964, with expenditure on gross fixed asset formation probably again increasing somewhat more rapidly than the gross Community product. This should in any case be true of investment in the building sector, since potential demand will be very high and greater numbers in employment will make it possible to step up activity. Investment in capital goods could also expand with more vigour than in 1963. In most member countries the "climate of investment"

will in fact almost definitely improve thanks to the expansion of exports, to the high consumer demand following the slower rise of costs, to the—at least relatively—improved showing of profit margins, and to the continuing need to save on manpower. It must however be remembered that the extent to which total fixed asset formation will increase also depends in large measure on economic policy. In France and Italy those responsible for this policy have found themselves faced with the need for intensified efforts to stabilize prices and costs. There is a possibility that the measures taken will not be entirely without influence on investment. In the present stage therefore it does not seem appropriate to publish a quantitative estimate.

Private consumers' expenditure may slow down slightly, particularly as mass incomes (in the Community as a whole) could rise more slowly than between 1962 and 1963. In fact wage increases will probably be somewhat smaller, although the growth of consumption will continue to be considerable. In real terms it is also likely to be favoured by a slower rise in consumer prices. For private consumption in particular it would at the moment be equally unwise to establish a quantitative forecast of Community growth for 1963 to 1964, since this will depend on the shape of things to come in France and Italy, i.e. on the effects of the stabilization measures. The crucial issue in these countries is to limit the expansion of nominal consumers' demand.

In these circumstances it is also not possible to give precise figures about the probable growth of production. This will in any case continue at an appreciable pace. As a working hypothesis for the Community as a whole we can perhaps reckon with roughly the same increase in real gross product between 1963 and 1964 as between 1962 and 1963. The growth of imports from non-member countries will remain considerable, although rates of growth could ease a little. The trade balance will probably not deteriorate further; it might even show a tendency to recover.

In general prices in the member countries should be appreciably more stable than between 1962 and 1963. This will in any case be the trend in the Federal Republic of Germany, Belgium and the Netherlands and probably also in Luxembourg. It could quite well apply to France and Italy too, if the anti-inflation policy is successfully carried through.

It seems idle today to attempt to ascertain whether the original causes of the price rises in these two countries were due to "cost inflation" or "demand inflation". Monetary factors certainly played an essential part, particularly the impact—accelerated at home—of high balance-of-payments surpluses. In France, as a result of large inflows of capital, these surpluses were still continuing at a time when the balance on current transactions had already considerably deteriorated, in a manner that brought it very much into line with the rest of the balance of payments. In Italy the disappearance of these surpluses was for a time offset by an expansionary monetary policy. In both countries, official budget transactions have also made a considerable contribution to general expansion of total demand.

Sometimes, however, it seemed that the tendency for strains to occur might well be neutralized by a selective policy, for example by curbing wage rises, by further action to encourage imports, a moderate restraint of credit—which, however, should not handicap the financing of investment—and a more cautious approach to public expenditure for consumption and to transfers. The chances of achieving this would have been all the greater had it been possible to frame a more successful wages policy. Once it had become evident that the results were inadequate (here it must be observed that the possibilities it offered do not appear to have been fully exploited) and that rising costs were not inhibiting the growth of nominal overall demand, which was to some extent “confirmed” by developments in the monetary sphere, anti-inflation policy had to be tightened up so that it should have a stronger overall braking effect.

At the beginning of July the Economic Policy Committee, after examining the “preliminary economic budgets” for 1964 submitted by member countries’ representatives on the Committee, had expressed this view in a memorandum. This is the first year in which such provisional economic budgets have been established on comparable lines and confronted. The aim of this operation, which will be carried out regularly in the future, is to enable the Economic Policy Committee, before the State budgets are worked out for the coming year, to give its opinion on the economic problems which are likely to arise during the year—in the expectation that its recommendations will be taken into account as fully as possible when budget policy is framed. The Committee’s memorandum has been forwarded by the Commission to the Council and to the Economic and Financial Committee of the European Parliament. It is reproduced at the end of this survey.

Since this memorandum was drawn up, the latest statistics and analyses have made it even clearer that the inflationary tendencies in Italy and France are in fact continuing (though perhaps in weakened form in Italy), whereas the remainder of the Community is moving towards greater stability. The problems which would result if this divergent trend continued are evident. The two countries mentioned must achieve price and costs stabilization rapidly, not only in their own interest, but also in the interest of the countries whose economies are closely interwoven with theirs in the Community and of further progress in establishing the Common Market. At the Conference of Finance Ministers of the Member States on 9 and 10 September the Commission, through its Vice-President M. Marjolin, urgently recommended that the necessary measures be taken.

The detailed policy which seems to be called for in France and Italy is described in the relevant country chapters. In view of the business situation to be expected in the other member countries and also in non-member countries, the Commission considers that a judicious policy of stabilization would not involve any danger of recession for France and Italy. The possibility of a temporary slackening of economic growth—which

moreover would merely be the basis for a possible later balanced speed-up—is however not to be excluded. It should be accepted in the interests of stability.

In the Commission's opinion priority should in the present circumstances be given to price stabilization despite the possibility that the pursuit in France and Italy of an effective price and cost stabilization policy of the type described might in certain circumstances further strengthen the external position of these countries and thus of the Community, with consequent aggravation of the disequilibrium in the international balance-of-payments situation. Apart from this question of priorities, however, it must be noted that the present international disequilibrium stems less from the imbalance of current accounts than from exceptionally heavy movements of private capital. This vital problem has been clearly recognized by the Government of the United States—the country from which these excessive outflows of capital mainly originate. Whether the counter-measures being prepared in the United States will completely achieve their purpose remains to be seen. In any case there is hope that these inflows into the Community may be so reduced that they will no longer exert inflationary pressure nor impede the stabilization policy being applied on this side of the Atlantic. Success here, while primarily of value because it would help to redress the international balance of payments, would produce advantages considerably outweighing the drawbacks of a possible, but in any case small, contraction of the Community's deficit on trade.

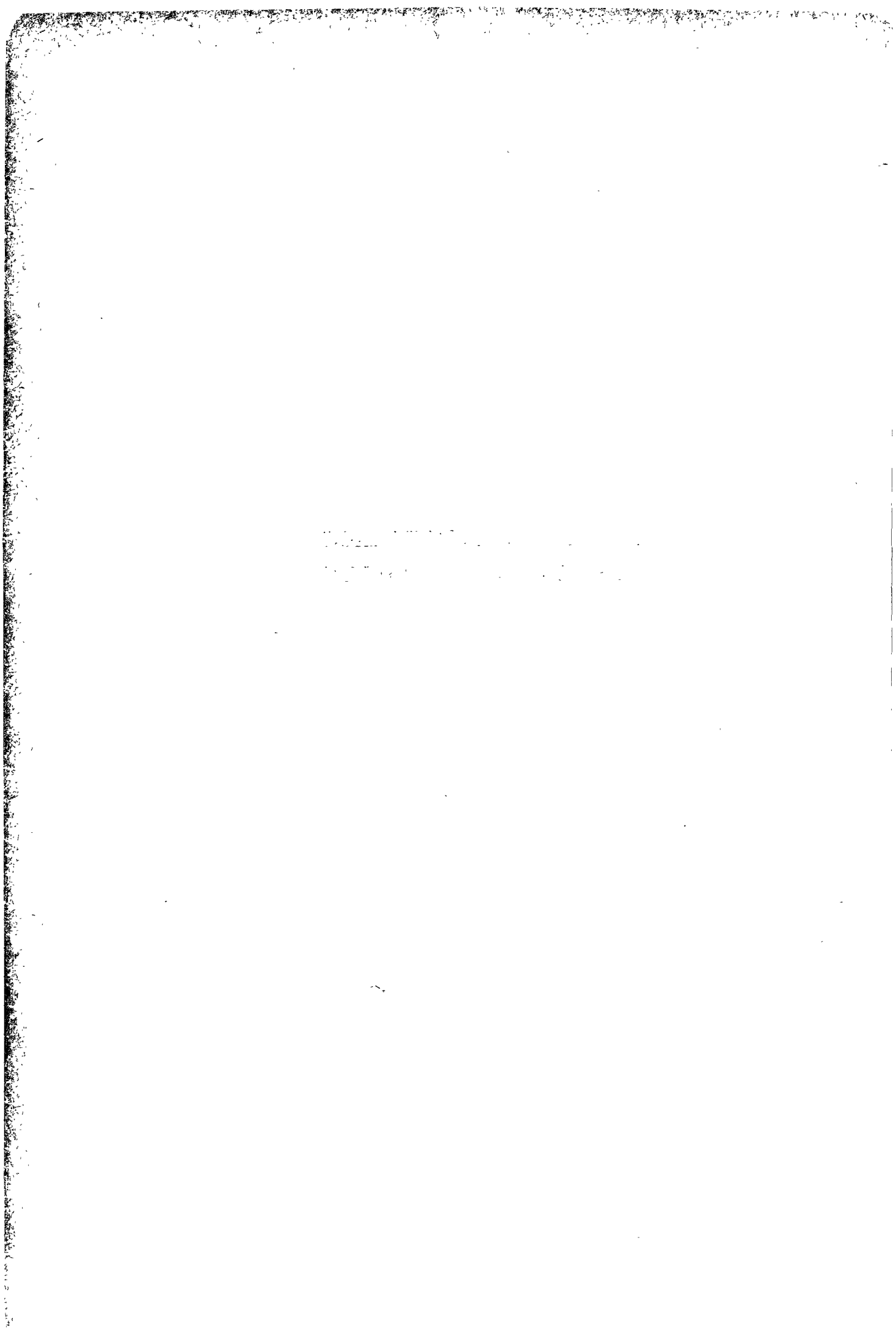
Generally speaking the other member countries can look forward with less anxiety to the prospect of rather more rapid economic expansion. Here, however, they should be reminded of the recommendations addressed to them by the Economic Policy Committee in its memorandum; these stressed the need to keep a tight rein on the expansion of public expenditure, to handle building demand with caution and to maintain the policy of restraint in connection with wages and incomes. A policy which reinforces any trend towards stabilization in the other member countries has become even more important in the light of the difficulties which have arisen in France and Italy. It is clear that a high degree of stability in the rest of the Community provides material support for efforts to stabilize the situation in these two countries.

The scale of the problems sketched out here is, moreover, fully and generally recognized, particularly of course in France and Italy, the countries directly affected. In France this already led to the announcement in mid-September of a special and comprehensive stabilization programme. The parts of this plan which are already definitive give grounds for hoping that if carried out consistently, in conjunction with certain stabilization tendencies which are in any case present, it will lead to better balance in the French economy.

In Italy too a number of measures have already been taken and forces making for stability are gaining ground. However, in this country certain further measures will probably be necessary if lasting price stability is to be achieved and a more favourable outlook for the balance of payments re-established.

In conclusion it should be noted that there is no reason to dramatize the situation. In the first place, the dangers are not to be compared with those which the Community faced at the very outset because of the inflationary pressures then at work in France. In particular, the French balance-of-payments and foreign exchange situation has improved out of all recognition, and Italy also still has big reserves. Secondly, the general economic trends are, as far as they can be foreseen, propitious to a price stabilization policy; the ways and means exist by which the balance in France and Italy—and thus in the Community—can be restored in a relatively short time.

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



A. Federal Republic of Germany

The second quarter and the summer months saw a fairly vigorous expansion in production and employment. No doubt this was partly due to efforts to make up for the production losses of the severe winter. But some signs are also discernible of a change in the general business trend.

This is in particular true of foreign demand, which again provided a very lively stimulus; investment expenditure also showed a distinct rise. Investment in building and construction increased very strongly. Though expenditure on equipment was probably no more than slightly above the level reached at the end of 1962, it seems that the slowing down of growth has been halted in this sector. Whilst public consumption increased very appreciably, expansion of private consumers' expenditure was relatively moderate, not only because wages and salaries rose less rapidly but also because households showed a perceptibly greater inclination to save.

After a fall-off in growth in the first quarter, industrial production rose sharply, notwithstanding the metal-workers' strike in South-West Germany. According to the working-day/output index of the Federal Statistical Office, it exceeded the level of the second quarter of 1962 by 4.6%. The trend in imports was also definitely upward.

Prices tended to be more stable. Consumer prices even slackened a little as a result of a drop in food prices, which had risen markedly at the beginning of the year.

The balance of current transactions recovered; nevertheless the surplus in the overall balance of payments declined because net capital imports were no longer as large as in the previous quarter. However, the official gold and foreign exchange reserves rose by approximately DM 1 000 million.

This upward development will continue during the rest of the year and probably also into 1964. Exports are likely to provide a very strong stimulus. Investment in building and construction will again increase very markedly. There is also in the private sector a greater propensity to invest in capital goods, and this may further increase under the influence of growing foreign demand and a lessening pressure on profit margins. Public consumption will once more expand appreciably whilst the growth of private consumers' expenditure is likely to be moderate.

Production will probably increase further and, assuming normal weather conditions, be fairly elastic. Developments so far and the outlook for the rest of the year justify the expectation of a growth rate for the national product in real terms of fully 3 % in 1963. The forecast for 1964 is that there will even be a speed-up and a growth rate of about 4 %.

In themselves, conditions should be favourable for a continued stabilization of prices. But the tendency towards a further increase of surpluses on current foreign transactions, if it were to persist and possibly grow stronger, may give rise to certain problems in this respect.

1. Recent developments

Exports of goods and services rose sharply in the second quarter of 1963 after being relatively feeble during the early months of the year. According to foreign trade statistics, exports of goods exceeded by fully 8 % in value and almost 11 % by volume the level attained in the corresponding period of last year, whereas in the first quarter the growth-rate had been only about 1 %. In July, the value of goods exported was as much as 10.5 % greater than in July 1962.

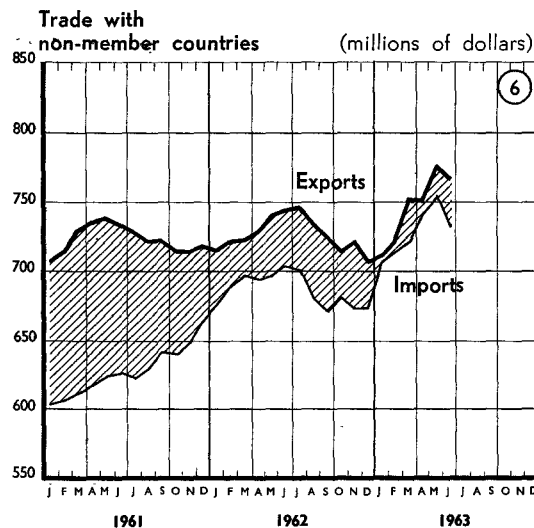
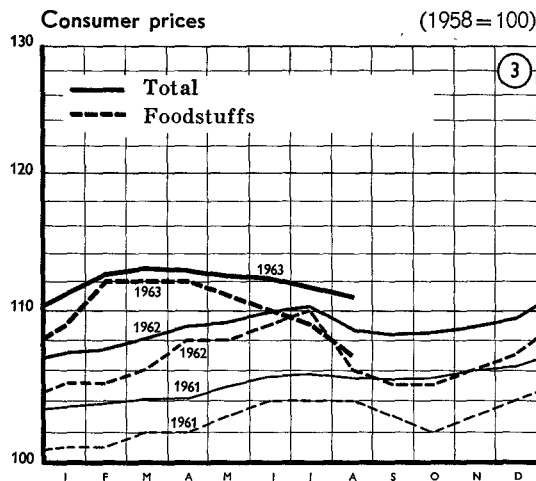
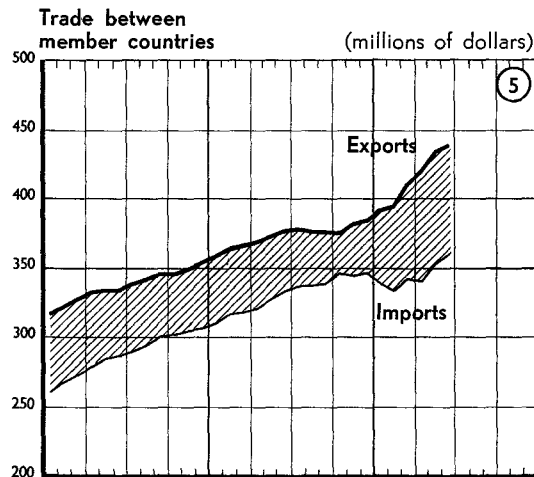
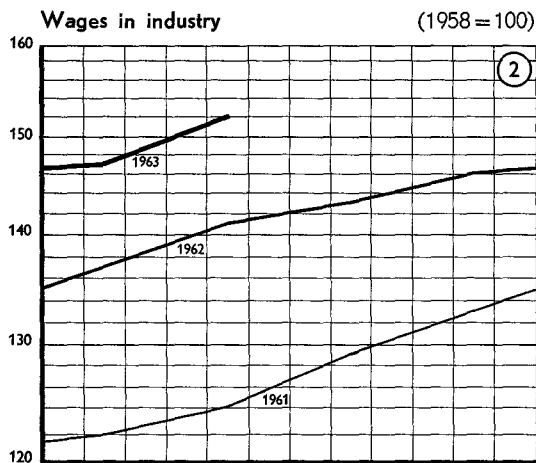
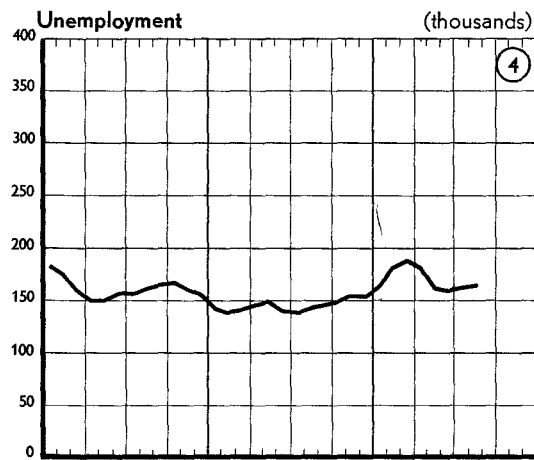
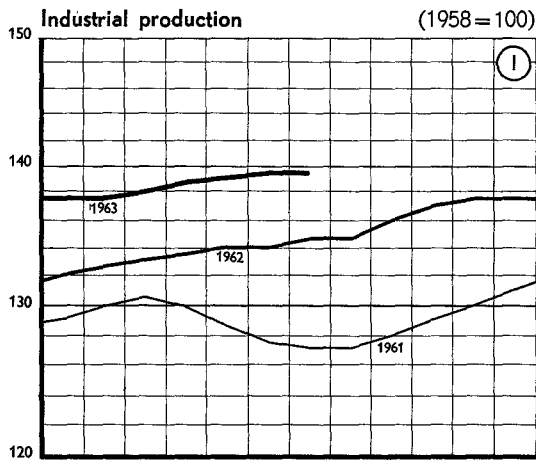
Exports to the EEC countries, especially France and Italy, rose particularly steeply; those to the other industrialized countries also improved considerably, whilst deliveries to the developing countries remained on the whole comparatively sluggish.

Domestic demand also gathered considerable momentum from the first to the second quarter. This was partly due to the spurt in activities to make up for the stagnation of the severe winter; but another factor was that the weakening cyclical trend of investment demand, which had been observed for some time past, appears to have abated.

Expenditure on gross investment in fixed assets went ahead again in the second quarter, after a decline in the early months of the year. This is especially true of the building and construction sector, in which expenditure rose extremely rapidly, the main emphasis falling on roads and communications, public buildings and housing, whilst commercial and industrial building were relatively weak. Expenditure by enterprises on equipment goods also rose again in the second quarter, but will probably not be found to have much exceeded the level reached in the fourth quarter of 1962. This is partly to be attributed to the metal-workers' strike in South-West Germany, which affected important producers of capital goods.

FEDERAL REPUBLIC OF GERMANY

ECONOMIC INDICATORS



NOTES :

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

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

Graph 2 : Index of average hourly gross earnings.

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

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

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

Finally, as regards investment in stocks, there has for some time been a certain tendency to replenish stocks of raw materials. Commercial stocks have also increased, which may chiefly be explained by the largely unexpected weakness in the growth of demand for consumer goods.

Expenditure on public consumption continued to rise substantially. Private consumers' expenditure showed little sign of an expansive trend. In retail trade, turnover in the second quarter was only 1.4 % higher in value than in the corresponding period of the previous year, and even a little less by volume.

Although in private consumption these results are partly due to exceptional factors of a statistical nature—in July a growth rate in retail sales of almost 8 % (value and volume) was restored—they nevertheless also reflect a considerable slowdown in wage increases. By new collective agreements wages rose by an average of only 4.5 % as compared with 7 % a year before. The level of negotiated weekly wages was about 5 % above that in the corresponding period of the previous year. However, actual earnings will probably show a somewhat higher rate of growth. Since transfer incomes also have again risen considerably, net mass income from these sources still shows a growth rate of about 7 %, as compared with almost 10 % for the whole of 1962, taking into account the rise in the number of persons in paid employment on the one hand and the progressive income tax rates on the other. But drawings by self-employed persons have probably not increased to the same extent and, above all, private savings have definitely risen more rapidly than net incomes.

As usual at this season, the number of unemployed declined appreciably in the second quarter and during the summer months. At the end of August it stood at 95 800, which is still 12 800 more than a year earlier. At the same time the number of vacancies registered at labour exchanges was 600 200—somewhat greater than at the end of August 1962. The main reason for the slight easing of labour shortages—though they are still acute—is probably that there is less hoarding of labour in some industries than hitherto. In fact the number of persons employed in industry at the end of June was 0.9 % lower than a year before. But the total number in paid employment again rose by 1.6 %. It should be noted that this includes a considerable rise (4.8 %) in the numbers employed in the building industry proper.

The total supply of goods and services increased considerably. In the first place, there was again a rise in agricultural production. According to provisional estimates the grain harvest did not fall far short of last year's, which was excellent. For certain fruits and vegetables this year's harvests were substantially above the average of past years. In animal production, however, only a modest increase is reported.

Secondly, industrial production showed a very marked upswing from the first to the second quarter, although the April and May production figures were adversely affected by strikes and lockouts in the metal industry in South-West Germany. According to the

working-day index of the Federal Statistical Office, industrial production in the second quarter exceeded the preceding year's level by 4.6 % (as against 1.7 % in the first quarter). Output in the building industry proper developed with exceptional vigour, reaching an annual growth rate of 14.5 %. Whilst production of consumer goods also showed an above-average increase (6.2 %) as compared with the second quarter of 1962, that of capital goods only just reached the level of a year before. In July industrial output as a whole exceeded by 4.1 % the level of July last year.

In imports of goods and services the upward trend continued. Despite reduced imports of agricultural products, foreign trade statistics show that in the second quarter they were about 7 % in value and 9 % by volume above last year's figures for the same period (first quarter + 5 % approx. in both volume and value) and in July these figures were as high as 8 % and 11 % respectively. These growth rates, however, include a rather steep rise in government purchases. The call on foreign services again rose sharply, more especially through tourism.

In recent months the price situation has been remarkably stable. This is, however, due in part to special factors such as the decline in food prices, which at the beginning of the year had been excessively high. The fact remains that producer prices for manufactured goods have been stable; in August they were only 0.4 % above the same 1962 figure. Owing to the special factors referred to above, the cost-of-living index even dropped a little in the second quarter, which is contrary to normal seasonal trends. In August it was only 2.1 % higher than the corresponding figure for the previous year, whereas at the end of the first quarter it had been 4.4 % above that of a year before. Excluding foodstuffs and beverages and tobacco the August index was, however, still 3.3 % higher than that for the corresponding period of the previous year.

In the second quarter, for the first time since the middle of 1961, the balance on goods and services transactions with abroad improved. It closed with a surplus of DM 790 million as compared with DM 590 million in the previous quarter and DM 750 million in the second quarter of 1962. This improvement is confined to the trade balance, which showed a surplus of DM 1 230 million (it had been DM 940 million last year). In the services sector the balance declined again. The deficit on unrequited payments stood at approximately DM 900 million, roughly the same as in the previous quarter).

Since net capital imports (including residual amounts not accounted for but excluding changes in the foreign currency position of the banks) fell from almost DM 1 800 million to just over DM 1 000 million, the surplus in the overall balance of payments declined from just over DM 1 400 million in the previous quarter to DM 900 million in the second. The foreign currency position of the banks remained substantially unchanged (there was a fall of DM 100 million) so that official gold and foreign exchange reserves increased by about DM 1 000 million.

Despite this surplus in the balance of payments, bank liquidity was under some pressure; cash transactions by public authorities again had the effect of withdrawing large

amounts of money from internal circulation. In contrast to the previous quarter and to the second quarter of 1962, the central public budgets (those of the Federation, the Länder and the Equalization of Burdens Fund) closed with an overall deficit, but public payments abroad were considerably greater.

Short-term and long-term bank advances to trade and industry were rather higher than in the first quarter.

2. Outlook

The trends which have been apparent in recent months are unlikely to undergo any material change by the end of the year.

Under the influence of expansive factors, external demand may increase. This is not only because of relatively short delivery dates in a number of important export industries—especially the capital goods industries—but also because the German competitive position seems again to have improved a little of late. Whilst prices in some major industrial countries are clearly moving upwards, most German export prices have recently remained predominantly stable or have even fallen slightly. Moreover, the business situation throughout the world is generally more lively. At any rate, export orders received by West German industry in the second quarter were almost 18 % above the corresponding 1962 figure and 7 % above actual sales (for the first quarter the figures were + 6.5 % and + 8 %). In July these figures were + 25.5 % and + 4 % respectively. It is significant that all major industries benefited almost equally from this increase of foreign orders.

Gross investment in fixed assets will increase. Expenditure on building and construction especially will rise very briskly; there will be a vigorous advance in road construction and investment in building in general will increase appreciably. One of the reasons for this is the large back-log, which has not so far been much reduced although new orders have been falling off for some time, partly as a result of the Government's concern to ease the strain on the building market. In the second quarter licences for public building represented about 5 % less in terms of space enclosed than they did in the corresponding period of the previous year. In housing, new orders fell to as much as 8.5 % below the level they had reached in the second quarter of 1962; no doubt this was due in part to delay in making public finance available and limitations on writing off for tax purposes. The greatest fall was in licences for industrial building, which declined to 26 % below the level of last year (in terms of space enclosed). However, last year's figures were abnormally high because before the entry into force of the building controls there had been a sharp rise in the number of licences issued for administrative buildings in industry and for commercial premises.

Despite this relatively feeble trend in plans for industrial or commercial building there are some signs that the industrial investment climate has recently improved a little. This is apparent in the sphere of capital investment. Domestic orders received in the typical capital goods industries such as mechanical and electrical engineering and ship-building showed a tendency to rise again in the second quarter and this trend may well become more pronounced in the coming months under the influence of briskly expanding foreign demand and less pressure on profit margins from labour costs and taxation. On the other hand experience shows that some time will elapse until this is reflected in greater expansion of effective investment expenditure.

Public consumption will continue to grow very vigorously especially since the effects of the delay caused in certain expenditure by the belated adoption of the Federal Budget for 1963 are no longer felt. Expansion of private consumption, mainly owing to the slower pace of wage increases, which is likely to continue, will remain moderate, though it may quicken a little in comparison with the first six months of the year.

With these prospects for overall demand and the consequent stimulus to the production of goods and services, there is little chance of any substantial easing of the tightness on the labour market, especially since the recruitment of foreign labour from neighbouring countries will probably become even more difficult.

Domestic supply will continue to expand. This is true both of agricultural production (where the rise is largely seasonal), but also of industry, in which the growth of output is expected to maintain its pace or even quicken a little.

Commercial imports will also rise, especially since agricultural imports are likely to increase once more. Nevertheless the improving trend in the balance of current transactions may continue.

Prices should in general remain stable—at any rate producer prices. Consumer prices, however, may again show a slight tendency to rise since increases in rents and in prices for services are to be expected, and these factors are not likely to be offset in the coming months by a drop in food prices.

With these prospects the quantitative estimates made in the last Quarterly Survey for the whole of 1963 can on the whole be allowed to stand. Because of vigorously expanding demand from abroad there may, however, be a more pronounced rise in exports than was expected. On the other hand, having regard to the price rises and losses of earnings caused by the severe winter of 1962/63 and the very marked increase of the marginal savings ratio of households noted in the spring, the volume of private consumption is unlikely to attain the originally estimated growth.

Supply and use of goods and services

	1961 (2)	1961 (2)	1962 (2)	1963 (3)
	At current prices in DM '000 million	% change by volume on preceding year		
Gross national product	310.4	5.5	4.1	3
Imports (1)	67.1	8.4	10.9	6.5
Private consumption	176.3	7.0	5.7	3
Public consumption	43.7	7.8	11.2	8
Gross fixed asset formation.....	77.6	9.7	4.5	2
Exports (1)	73.9	3.6	4.9	5.5

(1) Goods, services and factor income.

(2) Federal Office of Statistics : "Wirtschaft und Statistik", Jan. 1963.

(3) Commission forecasts.

Note : The 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 responsibility.

A preliminary assessment of future economic developments in the Federal Republic of Germany in 1964 suggests that growth will be maintained. In view of the present favourable trends in world trade, which are expected to continue, and the recent improvement in the competitive position of German industry, an expansion of exports seems to be well within the bounds of possibility. Expenditure on gross capital investment may also rise more quickly than in 1963, owing to the continuing strong demand in the building and construction sector and to the greater propensity of businessmen to invest. Expansion of expenditure on private consumption may also prove a little greater than expected, especially if the savings ratio were to drop a little.

Supply is likely to be fairly elastic, the more so since, assuming normal weather conditions, the number of gainfully employed persons (active population minus unemployed) will probably increase again and the shortening of working hours is likely to be less prevalent in 1964.

The present trends and prospects suggest that the gross national product in real terms may grow a little more rapidly than in 1963 and increase by a full 4 %. Imports are again likely to expand considerably. At any rate it is possible that contributions from abroad, that is to say the surplus on foreign trade in goods and services, will increase once more.

Conjunctural policy will have to bear these perspectives in mind. It would certainly seem advisable to refrain from any stimulation of demand, even in industrial investment, because here the slackening trend already seems to have been to some extent reversed, at least so far as forward planning is concerned. On the other hand, measures to restrain demand—or at any rate domestic demand—are also not indicated, since experience has shown that they may accentuate the tendency of “foreign contributions” to increase. An exception can be made in the case of demand for building and construction. Here public authorities should continue to ease the strain by careful calculation of the amounts to be spent, and the way they are spent, in outlay likely to influence the building market.

If in general no move should be made to encourage an expansion of demand, this is of course also true of foreign demand (i.e. foreign expenditure on German goods and services). Certainly no tax or other measures are to be recommended which would ultimately favour exports more than they are favoured at present. At the same time import policy—for agricultural products as well as others—should be even more liberal. There is ample margin for this, especially in relations with the other Member States of the Community. Though the new tendency towards greater surpluses is partly explained by developments in some major buyer countries, the Federal Republic for its part could nevertheless in this way contribute to keeping its surpluses on current transactions within reasonable bounds. Unduly high surpluses on current transactions with abroad would sooner or later provoke a new internal price rise.

3. The economic situation in West Berlin

In the second quarter the West Berlin economy made noteworthy progress, as did that of the Federal Republic. Investment in building and construction, which in the first quarter had been hampered by severe weather conditions, expanded very vigorously. Expenditure on capital goods also continued to rise, no doubt owing partly to the special tax incentives for investment offered to businesses in West Berlin. In contrast to the trend in the Federal Republic, private consumption continued to expand fairly briskly because, in the first place, there was a marked rise in wages and salaries, and secondly net mass incomes increased considerably faster than gross wages and salaries, owing in particular to new income tax reliefs introduced in the middle of 1962.

Industrial production made a rapid advance between the first and second quarters to exceed the level a year earlier by fully 4 % (2.4 % in the first quarter). There was a striking difference in comparison with the Federal Republic, in that the two main branches of industry developed in the contrary direction. Whilst the growth rate for capital goods was 7.3 %, production of consumer goods sagged to 0.5 % below the level of the second quarter of 1962.

The balance of trade in goods with the Federal Republic worsened in the second quarter, supplies from the Federal Republic having risen much more rapidly, reaching a level 6 % higher than at the same time last year, than deliveries to the Federal Republic, which improved only 1.6 %.

Consumer prices fell appreciably during recent months; contrary to the normal seasonal trend, food prices showed a distinct decline, more than offsetting price rises in other sectors. At the middle of July the cost-of-living index was only 0.4 % higher than a year earlier.

Expansion is likely to be maintained throughout the rest of the year. In the past few months there has been no further decline in the flow of orders to West Berlin industry; for the first time since the second quarter of 1961 it rose a little above the level of the previous year, whereas in the first quarter it was 1.5 % below it. Order-books also have recently lengthened a little, although this was largely because of the strong seasonal demand on the clothing industry.

The stimulus of demand may therefore suffice to ensure a further expansion of production. Nevertheless labour shortages will continue to be an obstacle, so that the West Berlin economy will remain dependent on obtaining labour from elsewhere. The conditions for this have certainly improved as a result of the more rapid rise of wages in comparison with the Federal Republic and because of the income tax reliefs granted. On the other hand the attraction of labour from outside is not only a matter of the level of wages but is governed by other factors such as the availability of housing.

B. France

Overall demand has clearly expanded at a faster rate since the spring ; at the same time certain inflationary phenomena have become more evident.

Exports, which had shown a hesitant trend in the early months of the year, once again provided a strong stimulus. Investment, too, was brisker, particularly in building and construction. Furthermore, private consumers' expenditure again rose very appreciably, owing to the swift upward movement of incomes, itself caused mainly by the considerable further advance in wages and salaries, but in part due to fuller employment.

An increase in the flow of orders caused the growth rate of industry to rise more rapidly : according to the INSEE index, which does not include building, output was 5.7 % higher in the second quarter than a year earlier. Because of tightness in the factors of production, especially the shortage of manpower, the difficulties encountered in any attempt to step up output increased again. There was a very sharp rise in imports.

Despite a considerable increase in supply, prices went on increasing appreciably ; for finished goods, and even more for services and construction, the rise was in fact rather steeper than before.

In the period from April to July, the trade deficit as shown in customs returns reached a figure of 951 million francs, against a mere 193 million francs for the same four months in the previous year. Mainly as a result of large net influxes of private capital, however, the balance of payments closed with such high surpluses that approximately \$ 340 million of foreign debt was repaid, most of it in advance, and a further \$ 220 million added to the official foreign exchange reserves.

The stabilization programme announced in the middle of September is hardly likely to alter, during the rest of the year, the trend, in real terms, that had been considered probable on the basis of the underlying tendencies observed prior to the announcement ; the price situation, however, might be affected in the shorter term by direct measures.

Overall demand is certain to keep on growing. With business activity expanding by and large quite considerably in the world, the outlook for exports is favourable. Fixed asset formation will increase further, demand for building in particular probably continuing to soar. The rise in expenditure on consumption by the public authorities will again be very steep, and private consumers' expenditure too may well

go up about as quickly as before. The probable development of the manpower situation affords no ground for expecting any early slackening of the rise in wages. Employment will in any case increase further.

In view of these developments in demand, it seems that the quantitative estimates for 1963 made by the Commission still hold good: the growth rate of the real gross national product will doubtless reach a figure of approximately 4.5 %.

At the moment it would be difficult to forecast what effect the stabilization programme will have on developments in 1964, particularly whether price stability can be ensured or what will happen to economic growth. However, a first analysis suggests scarcely any appreciable slowdown in the real year-to-year growth rate. If this situation suffices to keep prices and unit costs stable, it will be a resounding success for French economic policy. But one may wonder whether the pace of expansion of demand in monetary terms is being restrained sufficiently in relation to the actual possibilities of supply—in particular whether Government spending is not still going up too quickly and whether the deficit on the Treasury's cash transactions is not still too big. As the French economy now stands, a balanced budget would seem to be more advisable. Even if such a policy should put a sharper brake on economic growth for a short while, but at the same time restore the stability of prices, this slower growth would certainly be preferable to faster growth accompanied by a continuation or even an aggravation of inflationary pressures.

1. Recent developments

Exports of goods and services, which in the first quarter had barely reached the previous year's level, have moved up again briskly. Customs returns show that in the second quarter and in July the value of goods exported was almost 16 % higher than at the same time last year. This high rate of growth can be partly explained, it is true, by the slackening in exports during the corresponding period in 1962 and by the delayed delivery of goods held up in the winter, but essentially it is a pointer to a recovery in the underlying trend. The greatest gain was in sales outside the franc area, while exports within the area rose but slightly.

Expenditure on investment has also made a greater contribution to the expansion of overall demand in the last few months. Gross fixed asset formation would appear to have been appreciably above the level of a year earlier. Building activity rose steeply, with housing in particular influenced by the combination of a strong current demand and an endeavour to make good the heavy production losses caused by the winter frosts. Expenditure on capital goods also appears to have gone up. However, the growth of

investment varied greatly in the various sectors of the economy : it was very vigorous throughout the public sector, fairly vigorous in agriculture, building and commerce, but still very hesitant in private industry.

By and large, investment in stocks appears to have contributed little to the expansion of overall demand during the last few months. There are many signs that businessmen have begun to replenish their stocks of raw materials and semi-finished products, but both manufacturers and dealers appear to have reduced their stocks of finished products.

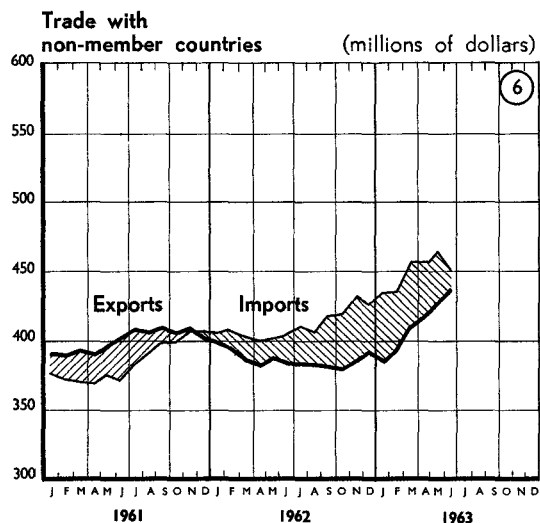
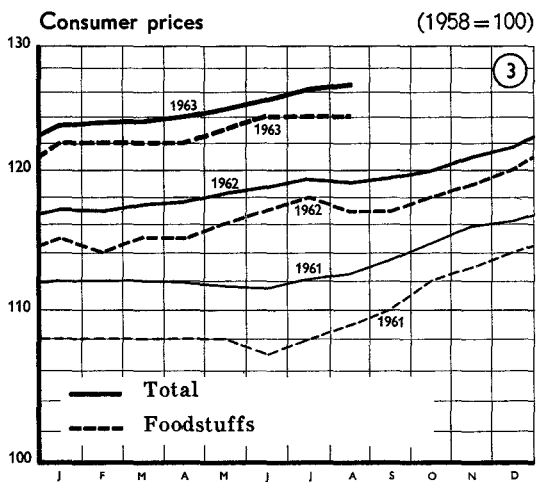
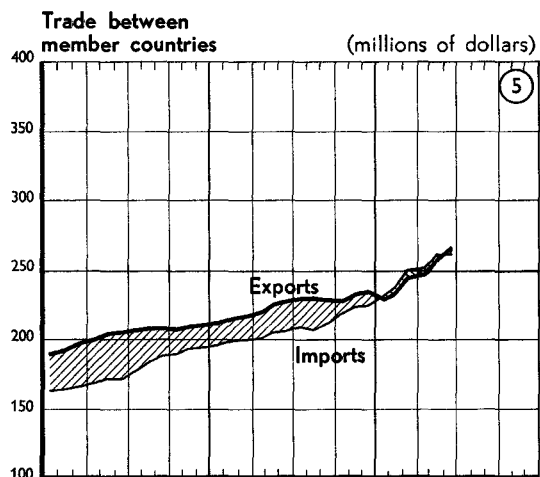
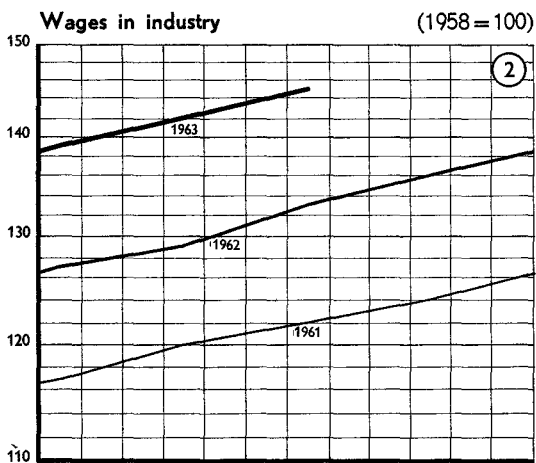
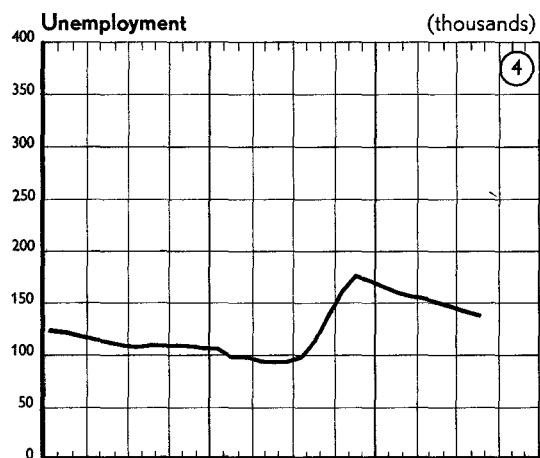
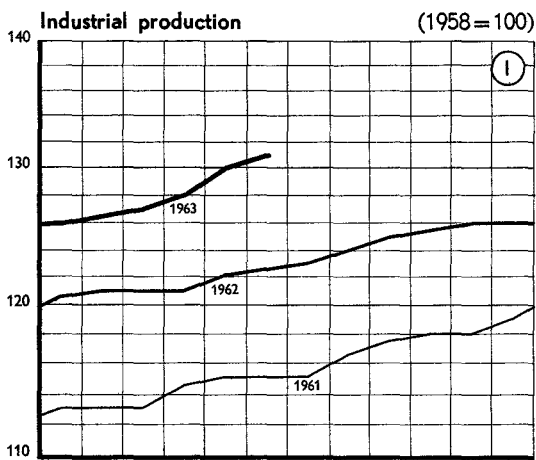
The steep rise in consumption expenditure has continued and even grown steeper. This holds good for both expenditure by the public authorities on staff and materials and for private consumers' expenditure. From April until July the turnover of the Paris department stores was almost 15 % higher in value than during the same period in the previous year. Although they contain a structural component, these growth rates still appear very high. It may be assumed that the proportion of private consumers' expenditure that does not pass through retail channels also grew apace. From April until June, for instance, approximately 16 % more new private cars were registered than during the same period in the previous year. The chances are that, with longer paid holidays, expenditure on services also rose briskly during the summer months.

The increase in private consumption was primarily due to the steep rise in wages and transfer incomes. The numbers in paid employment continued to mount appreciably, whilst working hours per week remained practically unchanged. Hourly wage rates and salaries also moved up faster throughout industry and commerce and again rose substantially in the civil service. In the private sector, hourly wage rates rose 2.5 % between 1 April and 1 July—compared with 1.8 % during the previous three months—and this put them 9.3 % above the level of a year earlier. On 1 July, wages paid by public enterprises exceeded last year's level by as much as 11 % to 13 %, depending on the sector involved; civil service salaries were 12.3 % higher than a year before. Towards the middle of the year the legally guaranteed minimum wage was increased by 4.2 %; on top of this, various social benefits were raised about the same time. Moreover, the possibility that the proportion of disposable incomes saved was lower than before cannot be entirely discounted. There is an increasing tendency for consumers to buy on credit.

Overall supply during the last few months was also rising somewhat more steeply than at the beginning of the year.

Agricultural production increased, as was normal for the time of year, but probably did not reach last year's exceptionally high level. Fruit and vegetables were the only commodities in which supply was at times abundant : the resultant drop in prices led to Government support for certain products. The grain and wine harvests were adversely affected by rain late in the summer, particularly in terms of quality. The supply of live-stock products, especially meat, failed to improve.

ECONOMIC INDICATORS

**NOTES :**

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

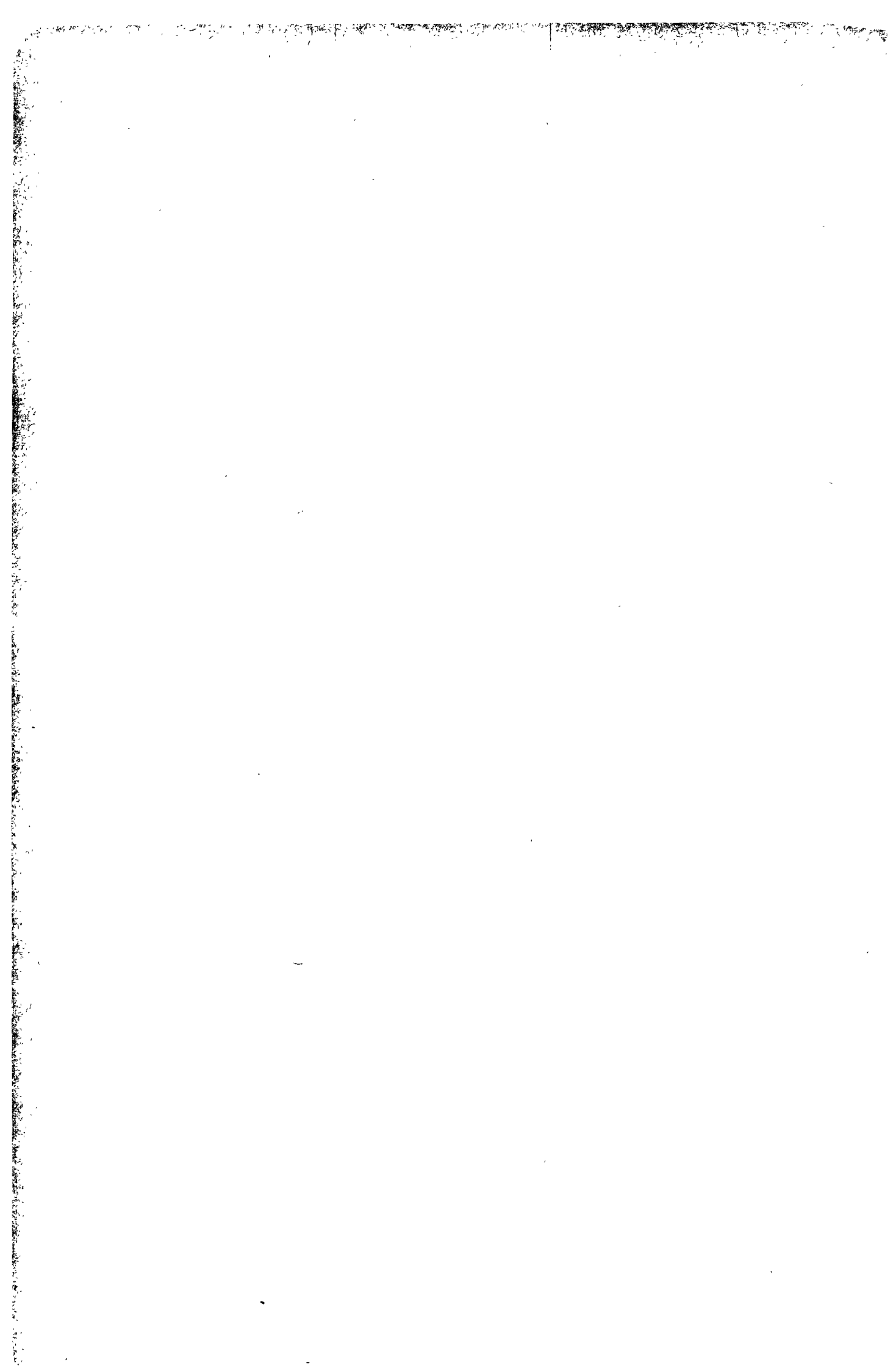
Graph 1 : Estimated trends based on SOEC seasonally adjusted data. Excluding construction, food, beverages and tobacco.

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

Graph 3 : Index of prices of 250 items in the Greater Paris area.

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

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



Following a decline due to strikes and bad weather in the first quarter, industrial production expanded rapidly again from spring onwards. The adjusted INSEE index shows an increase of 6.2 % between the first and second quarters, and a year-to-year growth rate of 4.1 % in April, rising to 7.8 % in June, with an average of 5.7 % for the second quarter. Although attempts to make up arrears obviously had something to do with this strong recovery in production, there can be no doubt that the underlying trend was more positive than before, especially in the consumer goods industries, which have stepped up production vigorously in the last few months wherever industrial capacity and available labour allowed. Even in the capital goods industries there appears to have been no further slackening in the growth of production. The INSEE business survey for June shows that in industry as a whole fuller use was being made of productive capacity. Orders were coming in noticeably faster, backlogs increased and delivery times lengthened. At the same time, managements reported an appreciable drop in their stocks of finished products.

The situation on the labour market again grew tighter. It seems that the influx of people returning from Algeria, the reduction in the length of military service and the effects of the post-war population bulge on the labour market brought no more than a certain temporary relief. The number of persons seeking jobs has fallen sharply in the last few months, and even if so far their number remains higher than at the same time last year, the qualifications of those still looking for work do not in many cases seem to fit the requirements of business. The number of unfilled vacancies again increased about the middle of the year.

As a result of briskly expanding demand, there has also been a very rapid rise in imports of goods and services in recent months. According to customs returns, the volume of goods imported in the second quarter and in July was about 20 % higher than the corresponding figure for last year. There was a considerable increase in imports of energy products; raw materials and semi-manufactures, and especially finished industrial products, were also imported in distinctly greater quantities.

Despite the appreciable increase in supply, prices again rose notably. Foodstuffs gave way to industrial products, and even more to services and building, as the main force behind this upward movement. Nevertheless, retail food prices went against the normal seasonal trend and increased by 1.1 % again between March and July. The retail price of industrial consumer goods clearly rose faster : in March the figure was 2.4 % higher than a year earlier, in July 4.3 %. During the last few months, the price of services went up much more than usual, partly because of adjustments in scales of charges fixed by the authorities. All in all, the price level of consumer goods rose 2.2 % between March and July—slightly faster than in the previous four months—and in July it was 5.8 % above the level of July 1962. Building costs also soared : by mid-1963 they were more than 11 % higher than a year before.

The deficit on trade, as shown by customs returns, continued to grow. Whereas the surplus of imports from April till July 1962 was only 193 million francs and derived wholly from trade with the rest of the franc area, it reached 951 million francs during the same period this year, almost entirely in trade with the non-franc world. The balance of payments has, however, been little affected as yet by this trend. Thanks to the continuing surplus on services and even more to a persistently large net inflow of private capital there was again a sizeable inflow of gold and foreign exchange. Although more than \$340 million of foreign debts were paid off—mostly in advance—between April and July, official reserves went up by a further \$220 million.

The influx of foreign exchange—and also the cash transactions of the Treasury—continued to make a strong contribution to the expansion of internal liquidity. In addition, the expansion of credit again quickened appreciably during the second quarter. Mainly because the special minimum reserve ratio (*coefficient de trésorerie*) was twice increased, banks were forced to make greater use of re-discount facilities at the Central Bank. It is also likely that they borrowed more abroad. The money market was on occasion extremely tight, and the rates for day-to-day money rose perceptibly. The capital market continued active yet easy, but managements did not resort to it much more than in the second quarter of 1962. The biggest increases were mainly in issues by public authorities; these included a Government loan, the first in several years.

2. Outlook

After the end of the holiday period, which with four weeks paid holiday becoming the general rule was this year longer and more incisive than before, business is again expanding briskly; considerable growth also seems assured for the remaining months of the year. The stabilization programme announced by the Government in the middle of September is hardly likely to have very much influence on developments in real terms as forecast up to the end of the year, though there might be some shorter-term effect on the price situation.

Overall demand will keep rising, though perhaps not so quickly as in the spring and summer, when there was considerable effort to make up arrears resulting from the bad winter. The outlook for exports is favourable in view of the expansive trend in some countries to which France sells a great deal. As the most recent EEC business surveys show, managements feel that in most cases the backlog of foreign orders is still rather low, but their assessment of the flow of orders has brightened considerably in recent months.

Fixed asset formation will continue to increase. Expenditure on buildings and equipment by public enterprises and the Government is rising according to plan, and for the most part capital expenditure in the private sector has already been settled for the

rest of the year in accordance with investment programmes that were presumably stepped up during the summer. Manufacturers of consumer goods in particular will probably carry out more of the schemes that were only tentative early in the year. Demand in the building sector will in any case continue to expand vigorously : in view of the limited elasticity of supply resulting from the labour shortage, there may even be more "overheating" in this sector.

The rise in public expenditure on consumption is likely to be very steep again in the coming months, although the most recent Government decisions indicate that the third supplementary budget for the financial year 1963, to be introduced in October, will not involve quite as sharp an increase in Government spending as was originally expected.

Private consumers' expenditure will continue at about the same rate of growth. The tightening of hire-purchase conditions, especially for private cars, can hardly take effect very quickly because of the lengthy delivery dates sometimes quoted. Moreover, it is always possible for households to offset the new restrictions by drawing on savings. Nor is any significant slowdown in the expansion of incomes to be expected in the next few months : employment is certain to increase further, and in many cases there are already new wage agreements which mean that wages and salaries per employed person will continue to move upwards. It remains to be seen whether at the next autumn "rendez-vous" the planned intensification of the national incomes policy can produce rapid results in the form of voluntary restraint on the part of management and workers. Furthermore, there will still be rises in the income of the self-employed—particularly in commerce, perhaps also in agriculture; this too will tend to make consumption expand.

These demand factors will carry industrial production higher still, particularly as stocks of finished products were unusually low at the beginning of autumn. There may nevertheless well be some slackening in the rate of expansion when compared with the rapid upsurge which occurred in spring and summer, since the effect of efforts to make good production losses is wearing off and in some important branches of industry the margin of productive capacity required for an expansion of supply appears to have shrunk. At any rate managements reported about the middle of the year not only that there was a growing shortage of industrial capacity but, even more serious, a recrudescence of difficulty in finding suitable manpower. The rise which can be expected this autumn in the number of people looking for jobs—a rise which is partly seasonal—will hardly be enough to produce any rapid and appreciable easing of the market.

Domestic supply will continue to be supplemented by considerable imports. In the closing months of the year the growth rate of imports could, it is true, be influenced by the expected return to normal of purchases of energy products, but imports of other raw materials, and even more those of finished industrial products, will maintain a high rate of growth—especially since the tariff cuts made as part of the stabilization programme will act as a stimulus to imports from both Community and non-member countries.

Although supply can on the whole be expected to expand very considerably, the underlying forces in favour of a further increase in prices remain very strong in view of the vigour with which demand continues to expand and costs to rise. However, rises in the price index may be damped down by the campaign for price reductions on some selected products of current consumption, by the introduction of some degree of price control on a number of industrial goods and the Government's decision that charges for public services should not at present be further increased. Moreover, reductions in import duties, which will have to be passed on the consumer because of restrictions on profit margins, should have a steadying effect on prices. Seasonal considerations alone indicate that food will become dearer again, quite apart from the fact that no decisions have yet been taken on modifying agricultural policy, which has hitherto been aimed at allowing prices to rise as one means of improving agricultural incomes.

By and large, the outlook is that the results in real terms for the full year 1963 will be in line with the quantitative forecasts already made by the Commission. The real gross national product is certain to reach the expected growth rate of about 4.5 %. Only for imports and exports of goods and services have significant upward revisions been required.

Supply and use of goods and services

	1961 (2)	1961 (2)	1962 (2)	1963 (3)
	At current prices in Bfrs. '000 million	% change by volume on preceding year		
Gross national product	319.67	4.5	5.8	4.5
Imports (1)	44.83	7.5	10.6	9
Private consumption	206.62	5.8	6.9	6
Public consumption	43.02	3.4	2.3	1.5
Gross fixed asset formation.....	62.39	10.0	7.5	5
Exports (1)	49.54	6.1	2.5	7

(1) Goods, services and factor income.

(2) "Rapport sur les Comptes de la Nation de l'Année 1962", SEEF, Paris.

(3) Commission forecasts.

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

The tendencies observed in the French economy suggested that in 1964 there would be a continuation of inflationary imbalance. Strains would have persisted on the labour market as the civilian labour force was bound to increase less rapidly than in 1963. The sharp rise of wages—resulting partly from excess demand for manpower—showed no sign of tapering off. It would have been all the easier, especially for dealers, to pass on increased wage costs in the form of higher prices as households could count on their incomes continuing to go up steeply, and as the climate for price increases was more and more favourable. There was a real danger that people would begin to adjust their way of thinking and their actions more and more to a considerable degree of inflation—and not only among managements and workers, but also in many government offices. The increasingly inflationary climate, which might have affected in particular France's hitherto very favourable terms of payment, made a rapid and considerable deterioration in the balance-of-payments situation appear to be quite a possibility.

The economic measures taken in the spring of 1963, which were only slightly restrictive—they were covered in some detail in the last Quarterly Survey—no longer sufficed to remove the dangers of inflation, i.e. to bring overall demand in monetary terms in 1964 closer into line with actual possibilities of supply. In this situation it was evident that more comprehensive measures would have to be taken. The sources of the excess demand are partly monetary; the liquid funds available to the business world are obviously too great: funds were repatriated from Algeria in 1962 in considerable quantities and those who returned from Algeria have been drawing on their savings to an increasing extent; the flow of capital from abroad has remained high (in particular from the dollar area and sterling area); and finally the cash transactions of the public authorities have had an expansionary effect. This monetary situation is the major reason why domestic demand in monetary terms would have been able to rise too rapidly in 1964. It had therefore to be regarded as a matter of extreme urgency to apply more effectively the instruments available in the field of financial and credit policy in order to damp down overall demand.

Given these circumstances, the first essential is that the Government's fiscal policy should be so framed that it contributes to stabilization; the contribution should be made by the budget as a whole, not just by selective measures. This means, then, that the Government's cash transactions must play a part in eliminating excess demand. Merely fixing the budget *impasse* at the 7 000-million-franc mark that has become a "guiding light" seems no longer adequate. It would be preferable to make an appreciable cut in the actual deficit on cash transactions, which has been growing steadily in recent years, and so to balance the budget; this could be done by cutting down sharply on the expansion of current expenditure and adapting the structure of revenue more closely to policy requirements, i.e. by using fiscal measures to restrict the excessive expansion of consumers' incomes.

As a complementary step, designed to make the fiscal measures effective and at the same time make use of the instruments of credit policy in a direct attack on excess demand,

bank lending must be more severely restricted. If the traditional methods of an increase in the minimum reserve ratio and open-market operations prove inadequate, the authorities will have to resort to more direct controls, though attempts will have to be made to ensure that the necessary funds are available to finance productive investment in the stricter sense, as there is nothing excessive about the upward trend of this element of demand. On the other hand, it seems thoroughly advisable to make borrowing more difficult for consumers.

In credit policy and even more in fiscal policy special emphasis should be placed on keeping the demand for building within bounds; a list of priorities might be established for the purpose. At present the shortage of manpower in this sector is particularly acute, and the overheating engendered here is constantly affecting other sectors. Expenditure on housing in particular should be kept in line with the actual possibilities of supply, which ought at the same time to be increased by appropriate measures.

Action should also be taken to ensure that agricultural policy is consonant with the need to keep the overall price level stable. It would at least be advisable to hold over measures which seek, by raising prices, to improve the position of farmers in relations to other sectors of the general public.

Clearly, specific action is needed in incomes policy—and even more in wages policy. But it would be a mistake to expect wages policy to make any great contribution to stabilization unless the expansion of overall demand is effectively curbed by action of the type suggested and a new economic climate created where there will be no excess demand for labour—which is itself largely responsible for the unduly sharp rise in wages and costs.

The stabilization programme put forward by the Government in September seems on the whole to be on the lines that are needed for keeping prices steady and that have been sketched out above.

The weight of the new measures is concentrated in the financial and credit fields: the budget *impasse* is to be reduced to 4 740 million francs by slightly restricting the rise of public spending, by cutting some extraordinary expenditure from the budget, by dropping the plans to make certain tax cuts and by introducing new taxes on items such as betting and profits from building speculation; excess liquidity is to be mopped up by the issue of a Government loan of 2 000 million francs on 23 September; the expansion of bank advances is to be limited to 10 % instead of 12 % between 1 March 1963 and 29 February 1964, while hire-purchase borrowing is made more difficult; certain steps will also be taken to encourage saving.

In addition to this a number of selective measures were taken in other sectors, mainly intended to increase supply either on the labour market (shorter military service, more vocational training, easier immigration) or on the markets for goods (reduction of duty on certain imports from member and non-member countries).

The Government has also considered it necessary to take direct action on price formation in order to influence the climate of opinion; these amount in effect to some degree of control on the producer prices of industrial goods.

In two important fields—agricultural policy and incomes policy for other sectors of the economy—no definite decisions had been taken as this report was being penned. But restraint on the rise of incomes is one of the crucial conditions to be fulfilled if the general level of prices is to be stabilized. Again it has been decided that no limitation will be placed on building demand, although this is where the gap between demand and supply is particularly wide.

At present it can hardly be estimated what real effect this “twelfth of September programme” will have on developments in 1964, in particular, whether price stability can be ensured and what will happen to economic growth. However, an initial analysis would indicate that there will only be a limited slowdown in the expansion of demand in monetary terms.

Demand from abroad might even rise rather more definitely in 1964, provided there is no further deterioration of France's competitive position on world markets, for the expected expansion of economic activity in the world should provide most favourable opportunities for increasing exports. The outlook for domestic demand is one of continuing growth. There has been no curtailment of the investment programmes, sponsored by the Government or by public enterprises, so expenditure on building and equipment in these sectors will go up again in 1964. Any perceptible slackening of businessmen's propensity to invest is hardly likely either, though here psychological factors that cannot be assessed at the moment may play a decisive part. Many factors point to an increase of about the same order as in 1963 in capital investment by private enterprises, unless the terms on which money can be borrowed stiffen much more than expected. While the stabilization programme should mean that the increase in consumption expenditure by the public authorities will be slightly restricted, its effect on private consumption is more difficult to assess. The most important of the conditions which must be fulfilled if there is to be a reduction in the pace of expansion is restraint in respect of incomes. The numbers in employment, however, are bound to increase; wages too will probably not stop going up, and the best that can be expected is that the rise may tend to be slower.

Given this continuing buoyancy of demand, and assuming an increase in agricultural production corresponding to the long-term average, the growth rate of the gross national product in 1964 could be 4 % to 4.5 %.

If this growth rate, which is still quite significant, can be combined with stabilization of the price level, it will be a great success for the French Government's economic policy. But one may well wonder whether the measures taken will reduce the pace at which demand in monetary terms is expanding sufficiently, when compared with the actual possibilities of supply, to produce the requisite stability of prices and unit costs. The rise

of public expenditure in particular seems still rather high and the deficit on the Treasury's cash transactions (though reduced) still relatively large.

Even if the policy that is needed to restore price stability should seriously reduce the pace of economic growth for a short time, it would certainly be preferable to faster growth if coupled with a continuation or even extension of inflationary pressure. Furthermore, it is just stabilization of costs and prices which can provide the basis for a further rapid but balanced economic growth—and this might set in as early as 1965. Continued inflation, on the other hand, would finally require measures to be taken that would result in a lengthy stoppage of growth or even a serious recession. For it seems clear that steadily rising costs and prices in the midst of a world where there will probably be markedly greater stability would in the long run endanger France's balance of payments as well.

C. Italy

In the second quarter economic growth was more rapid than is usual for this season, but this may have been largely due to the absence of certain inhibiting factors (unfavourable weather, strikes) which had affected output in the preceding months and to the endeavours made to offset the losses suffered. Expenditure on plant and equipment, and also—although to a lesser degree—an increase in the rate of growth of exports worked in the same direction. Private consumers' expenditure, for long the main factor in the expansion of domestic demand, maintained its very rapid rise.

While total agricultural production continued to develop rather haltingly, industrial production rose, according to the ISTAT Index as seasonally adjusted by ISCO, by no less than 4.7 % between the first quarter and the second. The unadjusted index was almost 11 % above that of the second quarter of 1962. There was a sharp increase in the growth rate of imports.

The price trend, which has for nearly two years been moving markedly upward, has been quieter since March. This development was, however, due in large measure to seasonal influences such as the lower prices of certain vegetable products. In July the wholesale price index was 5 %, and that of consumer prices 6.6 % higher than in July 1962. The corresponding rate of increase in the cost-of-living index was no less than 7.9 %; this is of particular importance because of its influence on the cost-of-living allowances under the sliding-scale wage agreements, allowances which have again gone up considerably.

The deficit on current account increased considerably despite a quite rapid expansion of net receipts from services; in the second quarter the deficit on trade amounted to \$666 million, which is more than twice as much as a year earlier. As a result, however, of a further considerable increase in foreign borrowing by the banks, the official gold and foreign exchange reserves declined by only \$8 million in the second quarter (\$115 million in the first).

Total demand will continue to expand throughout the rest of 1963. The outlook for exports is not very favourable, but both investment expenditure as a whole and private consumers' expenditure will continue to rise—the latter considerably. The pace at which production will expand is not likely to exceed the average registered during the first six months. For 1963 as a whole the gross national product in real terms may expand by 5.5 %, and industrial production by 9 %.

In 1964 economic growth will depend to an exceptionally high degree on the vigour and the orientation of the economic measures taken by the authorities. Present

price trends and the effect they are having on the balance of payments show that immediate and energetic countermeasures are called for. The temporary reduction in the growth rate which this would entail seems on the whole to be the lesser evil, especially as measures to stabilize the price and cost upsurge would create the basis for further faster growth in balanced conditions thereafter. Even if such measures were adopted, the real gross national product might well none the less show a clear increase.

1. Recent developments

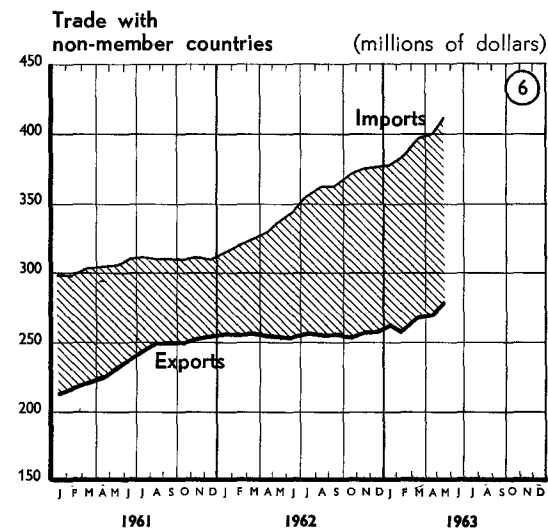
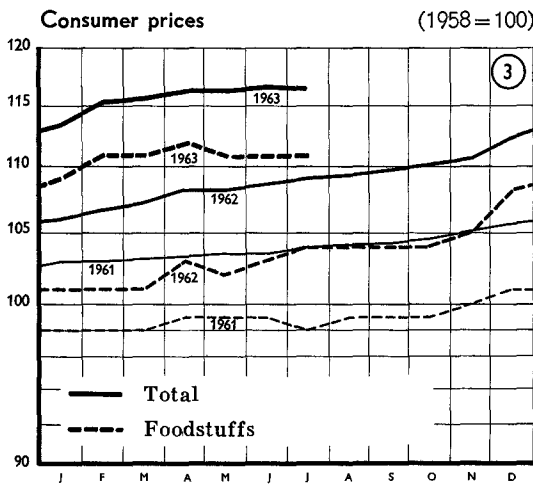
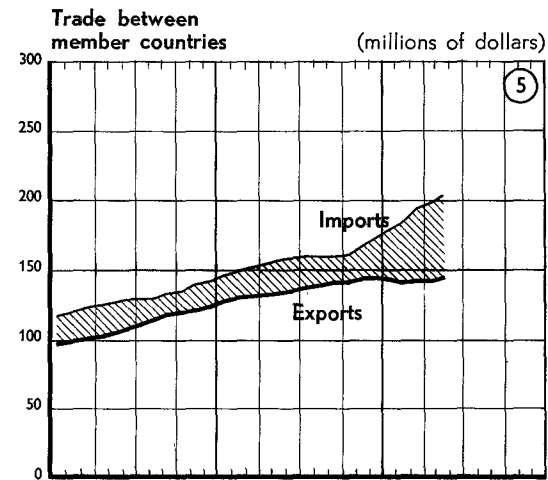
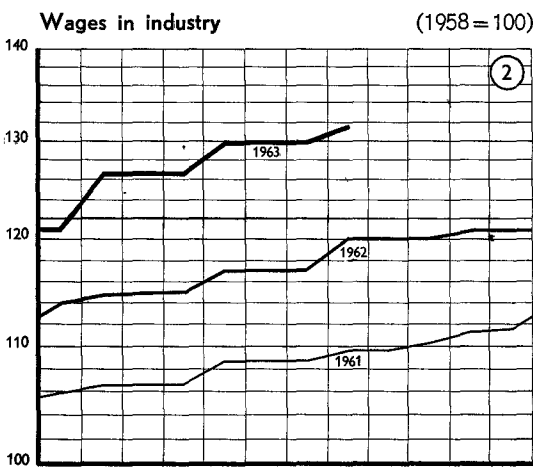
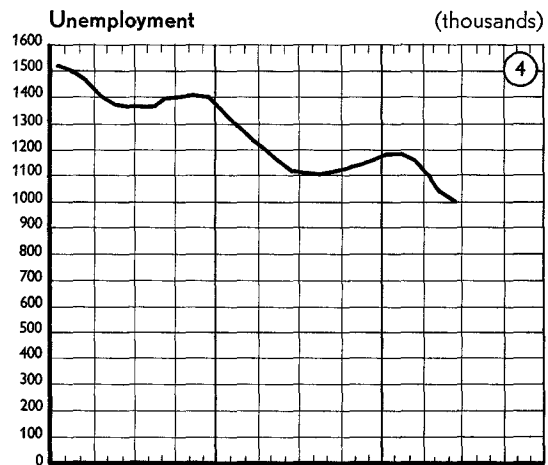
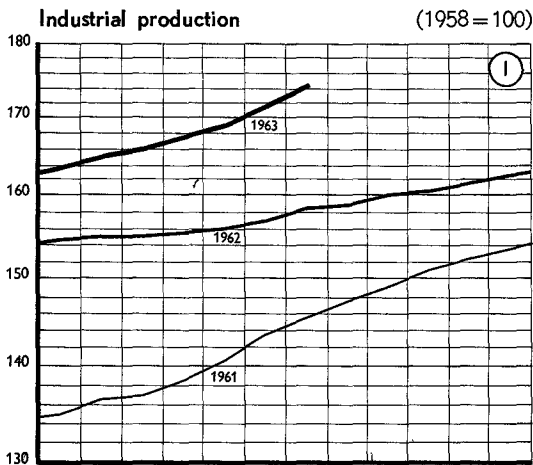
Exports of goods and services expanded at only a slightly higher rate in the second quarter than in the first, although the improved economic situation throughout the world and the absence of certain inhibiting factors—which had been present in the first quarter and had caused losses of output that had to be made good—would have led one to expect a more marked increase of pace. Exports of goods, as shown in the customs returns, were 7.8 % higher in value than a year earlier—slightly more than in the first quarter, when the figure was 5.2 %; since export prices were quite appreciably higher than in the previous year, the growth rate in terms of volume must have been decidedly smaller.

The products of the extractive industries, foodstuffs and certain items of transport equipment made the main contributions to the slight increase in the growth rate of exports. Analysis by destination shows that the increase was accounted for mainly by more sales to industrialized countries outside the Community, especially the United States and Japan. Exports of services also seem to have increased more rapidly than in the first quarter, although tourism did not come up to expectation.

Domestic demand again made distinct progress. There was an increase of total expenditure on gross fixed asset formation. The incomplete indicators available suggest, it is true, that investment in the building sector was stagnant or even falling. Housing completed in the second quarter was only 1 % above, and business premises completed were almost 17 % below the figures of a year earlier, while in the first quarter the corresponding growth rates had still been fully 9.5 % and 15.5 %. Expenditure on public works, on the other hand, probably moved up further, though very slowly.

Investment in plant and equipment advanced unmistakably, although here again the endeavour to make up for lost ground may have played a part. After some setbacks in the first quarter, which suffered from the exceptional cold and considerable labour disputes, the upward movement was resumed more clearly. Evidence of the improvement is provided by the rising production of capital goods and by the development of foreign trade in this sector.

ECONOMIC INDICATORS



NOTES :

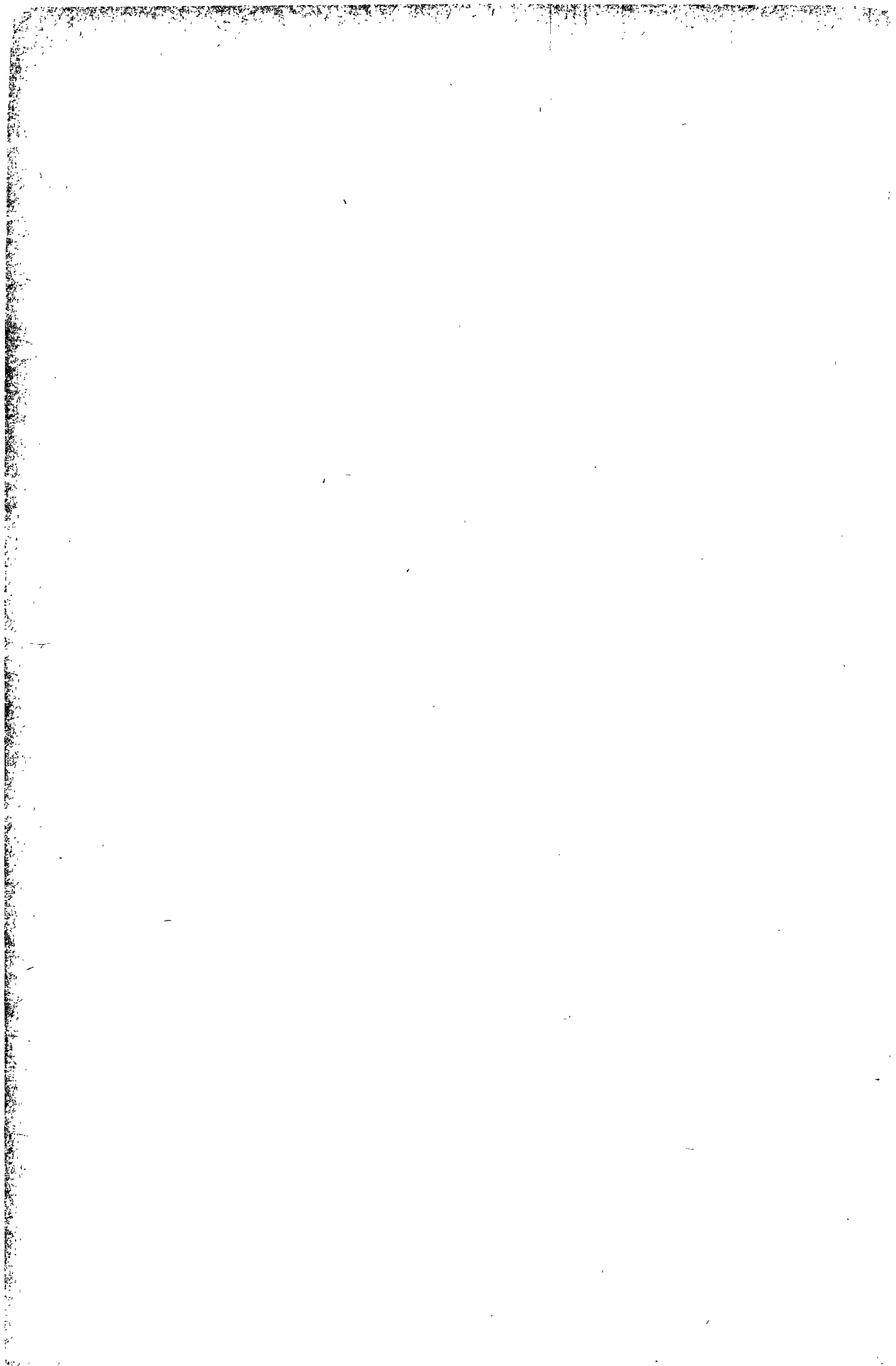
Source : Statistical Office of the European Communities (except as otherwise indicated).

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

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

Graph 4 : Registered unemployed at end of month. This series probably puts the absolute level of unemployment too high. Data seasonally adjusted by Commission.

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



The very rapid growth of private consumers' expenditure was maintained. The already high rate of growth in mass incomes gained further speed, mainly because of further considerable rises in wage rates and in the cost-of-living allowances paid under the sliding scale, but also because of the exceptionally rapid increase in employment. In commerce the average minimum agreed wages including family allowances were in the second quarter 10.1 % higher than a year earlier (7.8 % in the first quarter), for industry the figures were 10.6 % and 8.8 %, for agriculture 12.1 % and 11.4 %. Salaries rose at even higher rates, and in some cases the rate of increase itself was also moving up (in the public service, for instance, the rate reached almost 30 %). Labour continued to drift from the land and move to sectors offering better pay.

Old age and retirement pensions, too, were improved both in agriculture and in the public service. These increases in mass income appear to have been accompanied by a certain decline in the propensity to save.

Purchases of consumer durables, such as motor-cars and electrical appliances for the household, expanded at a striking rate. In the second quarter 45.6 % more new private motor-cars were registered than a year earlier.

According to sample surveys carried out by ISTAT, the number of unemployed showed a further marked drop; on 10 May it was 22.5 % below the level of 20 April 1962. There were almost 4 % more workers employed in the economy as a whole than at the corresponding time of the previous year. The shortage of labour—especially skilled labour—is evidently becoming rapidly more severe.

On the supply side, the expansion of agricultural production as a whole was slight. The wheat crop in particular is likely to have fallen appreciably short of last year's results which had, however, been very good.

Industrial production, on the other hand, increased more rapidly than before. According to the ISTAT Index, as seasonally adjusted by ISCO, the increase from the first quarter to the second was no less than 4.7 %. Preliminary returns suggest, however, that this figure declined somewhat in July. On the basis of the unadjusted index, the level of production was 10.9 % higher than in the second quarter of 1962, after a 5.4 % year-to-year growth rate for the first quarter. The year-to-year comparison shows that the most marked increases occurred in transport equipment and capital goods (from 10.8 % and 3.2 % in the first quarter to almost 25 % and 13 % respectively in the second). The production of consumer goods also expanded at a slightly faster rate. However, the special factors referred to played a part in this development of industrial production—there can be no doubt that the underlying growth was less rapid.

Imports of goods and services also expanded more quickly in terms of both volume and value. The value of goods imported (as shown by customs returns) was no less than

30.5 % above last year's figure for the second quarter, whereas the year-to-year growth rate for the first quarter had been 17.7 %. In terms of volume the rate of expansion was probably only slightly lower. Not only consumer goods, but in particular investment goods were concerned in the increase. Imports of raw materials also mounted more quickly than in the first quarter. According to foreign exchange statistics imports of services—not least in the shape of Italian travel abroad—also rose at a quicker pace.

The price trend, which has been moving markedly upwards for two years, with an especially steep rise between autumn 1962 and February 1963, has been rising less steeply of late. This was, however, largely thanks to the seasonal drop in the prices of certain crop products—especially fruit and vegetables—and to certain corrective movements. Prices for industrial products maintained their upward movement, though at a slower pace. From March to July the consumer price index rose by 0.7 % (4.4 % from November 1962 to March 1963); in July it was 6.6 % higher and the cost-of-living index, to which the cost-of-living allowances are tied under present sliding wage scale agreements, as much as 7.9 % higher than it had been a year previously. Wholesale prices also rose less steeply in the second quarter, though the trend was not so marked as for consumer prices.

The pace of growth of imports was considerably faster than that of exports, and this led to a considerable further deterioration in the trade balance. On the basis of customs returns the deficit amounted to \$666 million in the second quarter, or more than twice as much as a year earlier, when it had been \$312 million. Despite the vigorous rise in net income from services, the current transactions account for the second quarter showed a considerable deficit instead of the usual seasonal surplus. As at the same time the deficit on capital account also mounted rapidly, the deficit in the balance of payments as a whole (in terms of the Italian foreign exchange statistics) was no less than \$412 million as against only \$25 million in the second quarter of 1962 and \$268 million in the first quarter of 1963. If the official gold and foreign exchange reserves declined only by \$8 million in the second quarter (as against \$115 million in the first), this is mainly because of the very considerable further rise of \$383 million in borrowing abroad by the banks. In July the official gold and foreign exchange reserves were once again \$65 million up; they probably also rose appreciably in August.

As a result of foreign borrowing by the banks, net movements of funds in settlement of transactions with abroad had only a slightly restrictive effect on bank liquidity. The cash transactions of the Treasury had a more restrictive effect; this was however seasonal, because tax revenue in the second quarter is always specially high. When allowance is made for this seasonal factor, these transactions will probably show a tendency to improve liquidity, which was not the case last year. The rapid expansion of credit was maintained. The ratio of bank advances to deposits rose considerably; in June it was 78.2 % (in March 75.4 %). It is, however, also true that the ratio of advances to deposits plus certain other funds—in particular those from abroad—was not only naturally lower, but

also expanded less vigorously. At the same time the net yield interest return on government securities rose to 5.29 % in June and was 5.22 % in July (March : 4.92 %).

2. Outlook

The expansion of demand will probably be sustained for the remaining months of 1963 at about the same pace as in the first half of the year. The main contribution to this growth is likely to come from domestic demand.

Though the outlook for demand from abroad still points to a slight expansion, it has, if anything, again become less promising. On the credit side, the outlook for the world economy is far from unfavourable, and this should no doubt help Italian exports. Some stimulus will also come from the further reduction made in EEC internal duties on 1 July. The intended speed-up in the procedure for tax refunds to exporters and the planned extension of export credits could also provide an incentive. On the debit side, the possibilities of an expansion in Italy's important agricultural trade will certainly have shrunk because of developments and the outlook in the agricultural sector, which by and large are not so far very favourable. Above all, however, Italy's competitive position, as compared with previous years, seems quite generally to have suffered, the greatest impediment being the continuing and rapid rise in costs. The ISTAT index of export prices (calculated according to the Paasche formula) showed a year-to-year growth rate of not less than 4.6 % for the first four months of 1963, as against 0.8 % in the last quarter of 1962. In the first three quarters of 1962 this index figure had still been below that for the corresponding period of the previous year. At any rate, the backlog of orders in industry seems to have declined rather sharply. The "Forum" survey carried out by *Mondo Economico* for the second half of 1963 also shows that businessmen consider the outlook for exports to be appreciably poorer than before. Although the number of foreign visitors to Italy is again likely to expand more slowly as a result of the rapid increase in prices, the export of services in general will probably continue to rise vigorously, especially in terms of value.

Domestic demand can be expected to rise relatively strongly. In the first place, expenditure on capital investment is likely to maintain its growth. This applies to investment in building and construction; here potential demand may well have risen more rapidly than before. At any rate, in the second quarter the number of dwellings planned was 16 %, the number of industrial premises fully 21.5 % higher than a year earlier. However, not all of these plans are likely to materialize, because, in view of the stringency prevailing on the capital market, the banks have for some time been reticent on advances for building. The rapid rise in building costs, which has recently gathered further momentum, will also act as a brake. Expansion in the public works sector will presumably make only very slow further progress. However, expenditure on plant and machinery could well grow a little more rapidly, though it is unlikely to maintain the speed reached

in the second quarter. Cost push does not seem by any means to lead inevitably to greater propensity to invest in rationalization, especially as financing has become more difficult and there are psychological factors which continue to have a depressing effect on investment.

Secondly, official expenditure on consumption is likely to increase noticeably, as was mentioned in the last Quarterly Survey. The first budget estimates for personnel expenditure in the current financial year (which began on 1 July 1963) were almost one third higher than the corresponding estimates for the past financial year. On the other hand, if account is taken of the supplementary budgets, the increase is less steep. While in the financial year 1962/63 the supplementary budgets produced very considerable increases in personnel expenditure, those to be expected in the current year may be less expansionary in this respect.

Last, but certainly not least, there is reason to expect a further very rapid increase in private consumers' expenditure. This will reflect both the recent increase in mass income and further increases that will follow. Transfer incomes—especially civil service pensions—are being raised once again. Above all, new wage agreements in important sectors—especially in building and the textiles industries—will lead to new and considerable wage increases.

Except in agriculture and—possibly—building, production may well still keep up smoothly with the increase of overall demand. The EEC business surveys have shown that there are clear reserves of capacity in industry and that they are even tending to expand. However, the necessary additional labour—especially skilled labour—is more and more difficult to recruit, a fact which in individual instances seems to have blocked a more rapid expansion of production. On the whole, however, there is still a comparatively large reserve of labour : underemployment, in fact, widespread.

Imports—quite apart from seasonal variations—will without doubt continue to grow rapidly, though perhaps not at the exceptional speed attained last year.

The upward movement of prices, which is one of the main reasons for this growth of imports, is likely to continue. It must, however, be expected that the Government's policy of countering this upward movement by means of increased imports and a number of limited taxation measures (such as those recently applied to sugar, petrol, fertilizers and medicines) will continue to exercise a restraining influence. If the somewhat more restrictive credit policy recently pursued by the monetary authorities is maintained, it would exert an influence in the same direction and in the course of time this could become even more marked.

Seasonal factors will probably somewhat reduce the deficit on the balance of payments.

The amendments which, in the light of developments so far and of the outlook as it now appears, have had to be made in the forecasts for the full year 1963 clearly reflect the greatly increased pressure of domestic demand and also certain results of the cost and price upsurge : growth rates for the volume of private and public consumption must be put higher and much higher rates must now be forecast for the volume of imports, whilst the forecasts for the expansion of the volume of exports and of the gross national product in real terms remain virtually unchanged.

Supply and use of goods and services

	1961 (2)	1961 (2)	1962 (2)	1963 (3)
	At current prices in Lit. '000 million	% change by volume on preceding year		
Gross national product	22 022	8.4	6.0	5.5
Imports (1)	3 760	15.4	15.2	19
Private consumption	13 305	7.7	6.8	7.5
Public consumption	3 175	4.9	4.6	6
Gross fixed asset formation.....	5 099	12.4	9.1	7.5
Exports (1)	3 908	16.5	11.7	6

- (1) Goods, services and factor income.
- (2) Italian Central Institute of Statistics (ISTAT), Rome.
- (3) 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 under the Commission's sole responsibility.

As for 1964, it seems certain that growth will continue, but its pace will depend more than before on the orientation of economic policy and the vigour with which it is pursued. Unless more energetic steps are taken to counter the dangerous trends in prices, extreme measures may eventually have to be taken. The temporary slackening in the pace of growth which such steps may involve seems to be the lesser evil; it would still be possible to achieve a definite measure of growth in the real gross national product.

Although in recent months the price curve has become less steep, it still seems necessary to extend and considerably step up the policy of stabilizing internal costs and prices. This is needed in view of the rapid deterioration in the balance-of-payments situation : the extent of this deterioration is only very imperfectly seen in the official gold

and foreign exchange reserves, which still stand at a high level because of the increased short-term borrowing abroad by the commercial banks (\$950 million within one year).

Limitation of the growth of public expenditure—especially consumers' expenditure and transfer expenditure related to consumption—would be particularly effective as an anti-cyclical measure. Where budgets have already been adopted, cash expenditure should be delayed; this would lead to the accumulation of balances which should not be disposed of until some time after the price situation has become more normal; some moves in this direction are already discernible. In addition, it is worth considering whether fiscal measures should be used to stem in particular the expansion of private consumers' expenditure. In this way the desired limit could be placed on the extent to which the Government's cash transactions increased liquidity.

It will at the same time be necessary to tighten further the more restrictive line adopted some months ago in monetary and credit policy, especially as the rapid expansion of credit has so far supported the liquidity of enterprises and so increased readiness to make large wage concessions. It is true that bank liquidity has recently come under greater pressure owing to the very rapid rise in the volume of money in circulation and even more owing to the increasingly rapid rise in the level of bank advances, to which reference has already been made (in addition, obligatory minimum reserve holdings have naturally also increased strongly). The banks were, however, able to draw new funds from abroad thereby showing more clearly than before how in Italy too the usefulness of the traditional weapons of credit policy is being limited by the integration of the national money market in the international market. For this reason the expansion of lending by the banks should perhaps be directly curtailed in volume by fixing a credit ceiling. This would at the same time greatly reduce the banks' incentive to take up credits abroad.

The proposed overall braking measures in budget, tax and credit policy should be mainly aimed at limiting expansion of consumer demand. The conditions applying to investment—especially investment by enterprises, which is not very buoyant as it is—should not if possible be made worse. One element of investment demand however, namely building, will have to be restricted except where industrial construction is concerned. Action to reduce the clearly overheated demand in the housing sector seems particularly necessary; in view of the present excess demand in this sector such action need not lead to any slowdown in the rate at which activity in this sector is actually expanding.

Finally, special importance attaches to the trend of wages, which by bringing about a major increase in labour costs and mass income have contributed decisively to the pressure that has forced up prices. It would be in the best interest of all concerned if every effort were made to reduce the pressure of costs, perhaps by making still more effective use of the National Economic and Labour Council (CNEL), which is the Government's official advisory organ, and is composed of experts and of representatives from both sides of industry. Consideration should also be given to the possibility that the State-controlled sector of the economy—which is particularly large in Italy—should assume a leading role in this respect.

General restraint in wages policy is, however, conditional on the means to finance undue wage increases being reduced through application of the budget and credit measures referred to—and these should affect not only wages but also the non-wage incomes of other sections of the population. On the other hand it is clear that the more workers and managements can be induced to follow of their own free will a policy of more stable wages, the less need will there be for intervening sharply with the “classical” instruments of anti-cyclical policy.

The Italian economy is in any case expanding so rapidly that it can take in its stride any temporary deceleration due to traditional anti-cyclical measures. These establish the conditions in which the economy will be able to move ahead again more rapidly on an even keel.

On 25 September 1963—too late for discussion in the body of this survey—the Italian Government took the following decisions :

1. Government expenditure will be restricted and its structure improved. The budget deficit will be reduced. The Lit. 80 000 million excess of actual revenue over the estimates for the July-September period will be used to reduce that deficit.
2. Pending cases in litigation between the Government and taxpayers on matters of taxation will be speeded up and should bring in considerable further revenue during the next four months.
3. To encourage investment in industry a bill will be introduced offering, for a period of three years, additional incentives through income tax reliefs. At the same time the provisions on depreciation for taxation purposes will be improved.
4. Existing subsidies to housing construction are to be channelled more than hitherto into low-cost housing schemes, which will be expanded.
5. An increase of turnover tax on certain luxury goods (precious stones, luxury furs, sparkling wines, liqueurs, aperitifs, playing cards, antiques and works of art) is proposed.

Broadly speaking, these decisions are closely geared to what the current economic situation requires. It is, however, not certain that the measures actually taken will be sufficiently forceful to remove inflationary pressure. On the restriction on government expenditure, in particular, there is no indication of any concrete measures, or of their quantitative effect, though restrictions here constitute the decisive factor. Again, only the qualitative aspect of housing is to be affected, whereas limitation of the growth of demand in the sector as a whole would seem to be called for. Finally, in the field of incomes policy—especially in connection with efforts to slow down the expansion of private consumption income and rising costs—no new steps have been announced.

It is to be hoped that the Government's first stabilization measures will be supplemented by further, more vigorous action. The Government does, in fact, intend to take further anti-cyclical decisions in the near future.

D. The Netherlands

Economic growth speeded up in the second quarter and, as far as can be seen, during the summer months. Overall demand provided a marked stimulus, not only because of the strong seasonal recovery but even more as a result of a slight quickening of the underlying trend.

Exports in particular expanded with vigour. Fixed investment, too, must have risen appreciably, though this increase was largely within the building sector. The tendency for expenditure on equipment to contract seems to have been halted or even to have recovered slightly. Private consumption on the other hand, while it maintained its high level, showed little further expansion.

Contrary to expectations and despite a substantial increase in the numbers employed, strain on the labour market was again aggravated; unemployment even fell slightly below the level of the second quarter of 1962.

The growth of supply was bigger than in the previous quarter. The overall index of industrial production recorded a 3.8 % increase over the second quarter of 1962—after a year-to-year growth rate of only 0.6 % in the first quarter. Imports expanded even more rapidly.

The level of prices remained practically stable, but this was in part due to relatively sharp seasonal reductions in the price of some vegetable foods which even brought the cost-of-living index down 1.8 % from March to July.

Although the trade balance deteriorated somewhat, the overall balance of payments may well have shown a slight surplus.

It can be forecast with some certainty that the current business trend will persist until the end of the year. Demand from abroad will continue strong, and total expenditure on fixed investment will increase. The year-to-year growth rate of private consumers' demand may tend to decline. The upward trend of industrial output will probably continue at much the same pace as in the second quarter, and imports, too, may well maintain their rising trend.

Prices will again harden somewhat as soon as the seasonal price trend of some foodstuffs is reversed: the increase that has meanwhile been going on in the prices of certain other foods and in the prices paid for certain services will then be reflected in a rise in the overall index, but this will not be sufficient to establish the diagnosis of a serious upward trend of prices.

The forecast for the development of overall production between 1962 and 1963 (a 3.5 % - 4 % increase in gross national product) may well prove to have been correct.

The outlook for 1964 is also quite promising. According to preliminary forecasts, demand from abroad should make an increased contribution to economic activity. A definite rise in expenditure by enterprises on fixed investment is also not unlikely. In any case, expenditure on building will increase substantially. The expansion of private consumers' demand will again be vigorous, but it is likely to be slightly smaller than in 1963. In these circumstances—and if production is again more elastic—the growth rate of real gross national product may be as much as 5 %. These forecasts assume the maintenance of a moderating wage policy, but this is being made more difficult because of the renewed tightness of the labour market. In order to ensure that the economic situation shall be as balanced as possible in 1964 and that in the longer term there shall be a reasonable rate of economic growth, this policy should none the less be maintained.

1. Recent developments

Demand from abroad, in terms of actual exports of goods and services, gave a strong fillip to economic activity in the Netherlands during the second quarter. Exports of goods increased substantially : according to customs returns their value was 12.5 % higher than a year earlier—after the year-to-year growth rate had been 1.8 % in the first quarter. In July-August the growth rate was 14.2 %. The rise by volume was doubtless greater still (1), since the price of agricultural products—which had previously gone up appreciably—fell during the quarter and the quantities of these products exported also increased sharply. True, the higher rate of exports is partly due to the process of catching up on the backlog of deliveries that built up in January and February as a result of the severe winter and to an expansion in deliveries of military equipment. However, the principal causes were probably the improved economic climate throughout the world, the greater elasticity of production and the more modest expansion of consumers' demand in the Netherlands.

Domestic demand continued to move upwards.

(1) As the series are being revised, exact data on the volume of imports and exports are temporarily not available.

In the second quarter there was a considerable recovery in the growth rate of gross fixed asset formation, for which the first quarter had shown a drop of 11 % in value and 12.3 % by volume against the same period in 1962, mainly because of the effects of the winter. Greater efforts in the building sector (more people taken on and more overtime worked) enabled part of the production losses of the winter to be made good. The number of dwelling units completed in the second quarter was in fact almost 18.6 % up on the second quarter of 1962, and the number of starts rose even more sharply. Activity probably picked up noticeably in the other sectors of private building too. The same applies to public investment, which is mainly in building and construction : after a fall in the first three months, the volume of public investment in the second quarter was probably 15 % higher than in the corresponding period of 1962.

An appreciable increase in purchases of equipment abroad suggests that the tendency for investment to slow down in this field may have come to an end. The fact that in view of the increased elasticity greater recourse can be had to domestic supply gives reason to believe that buying on the home market rallied too. It is possible that there will be a further slight increase in new orders for capital goods.

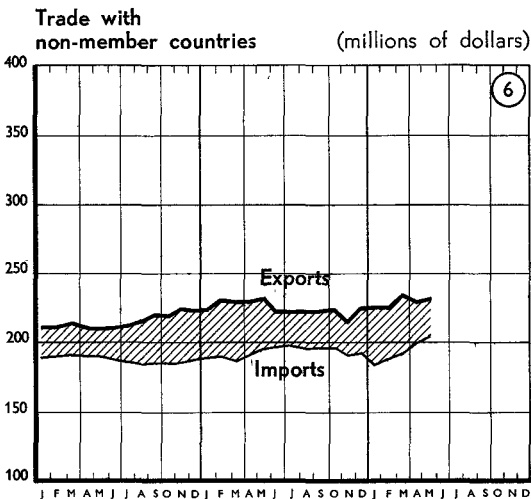
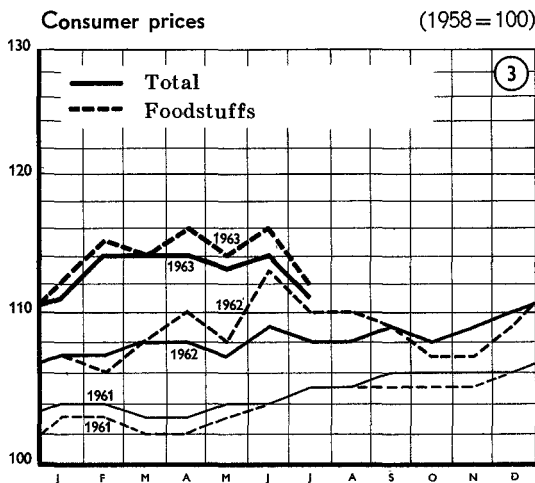
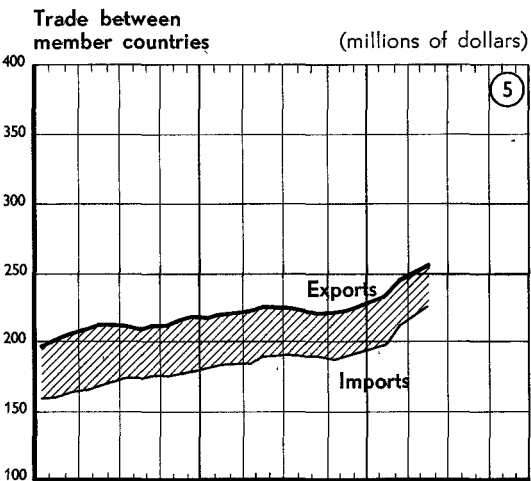
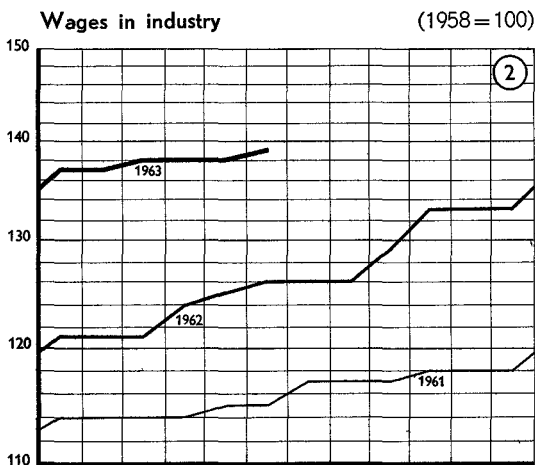
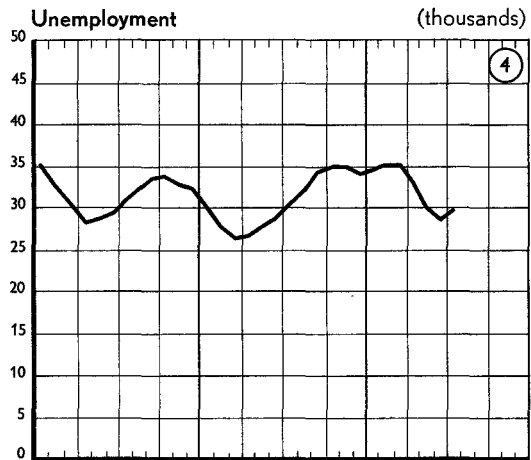
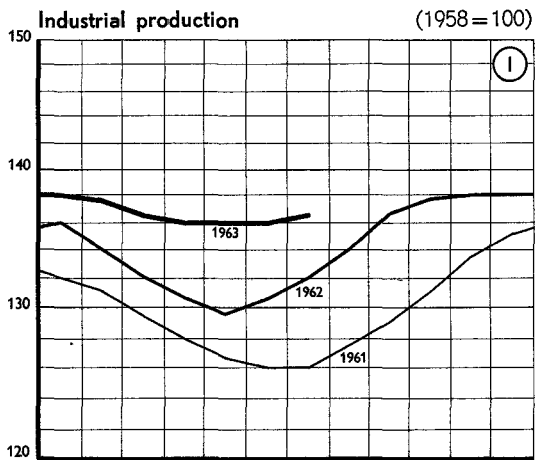
The rapid expansion that has been a feature of private consumers' expenditure since the third quarter of 1962 has lost momentum. None the less this expenditure was 8.9 % (value) and 5.2 % (volume) higher than in the second quarter of 1962, the corresponding rates in the first quarter having been 10 % and 6 %. The increase in expenditure was concentrated mainly on consumer durables, purchases of which were, in terms of volume, more than 9.1 % higher than in the second quarter of 1962.

The increase in private consumption was backed up by a further rise in incomes. Agreed hourly wages in the private sector rose in the second quarter, although by and large the rises went only a little beyond the recommended limit of 2.7 %. Furthermore, the distinct increase in numbers employed—especially in the building industry—added to the wages bill. This was probably 10 % higher than a year before, while in the first quarter the corresponding rise had been some 7 %.

Public consumption, too, has no doubt gone up once again.

Contrary to all expectations, there was no upward trend in unemployment, despite the increase in the working population; the number of unemployed was in the second quarter in fact only about 25 000 (monthly average), rather less than in the same period of 1962. Even at the end of July, in spite of the seasonal influx of young people to the labour market, unemployment was not as high as at the same time in 1962. The increase in the working population has thus been completely absorbed, probably for the most part in the ranks of the wage and salary earners; numbers in employment have risen most in

ECONOMIC INDICATORS



NOTES :

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

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

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

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

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

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

the building industry and in services. Nevertheless, vacancies notified reached a new peak of 145 200. So the expected easing of the labour market has not materialized.

The faster expansion of employment was, however, reflected in a greater elasticity of domestic supply, particularly in the output of the building sector—even if potential demand here is certainly still higher than potential supply—and in certain branches of the services sector. In industry, on the other hand, where numbers employed have increased but little, output has expanded as a result of higher productivity. The CBS index of industrial production was in the second quarter 3.8 % higher than in the second quarter of 1962—after a year-to-year growth rate of as little as 0.6 % in the first quarter. Adjustment to allow for differences in the number of working days does, however, reduce the difference between these figures a little. In most sectors, apart from some branches of industry suffering from a structural fall in demand, growth has certainly speeded up.

In the services sector there was also a high growth rate of about the same order as in 1962. On the other hand, agricultural production—held up by the very cold winter and the effects on certain harvests produced by a rainy late summer—does not quite seem to have reached its 1962 level.

Not only domestic supply but also imports of goods and services gathered further momentum. The value of imports of goods (as shown by customs returns) was 11.9 % up on the second quarter of last year. In the first three months of 1963, the year-to-year growth rate had been only 1.5 %. Imports in the first quarter of 1962 had, it is true, been relatively high. Among these, purchases of raw materials were again distinctly higher than before. Imports of certain finished products also expanded briskly, particularly textiles and vehicles.

After the speed-up early in the year, the upward trend of prices slowed down noticeably in the second quarter. As a result the cost-of-living index (1), which rose 3 % between December and March, went up only 1 % between March and June, and even this increase can be ascribed to a number of special factors. In the third quarter the price of some important items—particularly bread, butter, sugar, petrol and coal—went up, but the effect of these increases was more than offset by exceptionally large seasonal price reductions for other foodstuffs, with the result that the cost-of-living index fell slightly between June and July; it was only 2 % higher than in July 1962. By and large the level of wholesale prices remained unchanged.

Owing to the rapid rise of imports, the trade account deteriorated slightly : the deficit stood at Fl. 790 million—rather higher than in the corresponding quarter of 1962 (Fl. 730 million). The overall balance of payments showed a surplus in the second

(1) Excluding payroll taxes and compulsory social security contributions.

quarter. The total of net gold and foreign exchange reserves rose slightly between the end of March and the end of June : official reserves were up appreciably (Fl. 277 million), but there was a deterioration in the net foreign exchange position of the commercial banks which partly offset this gain. However, official reserves fell off a little in July, owing to a substantial advance repayment of foreign debts (Fl. 250 million).

Apart from seasonal or accidental strains, when in June money from the second Fl. 300 million government loan was paid in to the Treasury, the money and capital markets continued to be rather liquid. The Central Bank used open-market operations to support the liquidity of the commercial banks and kept the minimum reserve rate decidedly low at 3 %. Bank advances continued to expand, though not too rapidly.

2. Outlook

Between now and the end of 1963 the level of economic activity will doubtless continue to rise, but not appreciably faster than before.

Foreign demand will remain the most important expansionary factor, though the pace at which exports will expand may fall below the very high rates recorded in the second quarter. The expansion of exports will benefit from the improvement of the world economic situation, particularly in the major industrial countries. According to the last CBS survey, the flow of orders from abroad was increasing. The outlook for exports of consumer goods is still good, and there have been recent signs that foreign orders for capital goods will pick up. Moreover, increased production capacity, higher employment figures and the prospective slowdown in the growth of domestic consumer demand may well spur industry to greater efforts in exports. The proportion of exports to total production is likely to continue rising; in the first half of 1963 increased turnover in exports exceeded the increase of total turnover for the first time for a long while.

Expenditure on gross fixed capital formation will probably rise significantly. In the first place, greater elasticity of supply will make considerable expansion possible in the building sector; this in turn will affect other sectors, and overall demand will also be indirectly stimulated. Secondly, it is possible that the slight improvement in the readiness to invest in plant and machinery will be confirmed and reinforced more rapidly than was expected.

While the annual CBS inquiry among businessmen on their prospective purchases of capital goods indicates that expenditure over the whole of 1963 should fall off 20 %

from the 1962 figure, it must be noted that actual expenditure in 1962 exceeded forecasts by more than 20 %. It is also possible that the persistence of strain on the labour market, which had not been foreseen at the beginning of the year, will again lead to more investment in rationalization. As regards financing, the retention of the policy of moderation in raising agreed wages, together with increased output, might well put a brake on the narrowing of profit margins or even halt the process altogether; this too could have a favourable effect on investment.

Private consumers' expenditure in the coming months will probably show little change when compared with expenditure in the second quarter. Nothing suggests that the trend in the total wages bill will contribute to a stronger expansion of households' incomes. On the contrary, the rise in employment figures will be strictly limited, and most of the wage agreements due to expire this year have already been renewed. In view of the situation on the labour market it is of course more difficult now than in the second half of 1962 and in early 1963 to carry through with success the policy of restricting wage increases.

This being the outlook for the various components of demand, industrial production will presumably continue buoyant. A slight acceleration is possible as a consequence of increased elasticity in the means of production—and particularly because of recent improvements in productivity. Activity will also pick up in the building and to a less extent also in the services sector.

Imports should go up again, though the expansive trend could fall off slightly, particularly in view of the expected slackening of the growth of private consumption.

Once the seasonal fall in the price of certain foodstuffs has come to an end, the cost-of-living index will presumably tend to move slightly upwards, since the price increases for other goods and services that have occurred in the interim will then have a visible effect.

In view of developments in the course of the year so far and the prospects for the coming months, only slight changes are likely to be called for in the overall forecasts for the full year 1963. The increase in the volume of private consumption will be rather higher (4.5 %) than was expected earlier, and gross fixed asset formation may in terms of volume be slightly higher than in 1962—contrary to previous forecasts—particularly because building production losses during the winter were made good more quickly than was expected. Nevertheless, the forecast growth rate for the real gross national product is still between 3.5 % and 4 %, as the rise in the growth rate of demand was largely met by increased imports.

Supply and use of goods and services

	1961 (2)	1961 (2)	1962 (2)	1963 (3)
	At current prices in '000 million florins	% change by volume on preceding year		
Gross national product	44.80	3.1	2.7	3.5
Imports (1)	22.51	7.1	6.6	7.0
Private consumption	25.69	4.7	4.2	4.5
Public consumption	6.21	3.8	6.3	3.0
Gross fixed asset formation	10.85	6.1	4.2	2.0
Exports (1)	23.26	4.4	6.6	7.0

(1) Goods, services and factor income.

(2) General Statistical Bulletin, 1963, N° 7-8, Statistical Office of the European Communities.

(3) Commission forecasts.

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

In 1964 the business trend will probably be expansionary again. A slight speed-up in growth is eminently possible, since not only domestic but also foreign demand may go up more than in 1963. This will, however, probably be conditional on wages policy aiming at the restraint in 1964, as was achieved in 1963.

Exports will continue to benefit from the higher level of economic activity in the world and from greater domestic elasticity of supply. Although investment by shipping companies may decline somewhat, the increase in gross fixed asset formation will probably be supported by greater building activity—private and public—and a gradual extension of investment by enterprises in plant and equipment. The position of industrial building could still constitute a serious obstacle to any real upsurge in expenditure on extensions.

The rise in the income of private households may be slightly below that recorded in 1963 if—and this condition is beginning to look increasingly unlikely—the total wages bill goes up more slowly. The wage and salary bill per worker may rise less rapidly than

in 1963 if the policy of wage restraint is maintained and because of the reduced impact of the indirect factors which contributed to the 1963 increase. Transfer incomes, too, will probably increase less than they did between 1962 and 1963. Although consumers' demand as a whole may increase rather less than in 1963, the effects of this component of demand should nevertheless be greater in the second half of the year as a result of the rise in agreed wages during the first quarter.

If this is in fact how overall demand develops, there are good prospects for faster growth in domestic supply, which in turn will probably show greater elasticity again as a result of expected improvements in productivity and because employment figures could rise as much as they did between 1962 and 1963. The growth rate of real gross national product may well be as much as 4.5 % to 5 %.

As elsewhere, those responsible for economic policy in the Netherlands will, of course, have to continue their efforts to maintain the balance of economic growth and to ensure that in the long term supply is able to meet the growing demands that are sure to be made on it.

It would be advisable to encourage the incipient recovery in investment by enterprises; the increase in the number of industrial building permits intended for 1964—part of a policy that seeks to relieve the bottle-neck in the building sector and that should be stepped up—may make this easier. In addition, the current wages policy should certainly be continued, in order both to make funds available for investment and to keep the expansion of consumers' expenditure within such bounds as will permit a recovery in private investment without putting too much strain on total demand. That this policy would also tend to keep prices steady seems obvious.

Of course, as was mentioned above, renewed tightness on the labour market has made it very difficult to pursue a policy of wage restraint, so efforts to combat this should be redoubled.

Mention may be made in this context of the opportunities that would arise from recruiting more foreign labour, temporarily easing restrictions on overtime and allowing persons in receipt of pensions to work—and even more from a policy of limiting further moves towards reducing the working week. The plans for selective cuts in national service are perhaps a first step in this direction. A wages policy directed at achieving greater differentiation between wage rates in various industries might also result in available manpower being put to better use.

Failing such a policy, the prospects of balanced economic growth would certainly be less favourable. Any rise in the total wage and salary bill that is steeper than in 1963 might have a negative influence on external equilibrium and on the domestic price situation

both because of its repercussions on wage costs per unit of production and because of the more rapid expansion of private consumption that would follow. Profit margins might well tend to contract, and this would later have a considerable braking effect on investment by enterprises. In turn, the consequent slackening in the advance of productivity might in the long run reduce the pace at which the standard of living can rise in a population which is itself increasing relatively fast.

E. Belgo-Luxembourg Economic Union

Belgium

Economic expansion continued in the second quarter and probably in subsequent months as well. The main reason for this was appreciably heavier demand from abroad.

Internal demand also continued to expand, probably at a rather faster rate. The increase in fixed investment expenditure was, it is true, mainly due to the exceptionally sharp recovery in the building sector after the difficulties of the 1962/63 winter, but evidently purchases of capital goods by enterprises also tended to increase slightly faster; at the same time there was a spurt in household incomes which led to a corresponding increase in private consumers' expenditure.

Because of the livelier expansion of demand and the disappearance of difficulties caused by the bad weather, production showed a very definite increase. Industrial production, according to the IRESP Index, was 8.4 % higher in the second quarter than a year earlier. This compares with a year-to-year growth rate of only 2.6 % for the first quarter. It would seem that farm output was also up, though by only a small amount, on the 1962 figure. Lastly, the figure for imports moved up more rapidly.

After the rise recorded in the first quarter, prices remained on the whole stable or, as in the case of wholesale prices, even eased slightly. Seasonal movements in the price of foodstuffs had something to do with this. During the summer food prices in particular, hardened once more, and the longer-term tendency for retail prices to rise slightly reasserted itself.

The fact that exports increased more rapidly than imports made for a slight improvement in the balance of trade. At the same time, however, the balance of services deteriorated appreciably, which meant that the current account closed with a deficit. As against this, the balance of capital movements was positive—mainly as a result of a net influx of public capital—thus producing a slight surplus in the overall balance of payments.

All the available data and all other pointers suggest that economic expansion should continue at its present pace during the last months of the year. The growth rate forecast for the real national product between 1962 and 1963 may therefore be slightly increased to somewhere between 3.5 % and 4 %.

The outlook for the further development of the economy in 1964 is also very encouraging. An initial appraisal singles out demand from abroad and public expenditure on investment as the main expansionary factors; at the same time certain conditions which will allow of a gradual increase in the growth rate of investment expenditure by enterprises have in fact been fulfilled. On the other hand, a slight slowdown in the expansion of private consumers' expenditure is not to be ruled out.

Now that full employment has been achieved it is vital, if balanced economic expansion is to be secured, to continue efforts to put the national budget on a sound footing. Failing this, the danger would arise that the growth of the economy—which assessed as the real increase in GNP, might well amount to a good 3.5 %—might not be achieved in satisfactorily balanced conditions.

Belgium

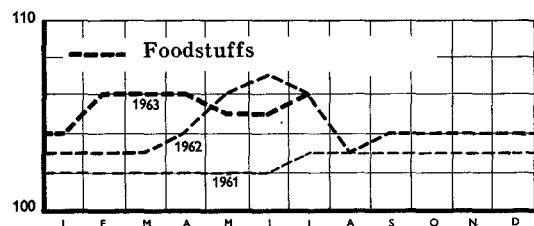
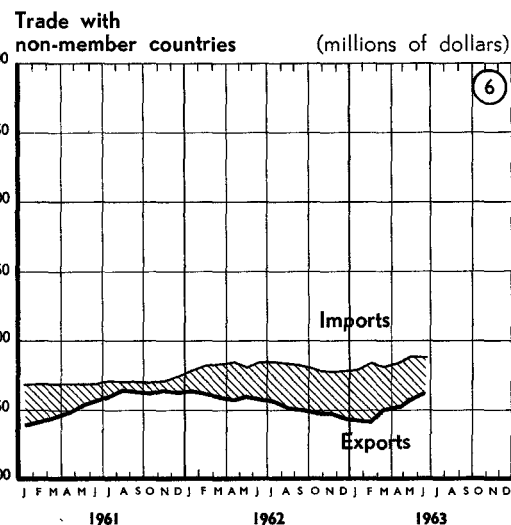
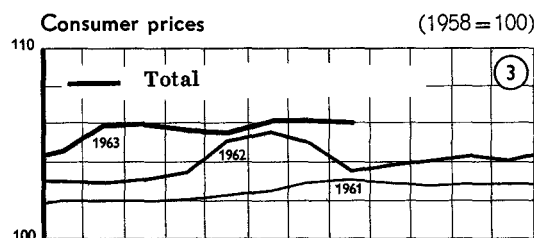
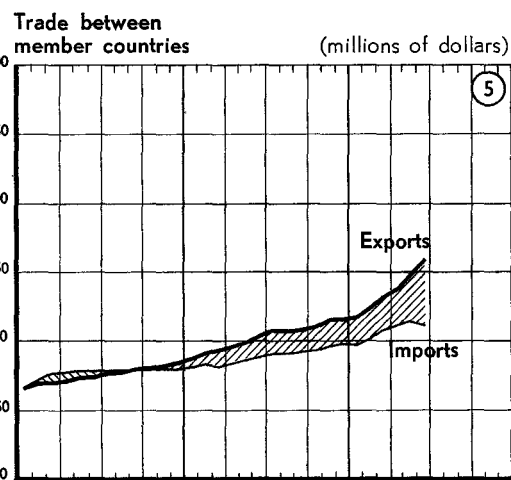
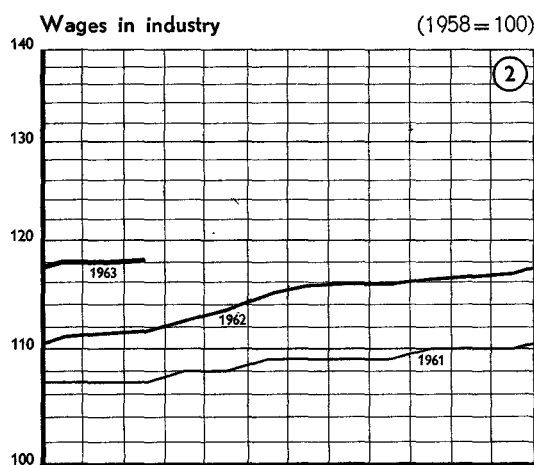
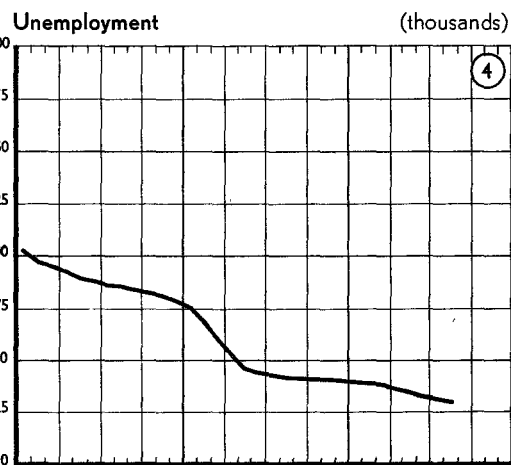
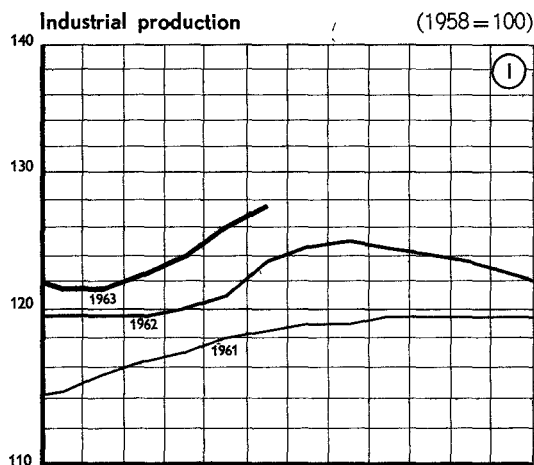
1. Recent developments

Exports of goods and services have soared since the end of the winter and this has been the key factor in Belgium's economic expansion. Customs returns show that the value of merchandise exports was 13.7 % higher in the second quarter and 20 % in July-August than a year earlier, against a slight decline in the first quarter. (Figures for the volume of imports and exports are not yet available). Although this development is certainly accounted for in part by special factors such as deliveries of military equipment and the need to make good the loss due to the severe winter, it seems to be mainly due to a strengthening of the underlying expansionary trend. While demand from abroad for consumer goods continued to make its contribution to the Belgian economy, this stimulus was reinforced by a somewhat more favourable trend in demand for investment goods and certain basic products.

Exports to other EEC countries advanced rather faster than in the second half of 1962, and exports to non-member countries, which had been declining steadily since the autumn of 1961, rallied a little.

The expansion of domestic demand also seems to have gained in strength, although gross fixed asset formation did little to stimulate the general business situation. Imports of machinery and appliances again moved ahead at a relatively brisk pace in the second quarter, and the decline in new domestic orders for capital equipment also seems to have been arrested about the middle of the year, but this does not suffice to show conclusively that the weakening trend in the propensity to invest shown by enterprises has been reversed.

ECONOMIC INDICATORS



NOTES :

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

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

Graph 2 : Index of wage rates.

Graph 3 : Index of consumer prices, excluding rents.

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

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

Total expenditure on building and construction rose very sharply; this was, however, mainly accounted for by the sharp recovery in the spring, which was in part seasonal and in part the result of efforts to make good the exceptional production losses suffered last winter. Broadly speaking, the various branches of building and construction all increased their activity appreciably, but it is in public works, particularly the construction of roads, that the increase was most marked.

Expenditure on public consumption continued to grow, mainly because of wage and salary improvements.

The upward trend of private consumers' expenditure continued in the second quarter. Although it is once again particularly difficult to assess the incidence of seasonal factors, it would none the less seem that the basic upward trend gathered a little momentum: actual earnings again increased appreciably as the result of autonomous wage increases or through the action of the sliding wage scale. This came into play mainly in April, and led to higher pay in several branches of the economy; and the propensity to consume may have gained to some extent in the second quarter from the growing reluctance of income groups to save in certain ways. A more stable retail price level served to stimulate the progress of private consumption in terms of volume. Once again, additional spending went mostly on consumer durables and on services.

Supply, too, in the second quarter was definitely on the upgrade.

In agriculture, there was almost certainly an increase in livestock production. This contrasted with crop production, which after winter damage, had at first developed more satisfactorily than had been expected, but was then stricken by heavy rain in the summer. Nevertheless the results for 1963 are likely to surpass those for 1962, which were admittedly mediocre.

Industrial production expanded distinctly faster: the year-to-year growth rate reached 8.4 % (IRES Index) for the second quarter, against 2.6 % for the first quarter. The increase was particularly marked in mechanical engineering (transport equipment), textiles, cement and chemicals.

Productivity (defined as output per person in paid employment) made fairly rapid progress, since demand expanded mainly in those branches of the economy where there was still idle productive capacity. But the increase in the number of employed was very small: the labour force itself increased only a little. In this connection it should be noted that the shortage of skilled workers grew more pronounced, although the number of firms whose activities were hampered by labour shortages declined slightly from the autumn of 1962 onwards.

There are now hardly enough unemployed to form an appreciable reserve labour pool. The number of wholly unemployed fell to an average of only 30 400 in the second quarter, as compared with 41 500 a year previously. The unemployment rate—total unemployed as percentage of all wage and salary earners covered by unemployment insurance—was only 1.6 % in August 1963.

Both imports of goods and services and supply from home sources increased at quite a fast pace. The value of goods imported was almost 11 % higher in the second quarter than a year earlier, where the year-to-year increase for the first quarter had been 4.8 %. (Figures showing external trade in terms of volume are not yet available). In this upward movement, imports of finished products rose faster than those of other goods.

Since the return of weather more normal than that of last winter, the general index of retail prices has eased only very slightly, because the effect of lower prices for food has been offset by price increases for several other commodities and a very sharp rise in the price of services. It is true that in the second quarter the index showed only a slight increase on the corresponding 1962 figure (0.8 %, against a year-to-year growth rate of 2.3 % for the preceding quarter), but this was mainly due to fortuitous factors which had forced prices up in the second quarter of 1962. During the summer average retail prices again began to rise slightly as food prices in particular hardened, and in August they were up 2.2 % higher than in the corresponding period for the previous year. The wholesale index also moved down slightly after the first quarter, although there was a rise in the price of several industrial products.

There has been some improvement in the balance of trade. In the second quarter there was a deficit of Bfrs. 1 600 million, as against deficits of Bfrs. 3 800 million in the previous quarter and of Bfrs. 2 700 million in the second quarter of 1962. The balance of current payments, however, has been adversely affected by a deterioration in the balance of services. The overall balance of payments probably closed none the less with a slight surplus, as there was a credit balance in capital transactions with abroad. The gross reserves of the Banque Nationale did not climb as quickly as in the first quarter (they rose \$34 million as against \$107 million), and the net foreign exchange holdings of the commercial banks have further deteriorated.

In the second quarter the Treasury continued to issue loans abroad, since heavier expenditure—due in part to the hard winter—had increased the need for funds, and certain effects produced by the fiscal reforms had made it more difficult to resort to long-term borrowing. Even the increased internal liquidity which resulted from borrowing in foreign currencies did not do much to improve the situation : the additional liquidity was either exported by private individuals or by enterprises (this in part accounts for the volume of private capital exports), or retained at home but largely in liquid form. The consequence was a steady tightening of the money market, which led the monetary authorities to change their policy and raise the bank rate from 3.5 % to 4 % on 17 July. This measure, the purpose of which is not only to adapt bank rate to changed conditions on the money market but also to curb the expansion of lending by the banks, which in many cases has gone too far, would also seem to be aimed at facilitating the financing of the budget deficit. To the extent that the terms and conditions of state loans (interest rates, etc.) are also adjusted, it might help to re-establish the normal cycle of treasury financing, thus limiting the need for the Government to resort to the money market and in particular to borrowing in foreign currencies.

2. Outlook

The rate of economic expansion in Belgium has been growing since the end of the winter, and this trend is unlikely to change appreciably in coming months.

With regard to foreign demand, the increase in exports will still be mainly accounted for by heavier sales inside the Community : the modest level of wage and price increases in Belgium has rendered its products more competitive, and this is bound to expand the already very lively demand for Belgian consumer goods in other member countries, notably France and Italy. Moreover, available information on orders received from abroad suggests that there could well be a livelier development in sales of certain products that have undergone preliminary processing and of several kinds of capital goods in coming months. This satisfactory trend in exports to EEC countries should be supported by a recovery in sales to non-member countries : general business conditions are still good in several industrial countries and the purchasing power of the developing countries is expanding. Pointers in this direction have been visible for some months past.

The trend in outlay on fixed investment in the coming months may well add to the volume of domestic demand : the prospects of a further increase in demand, in particular foreign demand, will almost certainly afford a stronger incentive to managements to put in hand schemes for extensions or conversions. Similarly the trend in profit margins, which have almost certainly improved, might well constitute an additional incentive to the execution of investment programmes. It is unlikely that the trend of expenditure on housing will move sharply upward, but the increase in the volume of appropriations for public works suggests that the distinct tendency for investment expenditure to rise in the public sector should continue.

The growth rate of private consumers' expenditure is unlikely to slow down : full employment and a steady improvement in wages and salaries seem to be keeping the propensity to consume at the level attained in the first half of the year. On the other hand, the increase in consumption by the public authorities may well lose a little of its pace : its growth rate seems to be once again rather nearer the long-term expansion rate.

The elasticity of domestic supply has remained relatively high and this means that the development of overall demand in the coming months will engender a fairly steady expansion of industrial production at about the same average growth rate as for the first half of the year. Orders are coming in well; the backlog, measured in terms of the time required to work off the orders, had been on the decline for some time, but this trend was halted about the middle of 1963.

Forecasts on the development of overall demand and of domestic supply suggest that Belgium will once again step up its imports.

Prices should harden slightly in the months ahead, mainly because services will cost more.

By and large, the forecasts concerning the growth of economic activity for the full year 1963 that can be made at this stage are rather more encouraging than those made earlier. Unless the expansion of home demand goes beyond the limits envisaged up to the present, the surplus on external trade (in terms of national accounting) is likely to be appreciably higher than the figure originally forecast. In particular, a very marked expansion of exports, offset by only a relatively modest increase in imports, may be expected to contribute to an increase of 3.5 % to 4 % (volume) in the gross national product. The growth rate of industrial production will even be slightly higher.

Supply and use of goods and services

	1961 (2)	1961 (2)	1962 (2)	1963 (3)
	At current prices in Bfrs '000 million	% change by volume on preceding year		
Gross national product	601.2	3.2	3.8	3.5
Imports (1)	214.8	6.6	8.4	6
Private consumption	413.1	3.1	4.0	4
Public consumption	71.4	0.8	6.0	2.5
Gross fixed asset formation.....	113.8	2.8	1.6	1
Exports (1)	214.3	7.5	8.9	7

(1) Goods, services and factor income.

(2) General Statistical Bulletin, 1963, Nos 7-8, Statistical Office of the European Communities.

(3) Commission forecasts.

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

Expansionary trends should continue in 1964, favoured by a probable further surge of exports. In addition, it is likely that the expenditure of enterprises on equipment will increase somewhat faster, thus strengthening overall demand. But progress in the construction of dwelling houses may be relatively moderate, and this may well set

limits once again to the expansion of gross fixed asset formation, which will advance at a rate barely exceeding that of the gross national product. The rate of increase of private consumers' expenditure may ease slightly. It should be possible, in general, for production to adapt itself to the growth of overall demand; this would mean that the growth rate of the real gross national product would be of much the same order as that attained between 1962 and 1963.

It would seem that by and large there is nothing to prevent the present balance of factors being maintained into 1964; there are no grounds for fearing that demand will get out of hand, and the increase that can be expected in productivity should, on the whole, offset the upward trend in wage costs. And there is a good chance that the balance of current payments will improve in comparison with 1963.

If this progress is to be secured, however, it would seem that public finance ought to make a larger contribution to the maintenance of financial stability. A further increase in the deficit and its partial financing by creation of money (for, seen from the angle of internal liquidity, the sale to the Banque Nationale for francs of foreign currency borrowed abroad is nothing else) might easily, in existing conditions of full employment, bring with it certain inflationary hazards. But, in the first place, the resumption of the policy designed to place the national budget on a sound footing will make it possible to prevent the re-emergence in 1964 of strains such as those from which the country suffered temporarily during the first half of 1963. In the second place, this policy may help to restore the efficacy of monetary and credit policy, now hamstrung by the Government's foreign debts. In addition, the improvement in the circulation of money which should result from a better balanced national budget will almost certainly serve to channel more of the available resources into use at home. Lastly, such a policy will strengthen the effectiveness of measures now under study for improving the machinery used to finance investments.

Grand Duchy of Luxembourg

The improved situation on the markets for certain grades of iron and steel was accompanied by a slight rise in demand from abroad during the second quarter of 1963. Business activity may also have been stimulated by consumer demand. Investment as a whole, however, does not appear to have grown appreciably.

Industrial production, which in the first quarter had been at its lowest ebb for years, has registered some recovery. In the second quarter the year-to-year growth rate was 2.6 %; this contrasts with a decline of 2.3 % in the previous quarter.

The developments to be expected during the next few months do not suggest that real gross domestic production for 1963 will be much higher than in 1962. In 1964, however, the situation may improve somewhat, inasmuch as the recovery in investment expenditure by entrepreneurs in certain buyer markets might lead to higher deliveries of iron and steel products from Luxembourg. The opening-up of certain new industries in the Grand Duchy may also contribute to an improvement in the production and export situation.

The rise in the cost-of-living index, which has been unusually rapid for Luxembourg, threatens to continue in the months ahead. Because of the effect that this development—which will doubtless be reinforced by the granting of future autonomous wage increases—could have on production costs and so on competitiveness, the efforts being made to ensure price stability ought to be increased.

1. Recent developments

The trend of foreign demand for iron and steel products, which had been weak since autumn 1961 and particularly hesitant since summer 1962, seems to have picked up somewhat during the second quarter of 1963. There was a moderate improvement in the backlog of orders in the iron and steel industry, due partly to an increase in the number of orders placed by non-member countries, partly to the brisk expansion of activity in some steel-using industries in member countries (motor vehicles and construction). Export prices did not, however, undergo any very appreciable changes: although since April the prices of exports to non-member countries have shown a slight upward trend, they had not by July regained the end-1962 level.

The expansion of home demand during the second quarter was very modest.

Expenditure on fixed investment does not appear to have significantly stimulated expansion. This seems to be particularly true of fixed investment by enterprises, and not only in the iron and steel industry but in all other industrial branches as well. From the information available it appears that in the building sector private and public expenditure did not even reach the level recorded in the second quarter of 1962. This development may, however, be due also to the fairly difficult supply situation in building and construction, which noticeably inhibited recovery after the winter.

On the other hand, private consumers' expenditure expanded appreciably. In fact, the income of households increased chiefly as a result of rises in wages and salaries due to adjustments under the agreement on a sliding wage scale, an increase in the wage rates in the iron and steel industry and in construction, an increase in the minimum wage, and improvements made during the summer in the wages and salaries paid by certain quasi-public institutions.

Industrial production made some recovery : according to the national index it touched the highest level reached since the third quarter of 1961, though still falling short, by 4.5 %, of the 1961 maximum. The year-to-year rate of growth in the second quarter was 2.6 % contrasting with a 2.3 % decline in the first quarter. In several branches of the economy, especially the electrical, building and mining industries, the progress made was above average. In the iron and steel industry production in the second quarter showed a year-to-year growth rate of 1 %, but the output of raw materials in July/August was 5.5 % higher than in July/August 1962.

The manpower situation was characterized by the fact that the total number of workers employed in industry and in construction was again below the level of a year earlier (down 2.4 % in the second quarter, as against 1.6 % in the first quarter). The total number of workers employed in the iron and steel industry and in mining decreased once again, continuing the regressive trend observed since the end of 1961, and the seasonal rise in the number of workers in certain branches of industry, particularly construction, was adversely affected by the marked manpower shortage. The total number of foreign workers in the second quarter of 1963 was 5.5 % lower than in the corresponding period of the previous year (2.8 % down in the first quarter). Unemployment continued to be negligible.

The third quarter saw a continuation of the more rapid rise in the cost-of-living index which occurred, owing to increases for bread and milk, between the first quarter and the second. The year-to-year increase was 2.8 % in the second quarter and 3.4 % in the third. The increase is, however, not entirely attributable to higher food prices, since there were increases in the prices of many other goods, fuel and light. In view of current price trends it is possible that the sliding wage scale will be applied a second time this autumn, as wages are now adjusted whenever the average increase in the cost-of-living index over the preceding six months is 2.5 points (formerly 5 points).

2. Outlook

It is by no means certain whether a swing in the basic trend of Luxembourg's exports has been achieved through the improvement observed since the end of the winter in the iron and steel industry. True, the stimulus exerted by certain important branches of industry in the buyer countries is likely to continue in the coming months. It is even possible that the weak trend so far noticeable in the capital goods industries of the member countries will in due course give way to something more favourable, and this too would benefit Luxembourg's steel sales. However, the possibilities of an improvement in exports also depend on the influence exerted by certain structural factors which by and large tend to keep the growth rate of iron and steel consumption below that of overall economic activity. These retarding effects have not yet been sufficiently reduced, even by the changes already made in the economic structure of Luxembourg and in the structure of its exports, to justify the expectation that there could be a vigorous revival of export activity.

In view of the very moderately expansionary outlook for demand from abroad and of the difficult supply situation in the building sector, it appears that in the coming months economic growth will not be significantly stimulated by gross fixed asset formation either, although investment expenditure in the new industries may increase further. Developments in the iron and steel situation are not yet likely to reverse the recessive trend in investment forecast in this sector, and in the building sector investment will probably continue to be restricted by the manpower shortage. Even though private demand for building may remain comparatively lively, public demand in the sector may even decline slightly. Therefore—taking all in all—the trend in gross fixed investment in the form of building will probably hardly change in the next few months.

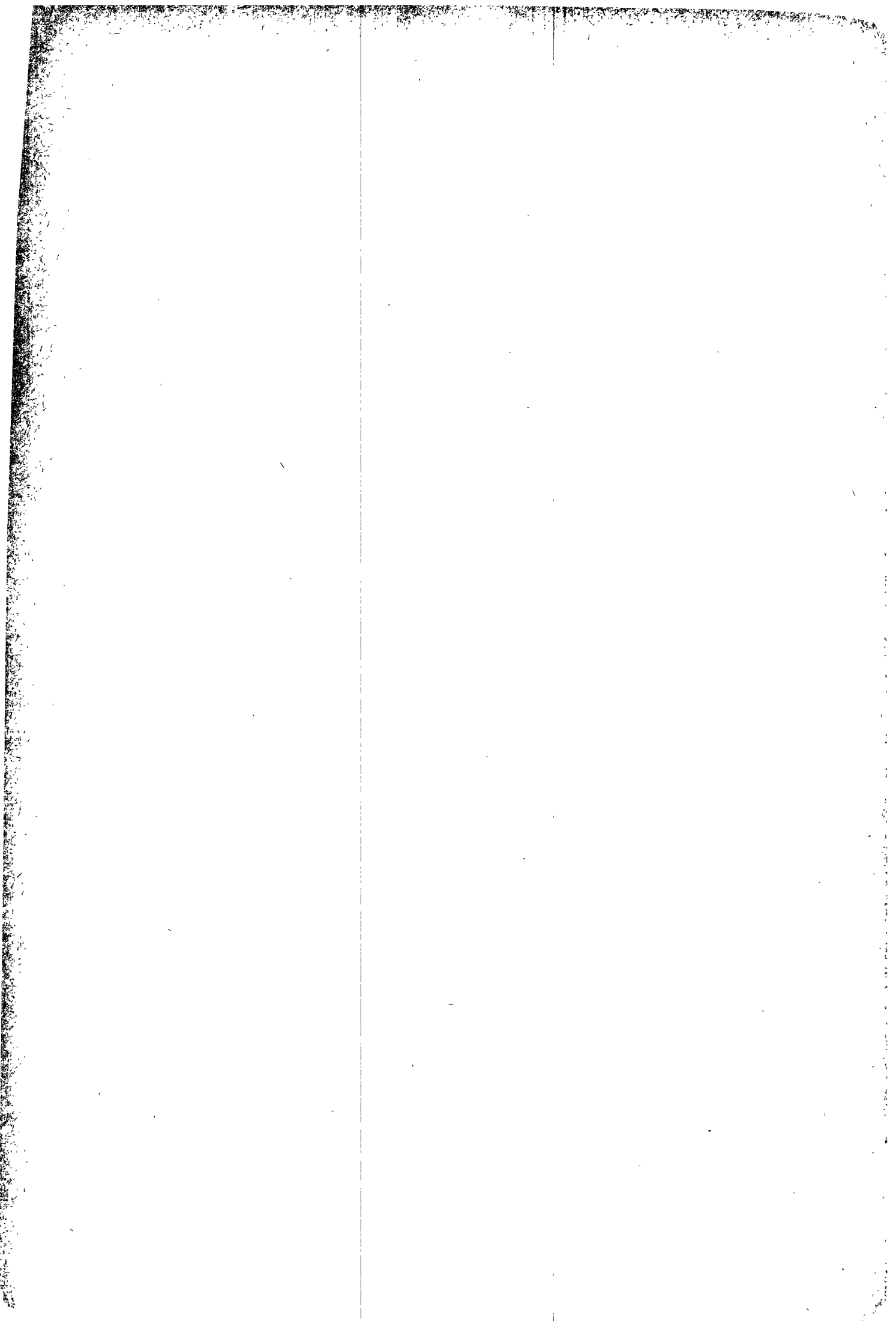
On the other hand, both private and public consumers' expenditure may well go on increasing. Expenditure by households, in particular, is certain to maintain the growth rate recorded thus far this year. Although the increase in overall employment has come to a standstill, the incomes of households will be augmented again towards the end of the year, largely as a result of the retroactive increase in the salaries of public servants.

The adaptation of supply to the trend of demand is likely to cause major difficulties only in the building sector and in certain services. Industrial production will probably stay slightly above the corresponding level of the previous year.

On the whole these trends suggest that the results for the full year 1963 will not noticeably differ from the estimates given in the preceding quarterly surveys. Real gross domestic product may show a very slight increase over 1962.

It is not, however, impossible that continued expansion of private consumption and a more vigorous increase in exports, coupled with the opening up of some new industries, may cause real gross domestic product to rise more significantly in 1964.

The latest developments in the cost-of-living index and in wages seem however to be pushing up unit costs, and this might impair Luxembourg's competitiveness abroad. Besides, demand in the building sector is likely to remain excessive in view of the manpower situation. It therefore appears necessary both to step up the efforts to recruit foreign workers and to encourage moderation on wages in just those industries most sensitive to costs. The hope of success in this direction will be greatly enhanced if the authorities pursue a policy which aims directly at stabilization of prices.



EUROPEAN ECONOMIC COMMUNITY

Economic Policy Committee

Economic Policy Committee on the economic budgets for 1964

Brussels, 9th July 1963

1. On 8 and 9 July 1963 the Economic Policy Committee discussed in detail the provisional economic budgets for 1964 and the policy problems arising from the overall economic forecasts thus made available for the first time. The Committee welcomed the fact that the budgets had been established and confronted along the lines and in accordance with the time-table laid down at its meeting of 7 and 8 March 1963. It expressed its satisfaction that it had in consequence been possible to achieve the essential aims—early information on the economic outlook and the shaping of policy on the basis of this information.

2. Collation of these forecasts at Community level is of course subject to certain reservations, notably on future price trends in several member countries and on the still provisional assumptions about the economic trend throughout the world in 1964. However, the Committee considered that the conclusions drawn from this overall survey were for the most part valid and that 1964 would see a continuation of satisfactory and also more balanced expansion if the appropriate economic policy were pursued. The gross Community product might rise at the same rate as in 1963—i.e. 4 % to 4.5 %; a decline of economic activity is in any case unlikely. A further rise in the level of employment is also to be reckoned upon, though it may well be slower than in 1962 and 1963. A slight easing of the labour market may occur. In all probability the growth rate of productive investment in the Community as a whole will be unchanged. Price increases will presumably tend to slow down, and in the balance of payments the current account will raise no particular problems. The Committee noted, however, that though the prospects of growth in most member countries seem generally favourable, in some countries (France and Italy in particular) the danger of continued inflation persists.

3. Pending a more thorough examination, later in the year, of the detailed economic budgets for 1964, the Committee expressed the view that in shaping their policies and in particular when establishing their budgets member countries should take the following considerations into account.

In countries where there is a danger that inflationary trends will continue, vigorous action should be taken to reduce excess demand and to halt the rise in costs. Preference should be given to selective measures, especially measures to limit the expansion of consumer expenditure in the public and private sectors. If, however, this selective policy does not suffice to stabilize prices in Italy and France, the only other solution is to introduce blanket restrictions, even if such action involves the risk of slowing down economic activity. The other Member States should keep their monetary and credit policy and budget and financial policy on the same lines as before, though caution would seem to be required with respect to the expansion of public expenditure. It would also be advisable for the member countries to pursue their efforts to apply an incomes policy which would take into account the principles put forward by the Committee in the memorandum it issued on 18 December 1962 on the question of bringing wages policy generally into line with anti-cyclical action.

Lastly, the Committee considered that there are other possible means of increasing supply on the home markets : a liberal attitude in tariff negotiations with non-member countries; more rapid tariff cuts within the Community, particularly in those countries in which the surplus on current account is again tending to go up; and intensification of vocational training and retraining. In the building sector it would be advisable, in order to combat the existing imbalance, to promote the rationalization of production and to improve the procedure for issuing building licences and the distribution of building activity over the year.