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

1

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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

In the last months of 1962 and at the beginning of this year the level of economic activity in the Community rose further; although in many sectors the pace at which production expanded suffered from the exceptional cold.

Total demand grew briskly. Exports to non-member countries continued, it is true, to show the hesitant trend which had been evident ever since spring 1962—in the fourth quarter they were hardly above the level of a year earlier and in the early months of 1963 they even fell below the corresponding level for 1962, owing in the main to difficulties of transportation between factory and port; but internal demand continued to expand. In particular, the growth of private consumption was again considerable, rising in step with the practically unabated expansion of income from wages and salaries. Public consumption and investment by the public authorities also provided the economy with an appreciable stimulus. Against this, the growth of capital investment by enterprises further weakened, except in Italy, where a perceptible recovery could be observed. Meanwhile, the unfavourable weather caused investment in the construction sector to fall off more than is usual at the time of year.

Until the end of 1962 this random factor hardly influenced industrial production as shown in the index of the Statistical Office of the European Communities; in fact growth even speeded up a little, the seasonally adjusted increase between the third and fourth quarters being about 2 %, after a rise of 1.4 % between the June and September quarters. The production index in the fourth quarter was up 6.4 % on the corresponding period of 1961.

Employment in the Community, after adjustment of the figures for seasonal variations, again rose, but in industry the increase was negligible. The speedier growth of industrial production therefore reflected an almost equally rapid rise in productivity.

The Community's imports of goods from non-member countries again advanced vigorously. In the fourth quarter of 1962 they were up 7.5 % by value over October-December 1961. As exports did not grow at the same time, the balance of trade deteriorated further: in the fourth quarter of 1962 there was a deficit of \$366 million—compared with approximate equilibrium in the corresponding period of the previous year. Official gold and foreign exchange reserves in the member countries went up \$201 million in the last quarter.

The upward trend of consumer prices continued at increasing speed towards the end of 1962, particularly as the cold weather forced up prices for some foodstuffs and fuels.

Even when these most recent economic trends are taken into consideration, no important changes are called for in the trend of demand in 1963 forecast in the fourth Quarterly Survey of 1962: very slight expansion in exports of goods to non-member countries, a moderate increase in overall investments, very vigorous—albeit somewhat slower—growth of private consumption and public spending.

When the cold spell abates there is likely to be a vigorous recovery of total industrial production and building activity. It will however probably not be possible to make up all the working hours lost in construction, particularly in view of the present labour shortage which almost all member countries are experiencing in this field. But the effect of these losses will probably hardly be felt so strongly as to call for any appreciable reduction in the 4.5 % estimate for the growth rate of the gross product of the Community made at the beginning of this year. As foreseen, industrial production may rise by 5 %, and imports will continue to grow roughly as predicted, so that the trade balance will once again deteriorate, even if less sharply than between 1961 and 1962.

The upward movement of prices should calm down appreciably unless the latest rises, which were mainly due to random factors, again aggravate the upward trend of labour costs and thus reinforce the longer-term rise in the level of prices. The Governments of most Member States are therefore rightly seeking to take even more vigorous stabilizing action while being careful to avoid, as far as possible any measures adversely affecting the growth of investment—which in any case has already weakened—and, consequently, of supply.

A. Recent developments

1. Demand

The expansion of total demand continued in the fourth quarter of 1962 and at the beginning of 1963, but was exclusively due to the vigour of internal demand in the Community. External demand—in the sense of effective exports of goods and services to non-member countries—continued to stagnate, as it has done since the spring of 1962. In the fourth quarter of 1962 customs statistics show the value of exports of goods to have been only 0.7 % higher than in the corresponding quarter of the previous year, after having fallen 1.7 % below the 1961 level in the third quarter. In the first two months of the current year exports were probably again lower than in January/February 1962. This, however, was probably due to the extremely cold winter in Europe and the waterfront strike in the United States.

In the fourth quarter of 1962, as in the preceding quarter, there was a rise—albeit a slower one—in the year-to-year growth rates of exports to the United States of America and the combined industrialized non-member countries in Europe. Exports to the developing countries were still considerably below the corresponding level of the previous year.

If the Community's exports to non-member industrial countries advanced only moderately, this is mainly because economic expansion in these countries was generally very slow. This applies to the United States no less than to the others. Here the seasonally adjusted real gross national product rose between the third and fourth quarters of 1962 by 1.4 %, which was more than between the second and third quarters. But this expansion was based on an increase in private consumers' expenditure, particularly on motor-cars and services, and on a rise in public spending, while exports and private investment tended to yield ground. From July 1962 until at any rate January 1963 there was no rise in industrial output. In the fourth quarter imports of goods from the Community were only about 2 % higher in value than in the corresponding quarter of 1961.

The development of the economic situation varied greatly in the EFTA countries, but on the whole expansion slowed down. Nevertheless, in the fourth quarter the Community stepped up its exports to this area by 5.7 % compared with the corresponding period of 1961. Exports to the United Kingdom continued to be very hesitant. With investment by enterprises declining and exports stagnating, Britain's industrial output and the adjusted gross national product even fell 1 % compared with the third quarter, and unemployment consequently rose sharply. Against this, Community exports to the other EFTA countries except Portugal still showed considerable growth rates, particularly in the case of countries like Austria, Switzerland and Denmark, where domestic demand in some branches is more or less over-heated.

The amounts of foreign exchange available to the developing countries are the chief factor influencing Community exports to them. In this respect there seems to have been no basic change in recent months despite an appreciable improvement in these countries' overall balance of trade thanks to their cautious import policy and the recent price rises on world markets for raw materials—attributable less to higher demand than to factors on the supply side. It is true that the sterling area countries succeeded in improving their foreign exchange position but this was more than offset by losses of foreign exchange in the Latin-American countries, where balance-of-payments difficulties continued, influenced not least by some flight of capital.

In addition, the expected increase in Community exports to Algeria has so far not proved vigorous enough : the value of exports in the fourth quarter was still 25 % below the level of October-December 1961. Against this, exports to the other countries and territories associated with the Community showed a year-to-year growth rate of 5 %. Exports to Latin America in the fourth quarter of 1962 were 27 % below the December quarter of 1961. Taken as a whole, the Community's exports to the developing countries in the last three months of 1962 were 8 % down in value on the fourth quarter of 1961.

Unlike external demand, internal demand remained dynamic, although the growth of gross fixed asset formation in the fourth quarter and especially in the early months of 1963 probably weakened appreciably. This is largely attributable, however, to the extremely unfavourable weather conditions, which had an increasingly adverse effect on investment in construction. There has been no essential change in the underlying trends as described and elucidated several times in these Surveys : persistent slackening of the growth of fixed investment by enterprises—in particular on equipment; slightly faster upward trend in public fixed investment; lively demand for housing, generally in excess of the possibilities of supply. It is noteworthy that, with certain differences in degree, these trends are present in almost all Community countries. In Italy nevertheless there was in the fourth quarter some recovery of private investment in equipment, and in the Federal Republic of Germany the tendency to weakness was temporarily halted.

On the whole investment in stocks did little to boost expansion. In most member countries imports of raw materials continued at a low level in the fourth quarter, although signs of some recovery were discernible in Italy and in Belgium. The rundown of stocks of iron and steel semis held by dealers and users continued, but a slightly improved trend has appeared since the end of 1962. In coal-mining the elasticity of production is relatively slight and the cold weather led to a sharp fall in pithead stocks.

Unlike investment expenditure, consumer spending continued to grow briskly, sometimes at an even more rapid pace than before. This applies both to public consumption—particularly increased expenditure on personnel—and in most member countries, to private consumer spending also. In France, Italy and Belgium at any rate the

rise in this latter category speeded up slightly. Only in the Federal Republic of Germany did consumer demand expand somewhat less rapidly in the last months of 1962 than in the first half of the year. The real expansion of consumption was in general somewhat hampered by the rise in consumer prices—a factor increasingly felt in the early months of 1963.

The increased spending by private consumers was largely due to the general expansion of incomes, which was quite considerable in all member countries. Thus the rise in wages and salaries in the Netherlands and France again gathered speed between the third and fourth quarters. In the Federal Republic of Germany, however, the growth rate of earned incomes tended to slacken off, less because of any abatement of the rise in hourly earnings than because of a quite appreciable slowdown in the expansion of the number of persons in employment, coupled with a perceptible reduction in the number of hours worked.

The growth of consumption again occurred mainly in consumer durables and services. In France and Italy, in particular, new motor vehicle registrations rose very considerably. In the fourth quarter they were 30 and 43 % higher in the two countries than a year earlier. At the beginning of 1963 the cold weather caused certain shifts in the pattern of consumption—spending on fuel, heating apparatus, winter clothing and food rose more sharply.

2. Supply

In the fourth quarter of 1962 and at the beginning of 1963 supply from domestic sources again rose—the increase at the beginning of the year being doubtless very small because of the bad weather.

In agriculture, where crop production is in any case limited at this time of year, output was very badly hit by the weather. On the other hand there was a clear rise in livestock production on the whole, though the output of milk also suffered from the cold spell.

The growth of industrial production even speeded up a little between the third and fourth quarters, although the average of the SOEC index for the fourth quarter ⁽¹⁾ was a little less above the corresponding 1961 figure than had been the case in the third quarter (6.4 % as against 6.7 %). About 2 % may be given as the rate of economic expansion between the third and fourth quarters of 1962, compared with 1.4 % between the second and third quarters.

(1) Exclusive of construction and food, beverages and tobacco.

This speed-up was not only to be observed in France—where with more manpower available the upward trend was very pronounced—but also in Italy and in the Federal Republic of Germany. Particularly in Italy, with the strikes over and investment in equipment rather livelier, the rise in production was brisker during the fourth quarter than in the preceding months.

In basic products developments continued to be very sluggish. Iron and steel output was almost completely stagnant and order books again shrank. The amount of coal mined rose only slightly despite the higher demand—mainly directed, however, to particular varieties—due to bad weather. The chemical industry alone continued to expand its production vigorously.

In most capital goods industries the growth of output has been modest. On the other hand the consumer goods industries as a whole, including textiles from September onward, stepped up production considerably. Growth was specially vigorous in some industries turning out consumer durables : the production of passenger vehicles in the fourth quarter was up 25 % on the corresponding level of the previous year.

Expansion continued in the services sector. It is true that loading and unloading in ports and on inland waterways was adversely affected by the long freeze-up, which even put some inland waterways completely out of action in the early months of 1963. This, however, considerably stimulated road traffic, and even more the transport of goods by rail.

The number of persons in paid employment increased further in all member countries, but at a rather slower rate than hitherto, especially in industry. In view of the slight acceleration in the growth of production it may be concluded that the tendency towards improved productivity noted since the spring of 1962 has on the whole been maintained.

It was in Italy that employment rose most vigorously up to the end of the year. According to Ministry of Labour figures, the number of unemployed in the country fell in 1962 by no less than 250 000, or 18 %. In France the increase in employment even speeded up towards the end of the year. The seasonally adjusted figure for unemployment, which had risen in the autumn largely on account of the influx of persons returning from Algeria, again fell back a little in the October-January period. In the other member countries the underlying labour market trends have hardly changed. The exceptionally cold winter weather was generally not reflected in unemployment figures before the end of January when, as was to be expected, its effect was specially severe in the branches connected with building and other activities which depend on the weather.

3. The balance of the markets

A fresh increase in the Community's imports helped to maintain balance between total demand and supply. Customs statistics show that in the fourth quarter the value of goods imported from non-member countries was 7.5 % higher than in the same period of the previous year.

This quite considerable increase in purchases from non-member countries consisted largely of heavier imports of finished goods, in particular consumer goods and motor vehicles. Still incomplete figures for imports by categories of goods in the last quarter of 1962 also show larger imports of energy products—a development which is likely, in view of weather conditions, to be much more pronounced in the early months of 1963. Imports of raw materials were on the other hand decidedly hesitant in most member countries, at least up to the end of 1962. Imports of food products also clearly slowed down in the Community as a whole; although in Italy—in contrast to the other Community countries some crops were less favourable in 1962 than in 1961—imports of farm products from outside the Community increased vigorously. The trend of Community imports from the various areas of origin was decidedly uneven, the EFTA countries profiting most from demand in the Community. In the fourth quarter their deliveries to the Community were up 11.1 % in value over the same period of the previous year; the year-to-year growth rate of purchases from the United Kingdom alone was 16.1 %. United States sales to the Six in the fourth quarter of 1962 were still some 6.4 % higher than in the same quarter of the preceding year, while imports from the associated countries and territories did not quite reach the level of October-December 1961.

Trade within the Community again gathered some momentum in the final quarter of the year. According to customs statistics of imports it was up 16.8 % in value on the same period of 1961, after a year-to-year growth rate of 12.6 % in the third quarter. Figures available on the development of trade by classes of goods indicate that on the whole the slowdown of trade in farm products was more than offset by higher purchases and deliveries of consumer goods. The Federal Republic of Germany, France and Italy, where consumption is expanding faster than in the other countries, greatly stepped up their purchases of consumer goods in the partner countries.

Of the individual member countries' accounts for intra-Community trade, the Italian account showed appreciable deterioration partly because of smaller deliveries of farm products. The still considerable export surplus of the Federal Republic of Germany also declined unmistakably in the fourth quarter.

Against this the improvement in the balance of the Belgo-Luxembourg Economic Union undoubtedly gathered further strength, with exports of capital goods and industrial semi-products rising vigorously. In France and the Netherlands the balance showed no change worth mentioning.

Price trends have changed but little, continuing to rise in services, while in the case of numerous industrial products there is a weakening of the upward push—the exception to this rule being certain goods which are much in demand to satisfy rapidly expanding private consumption. The upward movement of consumer—and of wholesale—prices in the fourth quarter and early 1963 clearly speeded up but this was mainly due to the effect of unfavourable weather conditions on the price of foodstuffs and fuels and to higher world market prices for some raw materials. Administrative price increases affecting rents, tobacco and public transport were an additional factor in some member countries.

On the whole the level of consumer prices at the end of 1962 was 6.4 % in Italy, and 4.6 % in France, higher than in December 1961. For the same period the increase in the Netherlands was 3.8 %, in the Federal Republic of Germany 2.9 %, and in the Belgo-Luxembourg Economic Union about 1 %.

The growth of imports, with exports more or less stagnating, caused the Community's balance of trade to deteriorate in the fourth quarter. There was an import surplus of \$366 million whereas in the same period of 1961 imports and exports had been almost in equilibrium. For this reason particularly the Community's overall balance on current account will probably have suffered a further distinct tendency to deteriorate. This probably applies also to the early months of 1963, when the long cold spell led to higher purchases from non-member countries.

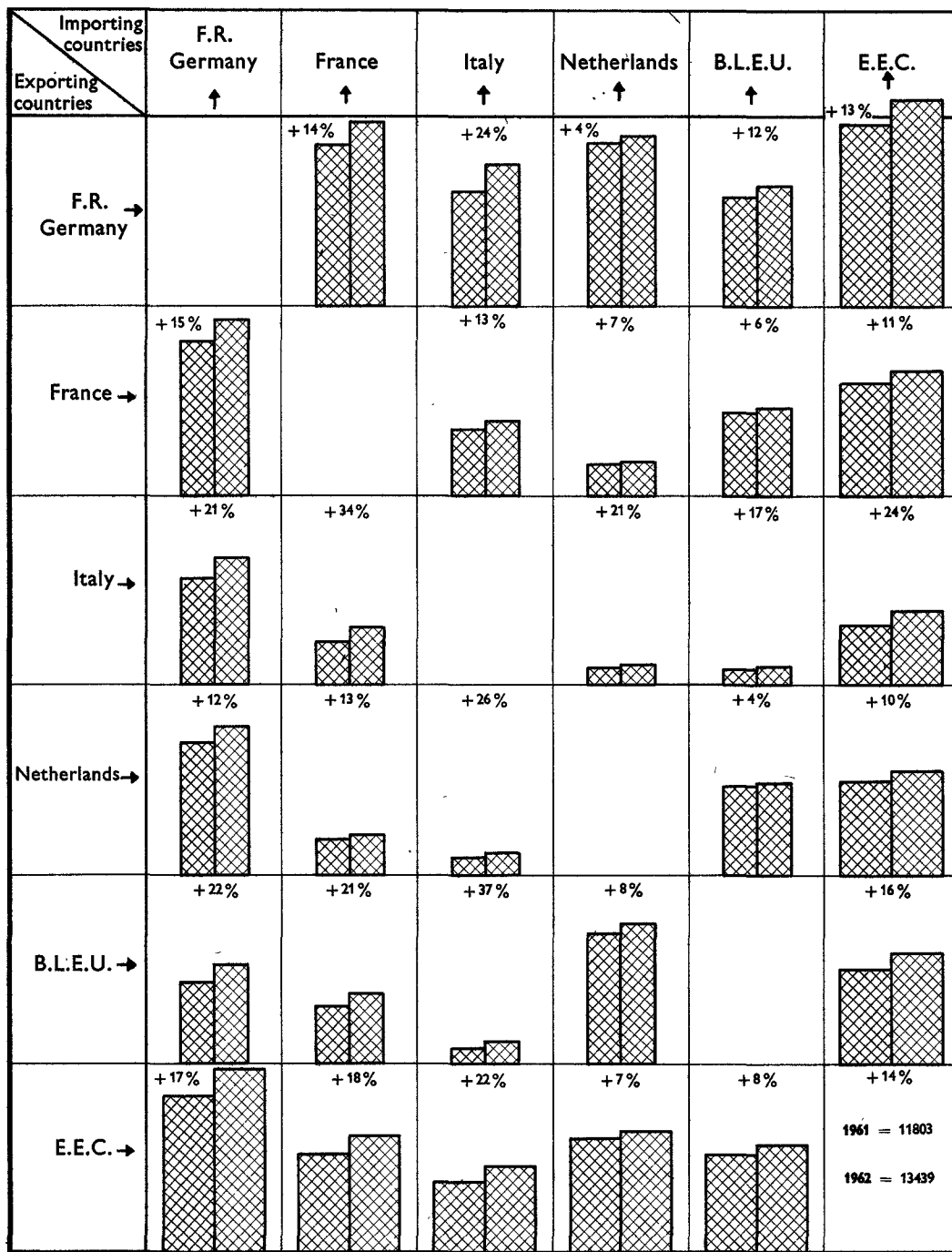
The rise in the official gold and foreign exchange reserves clearly weakened. The increase between the third and fourth quarters of 1962 was no more than \$201 million, compared with \$308 million in the third quarter. In the first two months of 1963 the official gold and foreign exchange reserves rose by a further \$74 million.

When allowance is made for seasonal influences, the monetary trends described in the last Survey have on the whole continued; predominance of forces making for greater liquidity in France and Belgium, and a tendency for liquidity to contract in the Federal Republic of Germany and Italy. The liquidity policy of the monetary authorities also continued without basic change. An exception is the Netherlands where, with the reduction of Bank Rate in January to 3.5 % and the suspension of the agreement between the Central Bank and the commercial banks to limit the expansion of credit, the policy of curbing liquidity was abandoned. In fact the expansion of the volume of bank credit had sometimes remained considerably below the permissible amount, one reason being the weakening of the propensity to invest.

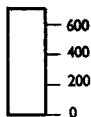
Internal liquidity throughout the member countries in the fourth quarter was favoured by the cash transactions of the public authorities. Capital markets, too, were

INTRA-COMMUNITY TRADE

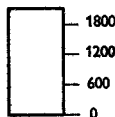
In million dollars



member countries



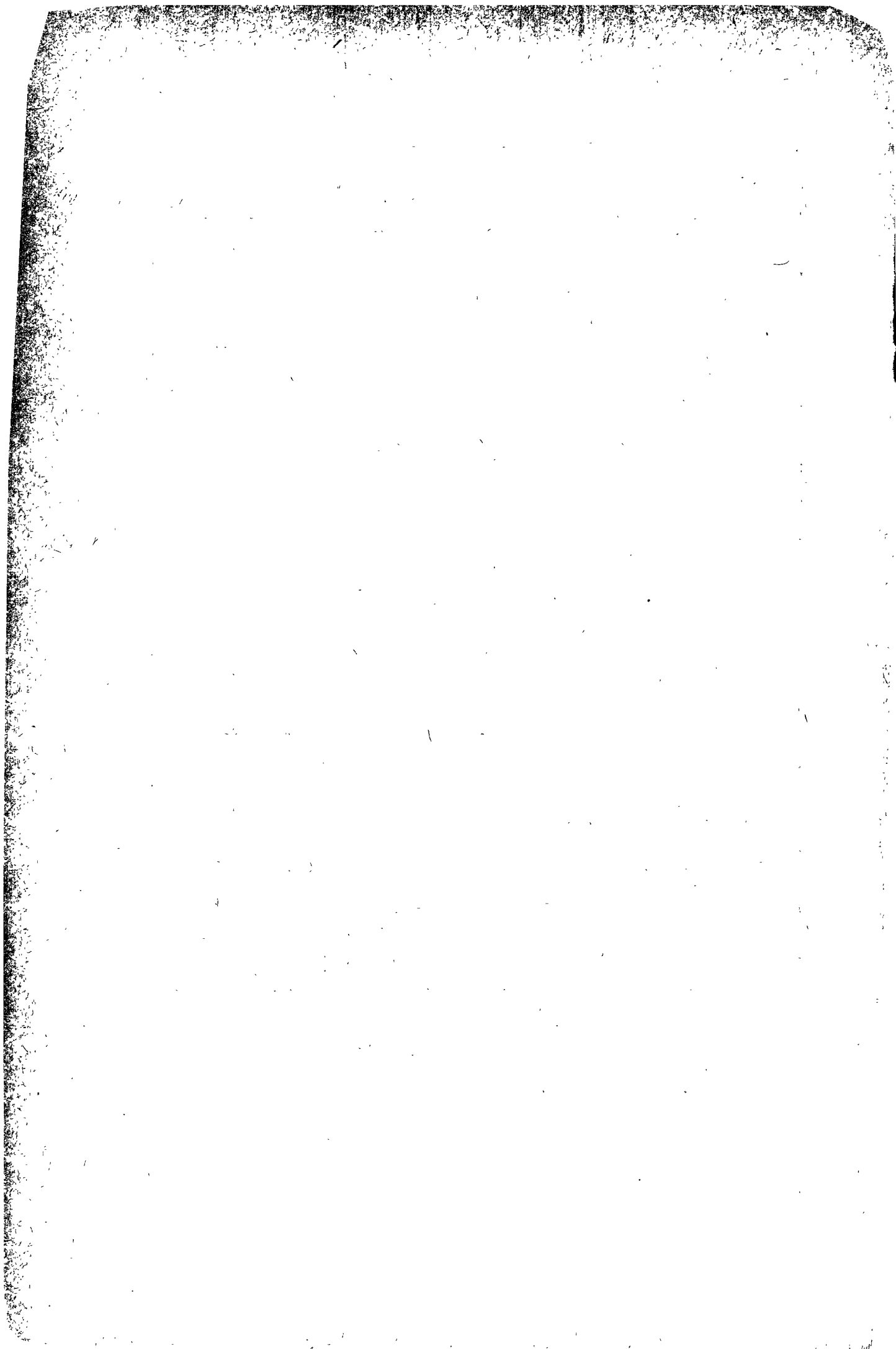
EEC



1961 = 11803

1962 = 13439

The figures for each trade flow are based on the average of the customs returns on both sides of the frontier.



well supplied with funds. At the beginning of 1963, considerable public loans were floated in the Federal Republic of Germany, the Netherlands and Belgium without causing undue strain. In Italy the capital market was further eased by large-scale redemption of public bonds in January. As the supply of capital increased—one reason being an improvement in public confidence—enterprises were again able to raise larger amounts of capital for the first time since mid-1962.

B. Outlook

Economic expansion in the Community should continue in the coming months : growth of demand will be almost entirely due to internal demand, with little contribution to be expected from external demand.

In fact the prospects for the Community's exports to non-member countries have not changed materially. The impression has been gaining ground that business activity in the industrialized non-member countries as a whole will maintain its very modest growth.

The business situation in the United States, for instance, has been shaping rather more favourably than was foreseen in the autumn of 1962. Against this, the latest trend in the United Kingdom has been more subdued, but the British Government nevertheless seems to be stepping up its efforts to get the economy moving again. Finally, the higher prices of raw materials could have certain stimulating effects on world business in the course of the year.

However, the determining factors which can be discerned in the United States economy still provide a very mixed picture. The tendencies visible in the trend of private consumption point to continuing expansion in the near future, and public spending will probably be stepped up appreciably, but new orders booked by the processing industries showed fresh signs of sagging at the end of 1962, while investment can also be expected to stagnate further. The tax reduction measures announced at the end of 1962 have now, however, been more closely defined : they provide for tax abatements totalling \$10 000 million net over the next three years, and this may mean that, after very moderate growth in the first half of the year, expansive forces will again predominate in the second. The decisive factor here will be whether Congress approves the fiscal measures without delay. If it fails to do this, the impact of the proposed measures is likely to be very slight in 1963, and in addition the psychological effect on investors may well be unfavourable.

Although the uncertainties surrounding United States economic policy call for caution in forecasting possibilities of export to that country, it seems reasonable to count on a slight increase. This expectation should also be justified in the case of the Community's deliveries to the United Kingdom, although here the economic situation is still stagnant. At the beginning of this year, however, further measures were taken to boost expansion : indirect taxation was reduced, transfer incomes increased, regional investment programmes stepped up and Bank Rate cut to 4 %. In addition an increase in spending of approximately 10 % under the 1963/64 budget was announced at the beginning of the year. Although the immediate prospects do not yet point to any recovery, it is perhaps possible to count on a resumption of economic growth later in the year.

The outlook for Community exports to the other industrialized countries again appears more favourable than for exports to the United States and Great Britain. Nevertheless, in view of the perceptible tendency for investment activity to slacken off in these countries too, the growth rates will probably decline a little. Prospects for deliveries to the developing countries continue to be uncertain : for the foreign exchange situation of these countries at the end of 1962 does not give an encouraging picture of their ability to pay for imports. It is not yet possible to say how far the improvement in the price of certain raw materials and the return to more normal conditions in Algeria will improve the situation.

In contrast to the relatively quiet outlook for exports, it can be expected that internal demand in the Community will continue to grow considerably in the coming months.

Nevertheless, it is clear from the most recent available figures on investment projects and on new orders to the capital goods industries that the further expansion of investment in plant by enterprises will be at best very moderate. True, the recovery in the growth of this type of investment observed in Italy towards the end of 1962 may continue. As against this, however, investment in the Federal Republic of Germany is likely to flatten out, if not even to decline slightly, particularly with the accelerated run-down of the backlog of orders for capital goods—and with new bookings less brisk for some time past. Similar tendencies can be seen in the Netherlands, and in Belgium a certain slowdown in growth must in any case be expected. In France, too, the growth of private capital investment is likely to be slower, although publicly-owned enterprises may well invest more.

No important change has taken place since the last Quarterly Survey in the factors influencing the propensity to invest. The slower growth forecast in labour costs per unit of output might indeed help to improve profits, but this is hardly likely to have any appreciable beneficial effect on investment in 1963. Moreover, as the manpower situation eases, the incentive to rationalization investment may tend to flag.

All in all, as explained in detail in the fourth Quarterly Survey of 1962, the factors inhibiting investment activity will continue to predominate. Nor should it be forgotten that the unusually cold winter will adversely affect the volume of construction generally for 1963; the estimates for this had been made on the assumption that weather would be normal. In fact, given very pronounced shortage of manpower in the Community—particularly in the Federal Republic of Germany and the Netherlands—it is hardly to be expected that the delays that have occurred in current expenditure on construction can be completely made up later in the year.

In contrast to the probable trend of investment by enterprises in the Community there will be a vigorous increase in investment by the public authorities everywhere except

in Luxembourg. In Italy especially its growth should be considerable. As construction is a highly mechanized sector, the likelihood is that output will rapidly increase and thus make up for losses caused by weather.

All in all the real increase in the Community's total gross fixed asset formation between 1962 and 1963, forecast at about 5 % in the last Survey, could be somewhat lower.

The rise in expenditure on consumption should be more or less as forecast, i.e. it should continue to be quite vigorous, if somewhat slower than in 1962. This holds for spending by the public authorities, but even more for spending by private consumers. Growth will remain lively, especially in Italy and France, while there are signs that it is weakening in the Federal Republic of Germany, mainly because of the slower expansion of wages and salaries.

On the whole supply will have no difficulty in keeping up with the trend of demand, though the situation may be more or less difficult for individual items : markets for raw and basic materials and semi-products will be quite easy, with even tendencies to over-supply; capital goods will experience no great difficulties; various necessaries and consumption goods, services, and in particular construction, will be more or less under strain.

After the probable slowdown because of weather conditions in the first months of the year, industrial production should grow faster in the spring. Measured by the index of the Statistical Office of the European Communities, there is no reason to suppose that it will not reach the year-to-year growth rate of roughly 5 % over 1962 forecast in the Quarterly Survey 4-1962.

Assuming that weather conditions for the remainder of the year are normal, the same will apply to the growth of the combined gross national products, despite the production lost in the construction sector, and perhaps also in certain farm products, as a result of the cold winter. Real expansion between 1962 and 1963 could be about 4.5 %.

The increase in imports from non-member countries will continue, even if somewhat more slowly : imports of consumer goods (with the exception of some foodstuffs) will gain in importance. The tendency for the Community's trade balance to deteriorate is likely to continue, even if less markedly than in 1962.

After the quite appreciable price increases towards the end of 1962 and particularly in the early months of 1963, a phase of more stable prices may occur later in the

year, the more so as some farm prices will fall a little if once the winter is over and the weather becomes more or less normal.

It is not to be expected, however, that the general level of consumer prices will return to where it was at the beginning of autumn 1962, since rising price trends for services and manufactured goods have continued and will continue, even if to some extent more slowly in the case of the latter, and because further administrative price increases are likely to be introduced by the public authorities. Moreover, it is not possible to ignore the danger that, owing to imperfect competition in some branches of production, and particularly of distribution, price falls will not be sufficiently pronounced; this danger may be accentuated by the rather too lively expansion of private consumer demand in some member countries.

It is clear in these circumstances that the problems of stabilizing prices has become the key to economic policy and government action. It must not, however, be forgotten that not all the means used in the past to counter the upward movement of prices can be applied today without doing grievous damage to economic growth, particularly as the trend of investment by enterprises is already faltering.

Wherever there is reason to fear an acceleration of the upward development of incomes following price rises attributable solely to the weather, it seems quite appropriate for Governments to apply measures specifically intended to curb rises in the price of representative consumer items in order to tide over the spell of severe strain. Otherwise wherever sliding wage scales connected with price indices exist, we would undoubtedly have to expect that they would be applied. This in its turn could mean that the slowdown in the increase of unit costs, which some countries hope to see in 1963, might never occur. The growth of private consumers' expenditure which for some time now has appeared to be rather too fast in several member countries, would then also remain too high, to the detriment of the growth of investments by enterprises. In those countries where the sliding wage scales in current use exert such influences, it would perhaps be useful to consider whether in the end machinery of this sort is really still needed at all when there are wage-policy criteria which are more favourable for the wage-earner of today than the mere maintenance of the purchasing power he has acquired.

These dangers would certainly be reduced if there were already an incomes policy which took account, independently of extreme but ephemeral seasonal influences, of the immediate and of the longer-term factors essential to price stability of adequate economic growth (particularly therefore of a satisfactory expansion of investment) and also of a reasonable sharing of the national income. Efforts to develop an income policy in most Member States appear so far to have made little progress. In some of them it is particularly important to provide the statistical, institutional and political bases—including not only short- but also medium-term forecasts in terms of national accounting—and to

use these as a foundation on which to plan overall economic policy, including incomes policy. In this connection it seems advisable at certain stages of this work—before its conclusion—that the planning authorities should be prepared to undertake any necessary consultation with the main sectors of the population, in particular with the employers' and workers' organizations.

An incomes policy suited to the requirements just outlined could in any case only be applied successfully if the development of monetary demand did not make it too easy for incomes to increase excessively. Member countries with high balance of payments surpluses are naturally more or less exposed to such potential dangers. They are a source of anxiety at present in France, where repatriation from Algeria has also led to an influx of liquidities which it is difficult to measure, and to the release of savings which are partly being spent on consumption. Here there is every reason to adopt a policy of deliberately limiting that growth of short-term operational borrowing which facilitates the financing of excessive wage increases and encourages the raising of prices. The French Government in fact took measures of this kind at the end of February, endeavouring at the same time to ensure that investment credits should not be affected. It may, however, be asked whether measures should not be taken to give even greater encouragement to savings, particularly by workers and to improve contacts between markets for short-term and long-term investment of savings.

In general, the authorities endeavouring to counter the tendency for prices to rise in the Community would be well advised to refer to the views expressed by the Economic Policy Committee in the autumn of 1962. The Commission has adopted the Committee's suggestions and forwarded them to the member countries in the form of recommendations. The Committee stresses that in those sectors where there is excess demand a policy of curbing its expansion should in fact be pursued. In some member countries this should be done especially by pressure on consumer demand—primarily through the income policy referred to—and on building—by cutting back both State subsidies and direct State expenditure on surface construction. On the other hand the Committee does not consider those fiscal and credit restrictions opportune which would militate against investment by enterprises.

The Committee also recommended action to increase supply and to improve its elasticity. Among measures to serve the first purpose, the Economic Policy Committee attaches value to facilitating imports by reducing customs duties in trade both within the Community and with outside countries: within the Community under Article 15(2) of the Treaty, and on imports from the outside world by joint decisions to reduce rates of duty under the common external tariff on the basis of reciprocity. Autonomous advance reductions of internal customs duties can be made relatively rapidly. In view of the fact that the demand/supply situation for the same goods still varies from one area of the Community to another, such a policy can make an essential contribution to improving the balance in some member countries.

Policy on trade with the outside world should also continue to be liberal. Here the Community can already point to several measures already in force. Italy and France have recently taken new steps to liberalize their trade; with very few exceptions imports of manufactures into the Community from non-member countries are fully liberalized; allowing for actual and foreseeable amendments, the incidence of the common external tariff over the Community area as a whole is lower than that of the previous tariffs of the member countries; all the measures by which the member countries have sought to liberalize capital movements among themselves have been in their essentials extended to non-member countries. The common agricultural policy, which must necessarily have certain protective effects, not least because of the farm policies followed in some important non-member countries, is in any case more liberal than the previous policy of the individual member countries. It puts an end to the protectionist barriers between them. As to its effects on non-member countries' exports to the Community, what has so far been created—the organization and procedures of the common agricultural policy—is in itself completely neutral. It is a machinery which can equally well serve liberal or protectionist ends. Whether or not imports fall in the long run to any marked extent depends mainly on the price policy decisions to be taken by the Community. In the end high Community prices for cereals will have a restrictive effect on imports: this also holds good for the imports of livestock and livestock products, where prices depend directly or indirectly on the Community's price arrangements for cereals. It is clear that relatively high farm prices are also undesirable for such economic policy reasons as the stabilization or stability of the general price level in the Community.

In general it may be said on the question of import policy that measures which encourage imports should not be rejected simply for fears that they will further inhibit the propensity of undertakings to invest or even endanger the balance of payments. If rising prices and costs are not energetically countered by these means too, they will be all the more likely to maintain their momentum and later lead in fact to an undesirable drop in investment or to serious balance-of-payments difficulties.

In the present economic situation it is obvious that measures which might hamper imports and thus make internal price rises more likely are not without their dangers. Even if fiscal or other reasons provide legally valid arguments for increasing the taxes on imports—how far this is the case is not at issue here—it must nevertheless be noted that such measures at the present time could make the economic situation more difficult.

The characteristic feature of the present and probable business trends in the Community is not, however, just the existence of price problems but, as has often been pointed out, the coupling of these problems with the sluggish trend of investment by enterprises. For some member countries the estimated changes in the annual figures for 1963 as against 1962—although still denoting some rise for the year—already mean that a downturn in business must be expected in 1963 particularly towards the end of the year. The danger of this trend continuing in 1964 cannot be entirely excluded. This would mean

that, taking the year as a whole, the decline in the growth rate of investment by enterprises which has been going on since 1961 would give way to shrinkage in absolute terms.

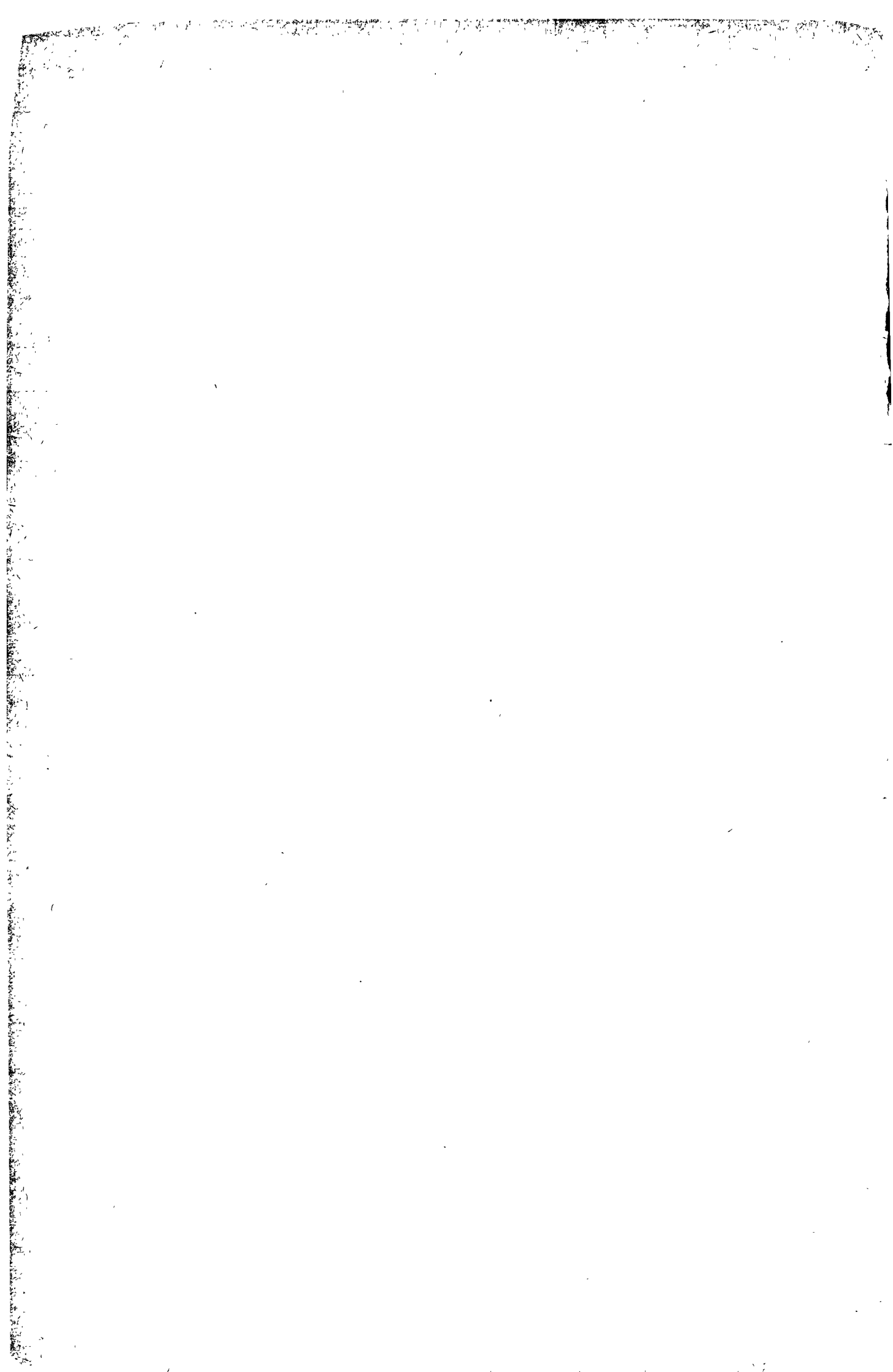
In this connection the future trend of business in the non-member countries seems to be important. If the United States and British Governments—the former in particular—do not succeed in really getting their national economies off the ground by the end of 1963, the direct and indirect effects of a more or less stagnant trend in the economy of these countries could again impair the propensity of Community enterprises to invest. It is not yet certain that reflation policy in the countries referred to will not again be hamstrung by balance-of-payments considerations.

In these circumstances the expansionary forces within the Community itself acquire increased importance. If there is to be further favourable economic development, and in particular if investment in the Community is to be underpinned, the „EEC factor”, i.e. the driving force generated by the progressive implementation of the customs union and the economic union, by the rapid expansion of internal trade and, in increasing measure, by the development of common policies in the most varying fields, particularly investment, must continue to operate.

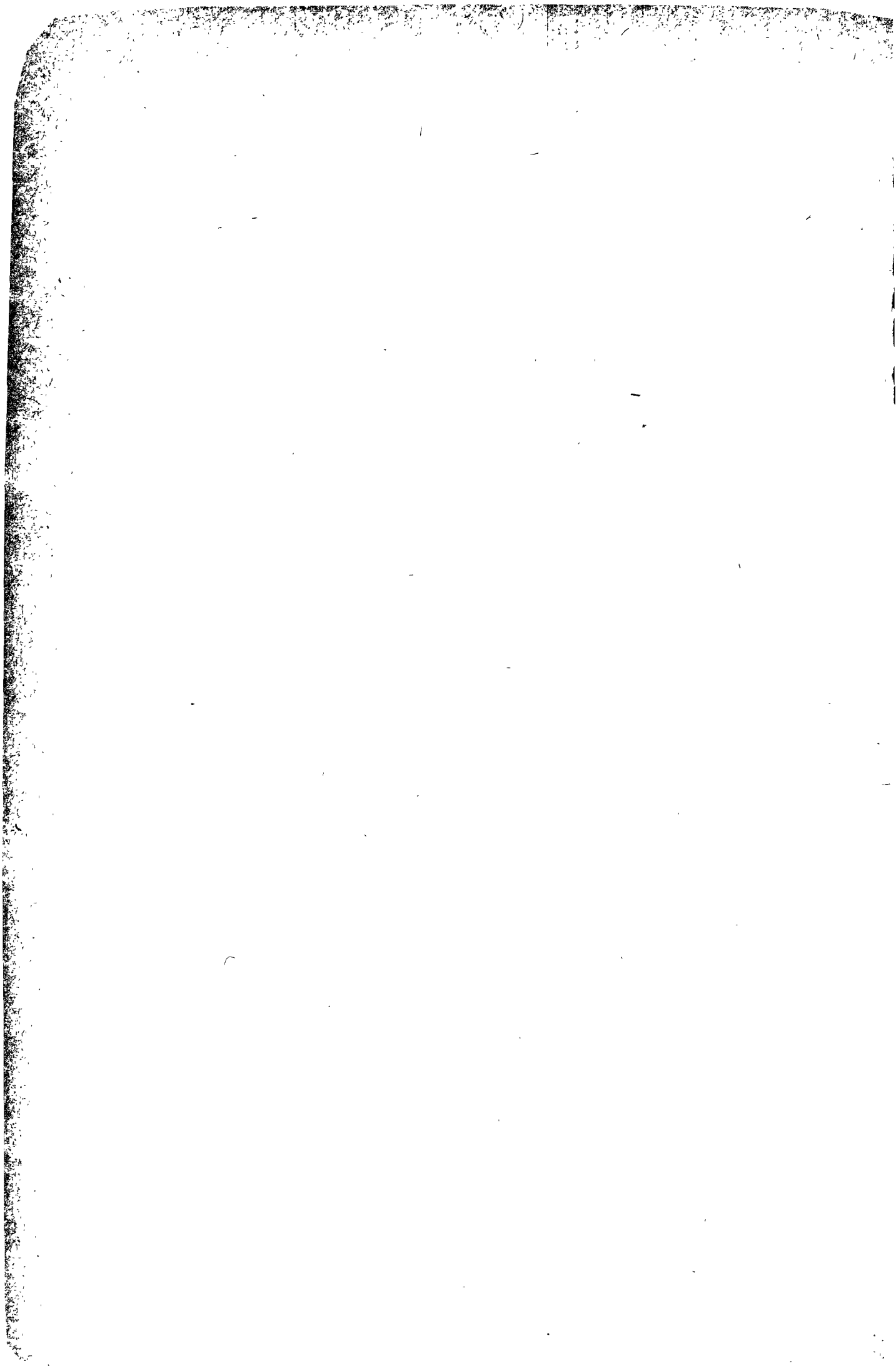
The authorities in the Community responsible for economic policy will also have to keep a close eye on the way investment by enterprises is developing and, where necessary, to take action to support it. In most member countries, however, there is at present no call for such action, since investment trends cannot yet be foreseen with sufficient certainty and since, in the short run, the expansion of other elements of demand is at present sufficient to ensure general economic growth. But even if a relative fall in directly productive investment is considered to some extent as a structural phenomenon—in the sense of a shift in the use made of the national product : increase in the share of consumption, return of economic growth to normal after the very rapid expansion in the first fifteen post-war years—it will none the less be necessary to see that this shift does not go too far if adequate expansion of the national product and full employment of the factors of production are to be ensured in the longer run. In this connection it must be remembered that the effects of rapid technical progress—which, from the economic angle, greatly shorten the life of capital goods—increase the importance of replacements. The result is that today a relatively high gross investment ratio is needed to achieve the net investment required for adequate growth.

Whatever happens, any appreciable absolute decline in investments by enterprises will have to be prevented, the more so as it could have cumulative effects which would also taken the drive out of private consumer spending. Even if this did not occur, a fall in directly productive investment would in any case limit the real growth possibilities of supply—and this would inevitably result in an even greater tendency for prices to rise.

Although in the aggregate there is still excess demand in various member countries, the outlook by sectors (consumer goods and services on the one hand and capital goods on the other) differs quite widely, at least if present business trends continue, and it would be not at all illogical or even "inflationary" to envisage measures to stimulate demand for capital goods should investment activity in fact weaken very greatly. The rise in prices and costs which was not prevented earlier—when there was still time—cannot be halted simply by allowing a considerable shrinkage of investment by enterprises.



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



A. Federal Republic of Germany

Economic expansion continued throughout the fourth quarter of 1962 and into 1963, although the cold spell greatly hampered activity in sectors dependent on the weather. Exports were once again somewhat more lively. The decline in the expansion of private investment came to a temporary halt. Public expenditure on investment and on consumer goods rose sharply. On the other hand, the vigorous expansion of private consumption levelled off a little.

Despite continuing tightness in the labour market, production rose appreciably. In the fourth quarter industrial production was 5.8 % higher than in the corresponding period of the previous year. Imports continued to expand vigorously, though the reduction in the surplus on current transactions was not quite as large as in the previous quarter. Prices stiffened again, especially in construction and the consumer goods sector.

In the fourth quarter trade showed a surplus of about DM 950 million; but current payments (i.e. including services and unrequited transactions) showed a deficit in excess of DM 500 million. The official gold and foreign exchange reserves remained virtually unchanged, but only because at the end of the year the commercial banks temporarily repatriated considerable foreign holdings.

Continued expansion is likely to be characteristic of developments in 1963. The slight tendency for exports to rise may well continue for the time being. While at the end of the frost period investment in construction, especially in housing and in the transport side of civil engineering, will again show a lively increase, a further slowing down in the expansion of equipment investment by enterprises must be expected. Public and private consumer expenditure is likely to rise vigorously, even though at a somewhat slower pace.

There will probably again be a tendency for production to rise, although the number in employment is unlikely to increase and working hours may be further shortened. The rate of expansion of commercial imports might slacken, owing in particular to a fall in agricultural imports. The price trend will probably continue slightly upwards mainly as a result of rising costs but also because of a rise in the rates for certain public services and in rents.

On the whole this outlook is in line with the forecast made in the last Quarterly Survey (4-1962). It would seem that industrial production for the whole of 1963 is likely to increase by 3.5-4 % over that for 1962, while the GNP at constant prices will probably go up by a good 3.5 %.

1. Recent developments

In the fourth quarter of 1962 exports of goods and services moved upwards a little more briskly than in the preceding quarters. According to the foreign trade statistics, the value of the goods exported was 6 % higher than a year earlier (in the third quarter the rise had been 3.3 %), products of the investment goods industries, especially automobiles, accounting for the major part of the increase. In January exports fell a little below the level of January 1961, partly because of the bad weather conditions and the effects of the American dockers' strike.

Domestic expenditure continued to give a considerable boost to employment and production. Gross fixed asset formation showed a further tendency to rise. To judge from the imports of investment goods and turnover in the typical investment goods industries, there was in the fourth quarter no further weakening in the expansion of equipment investment by enterprises. This cannot, however, be in any way interpreted as a revival in the propensity to invest; managements continued to show great reticence in planning and in ordering new investment goods. Although the early onset of severe winter weather noticeably hampered construction, investment demand continued to expand very briskly in building and construction.

Public expenditure on consumption again increased very appreciably—especially because of a considerable rise in defence expenditure, and of new wages and salary increases (in addition to an increase in civil service pay which amounted in practice to 5.5 %-6 % and took effect from 1 January 1963, a non-recurrent special allocation of 30. % of basic salaries was paid out in December).

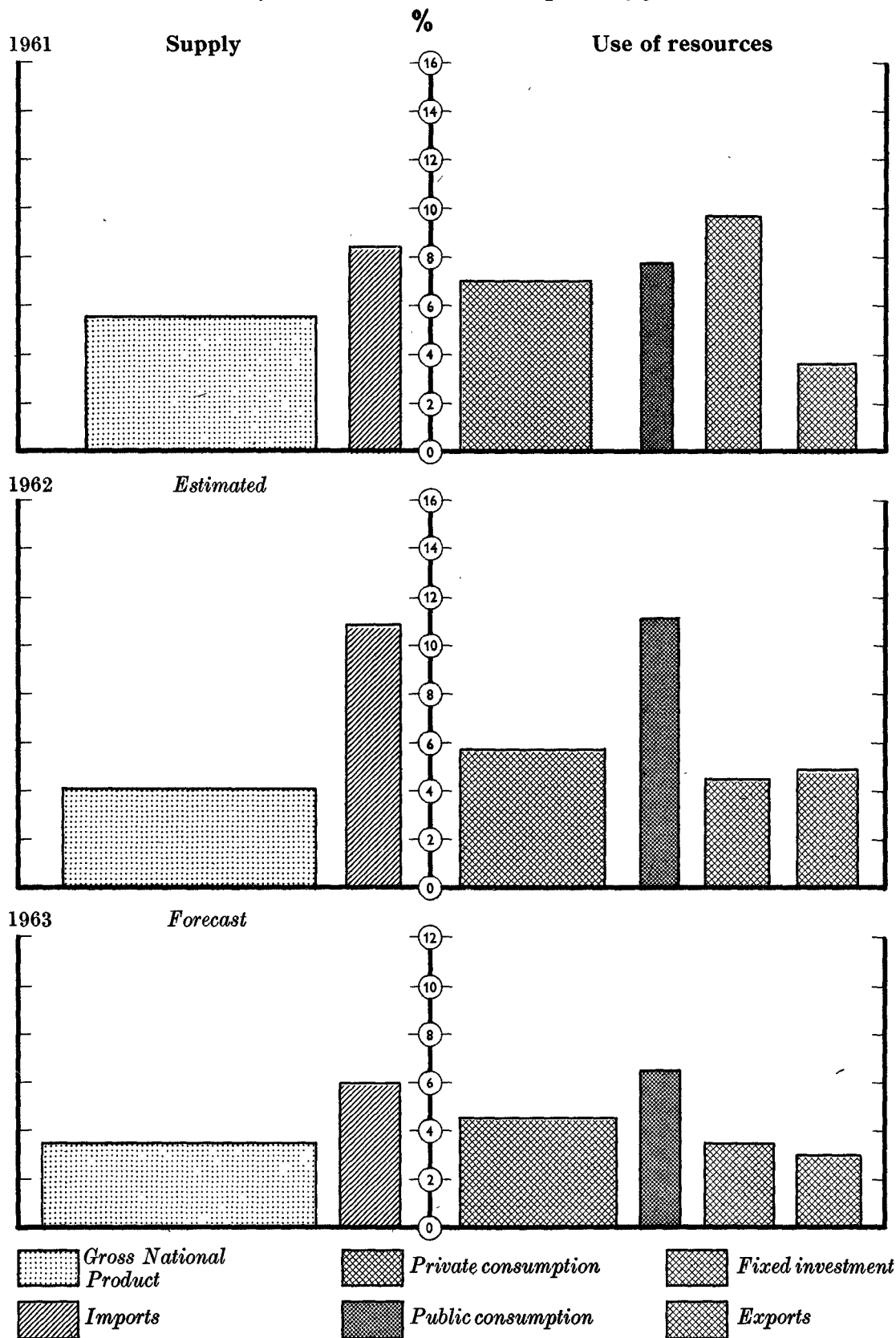
Though private consumption continued to rise strongly, its rate of expansion declined. In the fourth quarter the value of retail trade turnover was only 6 % above that in the corresponding period of the previous year, while its volume increased by only 3.3 %. The corresponding increases in the first half year had been a good 10 % and almost 6 %.

This easing was only in part due to the way incomes developed; there was certainly a rise in the ratio of savings to incomes. It is true that the year-to-year growth rate of agreed hourly wages fell from 8.1 % in the third quarter to 7.3 % in the fourth, but this easing is not yet reflected in the expansion of actual earnings. Nevertheless, the expansion of total incomes may have become a little less marked because of the slower pace at which employment is rising and of some slowdown in particular income transfers.

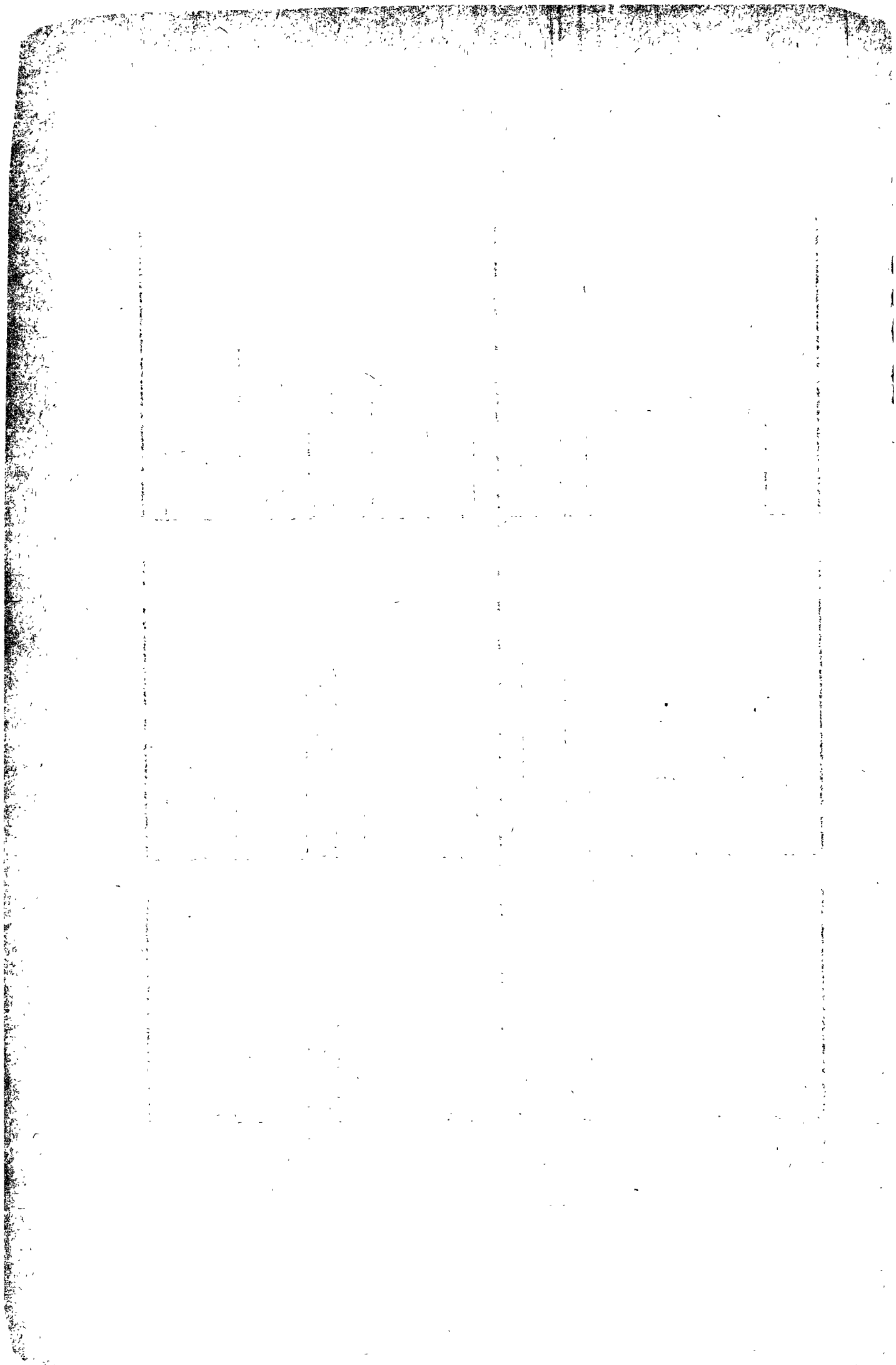
The early onset of unusually severe frost this winter brought with it a considerable increase of seasonal unemployment. At the end of February the number of unemployed

SUPPLY AND USE OF RESOURCES — GOODS AND SERVICES

Change in volume in relation to the preceding year



The width of each column corresponds to the aggregate value for the preceding year. Excluding West Berlin.



was 401 000, or 144 000 higher than a year earlier. In this connection it should be noted that unemployment statistics do not include construction workers receiving bad-weather money. None the less the underlying tendencies in the labour market still reflected relative tightness, due amongst other things to the continued shortening of agreed working hours. Workers released from certain branches of industry as a result of rationalization or a weakening of demand had no great difficulty in finding alternative employment. At the end of December 1962 the number of wage and salary earners was 1.8 % higher than in December 1961.

Despite this, there was little increase in the numbers employed in industry. Nevertheless, industrial production continued to expand. It would appear from the Federal Statistical Office's index of output per working day that it even reached a growth rate of 5.8 % for the fourth quarter; this means that for 1962 as a whole the increase was 4.7 %. However, in the course of the year the divergence in trend between one sector and another grew visibly greater. In the fourth quarter output of investment goods was only 1.6 % better than a year earlier, while the production of consumer goods was up 7.6 %.

Imports of goods and services again expanded vigorously. Although agricultural imports had been declining for some time, total imports of goods for the last quarter of the year were still 9.2 % higher in value and 10.4 % greater by volume in 1962 than in 1961. In the third quarter the year-to-year growth rates had reached almost 10.8 % (value) and 12.7 % (volume). Imports of finished goods alone were even 26 % higher in value than at the same time last year. However, this includes the greater part of Government imports. In January, imports were barely 3 % above those of a year earlier.

Although in some sectors the demand/supply situation is improving or is already in a state of equilibrium, the level of prices has been rising further, not least because of mounting costs. While on the whole agricultural and industrial producer prices showed marked stability until the cold spell, building prices have climbed very noticeably. In February the price index for the building of houses was 6.9 % up on a year earlier. The cost of living has also gone up, not only because prices for foodstuffs and services have stiffened but also because the average of industrial consumer goods prices has continued to creep. In January the cost-of-living index was therefore 3.6 % above that of January 1961.

In the fourth quarter of 1962 the balance of current foreign transactions again improved a little, largely for seasonal reasons. As in the previous quarter, the trade balance alone closed with a surplus of some DM 950 million. Nevertheless, current items, which include services rendered without payment, showed a deficit amounting to more than DM 500 million, following upon a deficit of DM 500 million in the previous quarter and a surplus of DM 100 million in the fourth quarter of 1961.

The overall balance of payments revealed an even greater deficit; in addition to the deficit on current account there was also a deficit in capital movements (including the residual items not covered by statistics) amounting to some DM 700 million. Therefore, in the fourth quarter the sum total of the gold and foreign exchange reserves held by the banking system (Deutsche Bundesbank and the commercial banks) was reduced by DM 1 100 million. Practically the whole of this loss was sustained by the net foreign exchange position of the ordinary banks who, as part of their window-dressing, temporarily repatriated some of their foreign holdings at the end of the year. Despite these transactions the Bundesbank's reserves remained unchanged.

Despite this the general effect of developments in the balance-of-payments situation was again to expand bank liquidity circulation, because official payments abroad not financed from money in internal circulation were higher than the deficit in the balance of payments. None the less these effects have for some time been much less than in the years when—if the considerable official payments abroad are not taken into account—there were very high balance-of-payments surpluses. While bank liquidity was held in check, amongst other factors, by the rise in minimum reserves caused by the increase in liabilities—the minimum reserve rates were not themselves put up—a contribution to liquidity (the first of its kind for several years) was made in the fourth quarter by those cash transactions of the public authorities which exert an influence on the internal situation.

The overall cash deficit (including foreign payments) of the Federal Government, the Equalization of Burdens Fund and the Länder amounted to DM 2 500 million in the fourth quarter as against DM 1 500 million in the fourth quarter of 1961.

The vigorous expansion of bank advances continued in the fourth quarter, the main emphasis again being on an extension of medium- and long-term credits to trade and industry. Owing to the narrowing of profit margins, business is increasingly dependent on bank credits to finance investment, especially as the issue of stocks is a difficult alternative in view of the present stock exchange situation.

2. Outlook

Though the expansion of demand, while still on the whole lively, has again been losing something of its impetus, the economic outlook for the coming months is very favourable. It is likely, however, that expansion will stem even more than hitherto from expenditure on consumption.

The slight upward move in exports registered in the fourth quarter of 1962 may, none the less, resume with the beginning of spring. Recently, orders from abroad seem

to have been increasing slightly. In the fourth quarter they were 4 % higher than a year earlier and in value equalled deliveries for the quarter; in the third quarter the corresponding figures had been -1 % and -7 %. It is also possible that after the end of the American dock strike exports to the United States may pull up again, not least because of arrears in deliveries caused by the strike.

In the course of 1963 a considerable slowdown is to be expected in the expansion of equipment investment by enterprises. An inquiry by the Ifo Institute into investment plans shows that for 1963 an increase of 3 % can be counted on for gross fixed asset formation in industry; investment for rationalization will again account for a growing proportion of the total. The reduction in domestic orders being received by the investment goods industry is a further indication that investment activity will tend to level off. In the fourth quarter these domestic orders had been more than 3 % lower than at the corresponding time in the previous year and about 11 % below the domestic turnover for the period—in mechanical engineering the figures were even 13 % and 20 %. If, nevertheless, a slight increase over the year can be counted on for equipment investment, this is because the backlog of orders is still fairly high. In mechanical engineering they provided, at the end of December 1962, for 5.7 months of production as against 7.2 months in December 1961 and 3.8 months in December 1959.

Despite the damping measures taken by the Federal Government, expenditure on investment for building is likely to go on mounting noticeably. The hesitant investment policy of enterprises meant that fewer licences for industrial building were issued in the fourth quarter than in the corresponding period of the previous year; on the other hand, there has been a rise in the seasonally adjusted figure of orders in the housing sector, where the backlog of 785 000 dwelling units at the beginning of the year may have been further increased by the reduction in building activity caused by the frost. Public orders for building—measured by cubic content of the buildings—were in the fourth quarter 12 % higher than a year earlier. Construction work in the transport sector also can be expected to increase considerably.

The vigorous expansion in public expenditure on consumption is likely to continue at an only slightly reduced pace. Private consumption, too, will go on mounting vigorously. However, the rise in total income from wages and salaries will probably be somewhat slower in the coming months. In the first place, the increase in total employment may turn out to be markedly smaller than last year, because domestic labour reserves have been virtually absorbed and the recruiting of foreign labour is becoming increasingly difficult. Secondly, wage increases are not likely to be quite as high as in the previous year—partly because collective agreements have been extended, but also because some restraint is being shown in wage demands and concessions.

Since, for reasons already given, the rise in the number of employed will be feeble and will be more than offset by a reduction in the number of hours actually worked each

week and by the introduction of longer holidays, the expansion of output will—apart from the influence exerted by demand—depend largely on greater productivity. It is likely that advances in productivity will continue to be considerable in view of industry's efforts at rationalization, so that industrial production will maintain its upward trend, especially since the frost has caused considerable arrears in sectors which depend on the weather, particularly in those supplying the building industry. Because of the difficulties at the beginning of 1963, the volume of construction may well rise a little less as compared with 1962 than would have been the case under normal weather conditions. It is hardly to be expected that all the arrears can be made up.

Expansion in commercial imports is likely to fall off further, largely because of a decline in the import of foodstuffs.

Although, with the exception of the building market, demand and supply are tending towards a better balance, the tendency for prices to increase may continue; this is largely due to the fact that wage-costs per unit of output are still rising, though perhaps not as markedly as last year. Also there is reason to expect that the charges for a number of public services will be raised and that rents will go up as a result of the partial decontrol of housing.

Since this outlook does not differ in essence from the forecast made in the fourth Quarterly Survey for 1962, the reader can be referred to the conclusions drawn in that report with regard to policy. These suggest that there is no immediate reason for any general measures of credit and financial policy to curb or stimulate demand. Specific action should be taken in two directions : first, the rise of costs and prices should be damped down by putting a brake on the expansion of demand in those sectors which must still be regarded as "overheated" (this applies in particular to the building sector, on which, incidentally, the public authorities themselves exert great influence, so that it should be relatively easy to co-ordinate the necessary measures); at the same time imports should be further encouraged, especially by making use of the still considerable scope for the reduction of duties on imports from other Community countries, and, finally, endeavours to work out an incomes policy should be redoubled and expedited, so that within this policy the rise of cost incomes can be curbed. This in turn would work in the second of the directions referred to, in other words it would help to support the propensity to invest. Failing this, there would be a risk that in certain circumstances, such as continued weakness in the world economic situation, various measures would after all have to be taken to prevent a fall in investment by enterprises. In this connection it should be realized that these measures would then be taken at a time when the level of costs was higher than it would have been had a reasonable incomes policy been applied. The implications, especially for the longer term stability of the value of money, must be obvious. Finally, it should be pointed out that credit and capital market policy—and in particular the latter—should continue to be directed towards maintaining or creating favourable conditions for the financing of investments by enterprises.

On the whole the forecasts for 1963 which the Commission had made at the end of 1962 tally with those contained in the recently published "Wirtschaftsbericht der Bundesregierung" (Federal Government Report on Economic Trends and Prospects). That Report presents current economic problems in much the same light as the Commission and arrives at certain views on the attitude that should be adopted in this context by the Government and the more important sectors of the population. The document does not, however, report on specific measures or action, taken or proposed, for dealing with each of the problems in accordance with the views expressed. It would be most useful if actual policy were now brought into line, as far as possible, with the objectives set. This task is facilitated by the exactness which distinguishes the Report with its quantitative forecasts in terms of national accounting. On the other hand it is this time made more difficult to put such a policy into practice because the Report was drawn up at a decidedly late stage and the main local authorities and boards and the representatives of the more important sectors of the population (especially employers' and workers' organizations) have not yet been consulted. The Community's Economic Policy Committee has on several occasions recommended this latter action in particular.

3. The economic situation in West Berlin

In 1962 economic expansion in West Berlin slackened noticeably more than in the Federal Republic. This is probably only to a minor extent due to the trend of demand. Bottle-necks on the supply side played a decisive part, especially the shortage of labour which was even more stringent than the already very tight situation in the Federal Republic. When the Soviet-occupied part of the city was sealed off on 13 August 1961, some 50 000 persons working in West Berlin but living in the eastern part of the city and representing about 5.5 % of the dependent labour force, were cut off overnight from the West Berlin economy. Though in 1962 a considerable number of persons moved from the Federal Republic to Berlin—many of them encouraged by an increase in the income tax preference—this was not sufficient to meet the labour requirements of the West Berlin economy.

As a result, industrial production increased by barely 2 % in 1962, as compared with 9 % in the previous year. The rate of growth increased from just under 1 % in the first half of the year to more than 3 % in the second, in which the loss of the workers coming from East Berlin no longer played the same role statistically as in the first, when its full impact was felt. The GNP at constant prices has probably increased by a good 2 %, as compared with 6 % in 1961.

As for the further outlook in 1963, there is good reason to believe that the expansion of the GNP in real terms will again become comparable with the growth rate in the Federal

Republic. Though in contrast to what happened in the Federal Republic overall orders received by West Berlin industry in 1962 fell by almost 10 % below the 1961 level, the backlog of orders is still fairly heavy. It is also likely that the Federal Government's programme of economic support for West Berlin, which is intended to compensate the political and economic disadvantages inherent in the city's position, will take greater effect. This programme not only encourages investment through increases in the existing tax privileges, but by raising wages and income tax preferences and by granting other kinds of financial relief it endeavours to make West Berlin more attractive to workers from West Germany.

B. France

Economic expansion continued in the fourth quarter of 1962 and, as far as can be seen at this juncture, in the early months of this year. Foreign demand made little contribution to economic growth, but domestic demand continued to rise vigorously, with the main driving force shifting even more clearly than hitherto from investment to consumption. Disposable income of households probably increased more rapidly, owing in the main to the continued vigorous growth of wage rates coupled with larger numbers in employment.

In general supply has been able to follow demand without much difficulty. In the fourth quarter of 1962 industrial production was up about 7.5 % on the corresponding period of the previous year. Imports also rose very vigorously.

Prices again showed a clear advance. Much of the rise was due, it is true, to the scarcity of certain farm products caused by weather conditions, but wage costs also increased again. These increases were in part passed on to the consumer, particularly in those sectors where the upward pressure on prices was encouraged by the expansion of demand.

Although the balance of trade with countries outside the franc area tended to grow worse, the basic balance of payments was again strongly favourable, with the result that the official gold and foreign exchange reserves rose, despite further advance repayments of foreign debts, by \$80 million.

The outlook for the further growth of production and employment is on the whole good. Nevertheless, there are signs that the individual factors of demand are not developing evenly. The expansion of exports, for example, may remain decidedly weak, and the formation of fixed assets by private undertakings may also grow less rapidly. Against this the existing programmes of public enterprises and, in particular, of the State continue to maintain high growth rates for expenditure on construction and equipment. Private consumption will increase more rapidly than productive investment and the national product. At the same time the expansion of income responsible for this trend means that the upward pressure on production costs will be maintained. Rising price trends may therefore be expected to continue, particularly in those fields—private consumption and construction—where supply possibilities are limited or demand is growing rather too rapidly.

On the whole this prospect tallies with the forecasts given in the last Quarterly Survey for the full year 1963. In relation to 1962 the real gross national product should be up about 5 %, and industrial production about 6 %. Investment by private undertakings might rise somewhat less and private consumption somewhat more than was forecast, and it will be more difficult to keep prices stable.

1. Recent developments.

Foreign demand has made little contribution to the French economy in recent months. Customs statistics no doubt show, it is true, that the value of goods exported in the fourth quarter of 1962 was 3.7 % higher than in the corresponding quarter of 1961, whereas in the two preceding quarters it had been down. This was however exclusively attributable to the unusually high October figures, which were in part explained by seasonal shifts. Towards the end of the year certain tendencies to weakness again emerged. At the same time an important change occurred in the breakdown of exports by area : deliveries to the franc area, in particular Algeria, recovered from their low ebb in the third quarter of 1962 and became stable at a higher level. Against this the growth of exports to the countries outside the franc area seems to have come to a halt and even—for the time being at least—to have given way to a decline.

Domestic demand continued to rise vigorously, perhaps even rather more quickly than before, in the fourth quarter of 1962, and all the signs suggest that this rise has lasted into the early months of 1963. It became increasingly evident that consumption by households was the driving force of expansion, while the investment activity of private enterprises reflected some hesitation and investment in general was adversely influenced by the exceptional weather conditions experienced this winter.

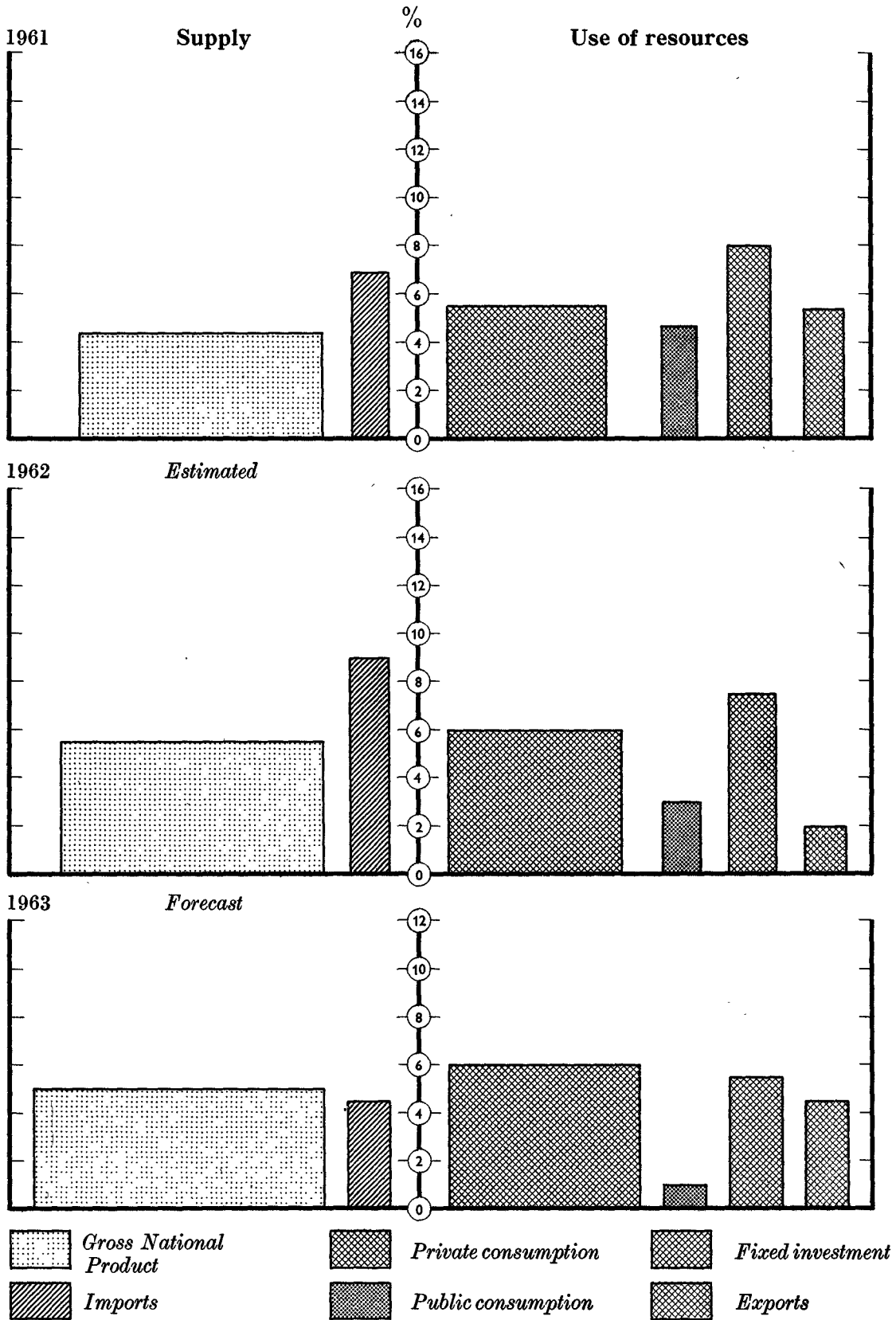
Housing was without doubt the branch hardest hit by the early onset of frost, which occurred just when a supplementary programme to provide accommodation for repatriates from Algeria had begun. The total number of dwellings started and completed in recent months was almost certainly below the level of a year earlier. Civil engineering work for public authorities also had to be suspended earlier than usual. Taken as a whole, however, the underlying trend of gross fixed asset formation continued to be upward. On the one hand the implementation of private industry's 1962 investment programmes probably caused even higher spending; on the other, investment of enterprises under public ownership increased steadily, as required by the directives of the Fourth Plan. Finally, direct investment by the State went up quite considerably, in line with the forecasts made in the budget estimates.

Apart from the fairly considerable build-up in reserves of some farm products, investment in stocks probably provided no special stimulus in recent months. It would seem that industry is still hesitant about adapting its holdings of raw materials and semi-products to growing production. Stocks of manufactured goods held by manufacturers and by dealers further declined under the pressure of heavy demand.

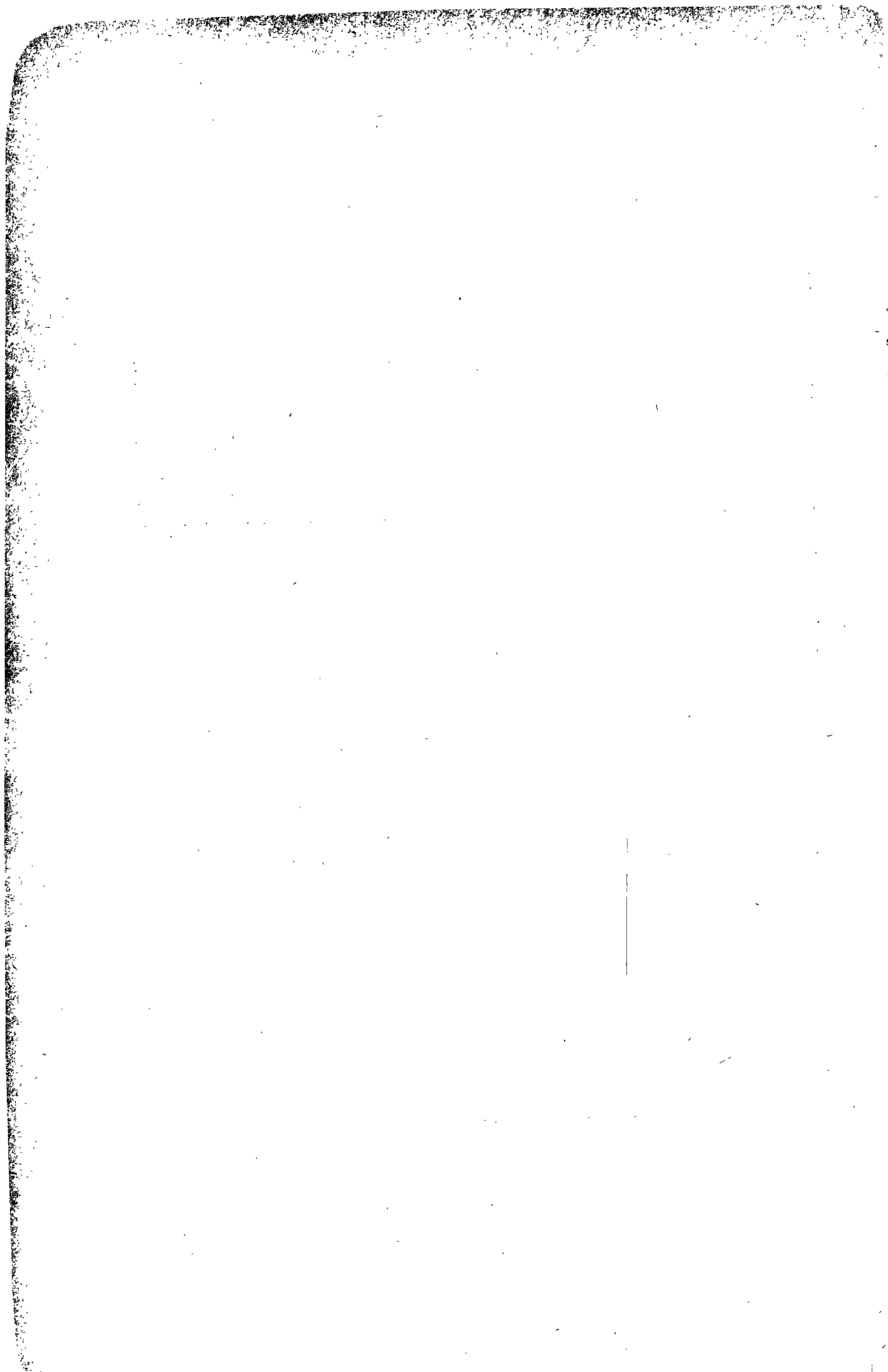
The already quite vigorous expansion of private consumption gathered further momentum at the end of 1962, and the turnover of the Paris department stores in the fourth quarter was no less than 17 % above the corresponding figure for the previous year.

SUPPLY AND USE OF RESOURCES — GOODS AND SERVICES

Change in volume in relation to the preceding year



The width of each column corresponds to the aggregate value for the preceding year



Provincial centres, where population increase was particularly heavy as a result of immigration from Algeria, reported even higher rates of increase. The basis for this spending was a probably equally speedy increase in the disposable incomes of households. Hourly wages, which at the beginning of the fourth quarter of 1962 were already 9 % higher than a year earlier in private industry and 12 % in State enterprises—again rose appreciably. Wage rates in public services also increased in recent months and special one-time bonuses were granted. The speedier growth in the number of persons in employment also played a part. Since transfer incomes, too, rose markedly—not least as a result of the decisions thus far made under the “national income policy”—mass incomes in the fourth quarter of 1962 were well above the level of the previous year.

In recent months supply has had little difficulty in following this expansion of demand.

In agriculture, however, the unusually cold winter weather had a very adverse effect on crops. Against this, there was probably a further clear rise in livestock production. Because of insufficient fodder supplies meat was sometimes very plentiful, and official stockpiling agencies were obliged to take up large quantities from the market.

Industrial production increased a little more rapidly. Whereas the growth rate according to the seasonally adjusted INSEE index was 2 % in the September quarter, it was 2.5 % in the fourth quarter—in each case compared with the preceding three months. In the last quarter of 1962 the rise was about 7.5 % over October-December 1961.

This relatively high elasticity of industrial production is primarily attributable to the fact that demand advanced more strongly in those sectors which had not been working to capacity and where there was room for considerable advances in productivity. Moreover, with the heavy influx of repatriates from Algeria and the first early releases from military service, it became somewhat easier to step up numbers in employment. In any case the proportion of undertakings which reported that business was hampered by labour shortages declined slightly towards the end of the year, though no thorough-going easing of the situation on the labour market is yet to be noted despite the very appreciable increase in the civilian labour force. The number of posts to be filled remains quite high, since persons looking for work are often unsuited to the jobs offered, either because their skills are not those required or because they live in the wrong places.

In recent months supply from domestic production has been increasingly supplemented by imports, particularly from countries outside the franc area. Customs statistics show that imports of goods in the fourth quarter of 1962 were up about 12 % to 13 % by volume on the same period last year. In particular, imports of consumer durables rose very strongly if seasonal factors are left out of account, while the advance in imports

of capital goods was clearly slower. Imports of semi-products and raw materials again showed a modest degree of expansion.

Despite the speedier expansion of production and the vigorous increase in imports, the upthrust of prices has become even stronger in recent months. Between September and December 1962 the level of consumer prices went up about 1.9 %, and was thus some 4.6 % higher than at the end of 1961. Increased prices for certain foodstuffs, which were largely attributable to unfavourable harvests and the early onset of frost, played a large part in this process. But the prices of a number of industrial products—in particular consumer durables—and of certain services also showed a more marked upward trend.

The vigorous increase in imports combined with a feeble upward development trend in exports to produce a further deterioration in the balance of trade. For the first time since 1958 the adjusted figures again showed deficits, although in the fourth quarter the traditional surplus in trade with the franc area was restored. The tendency for deficits to develop on merchandise trade with countries outside the franc area did not yet seriously affect the balance of payments reckoned on a cash basis. Surpluses on current account continued high and, since private net capital imports remained quite large, a further \$150 million of public external debts were repaid in the fourth quarter of 1962—in most cases ahead of time—while official gold and foreign exchange reserves were increased by \$80 million.

It was not only the payments situation—and the probably continuing repatriation of funds from the franc area—which swelled the amount of money in circulation; the cash transactions of the public authorities also played a part. In fact the surplus of Treasury expenditure in the fourth quarter of 1962 was probably greater than in the corresponding period of 1961. In addition it was financed exclusively on a short-term basis—in the main by issuing Treasury bills. Bank advances to industry and private customers also increased more vigorously. The volume of short-term and medium-term credit outstanding rose in the fourth quarter by FF 5 800 million, compared with just FF 4 600 million in the corresponding period of the previous year : at the end of December 1962 it was 17 % higher than at the end of 1961. At the same time industry again stepped up its demands on the capital market both by increases in capital and by the issue of fixed-interest-bearing securities.

2. Outlook

The way the economy has been shaping in recent months does not indicate any change worth mentioning in the outlook for the year 1963 as described in Survey No.4 of 1962. Nevertheless, certain symptoms of some unevenness in developments have been becoming more evident.

It is, for instance, hardly possible to overlook the present weakness of exports. It is true that increased deliveries to the franc area are to be expected as the situation in Algeria returns to normal. But the prospects for exports to countries outside the franc area are fairly uncertain—witness the answers to the monthly EEC inquiries from businessmen. The situation continues to be hesitant in major importing countries, whereas the domestic market promises favourable sales possibilities in important sectors; rising prices and costs may also be beginning to act as a damper on exports.

There is no doubt that internal demand will expand very strongly in the coming months, although total gross fixed asset formation will probably lose some of its momentum. When questioned in November last year by the INSEE Institute about investment plans for 1963, private enterprises generally gave more pessimistic replies than a year earlier. But the economic factors which continue to cause private industry to spend heavily on expanding and rationalizing plant—i.e. rapidly growing private consumption and constant pressure of costs—have scarcely lost anything of their importance in recent months. An upward revision of investment programmes is therefore quite on the cards, the more so as the INSEE inquiry referred to took place at a time when special political factors were influencing the atmosphere. The programmes which provide for a continued increase in the amount expended by public enterprises for investment in building and equipment are in any case already laid down, and the same is true of direct investment by the State. Here however—as in housing moreover—the long winter freeze-up could cause delays which it will not be easy to make good later in 1963.

The growth of private consumption should continue with at least the anticipated vigour, as the prerequisites doubtless exist on the income side. The appreciable increase in the civilian labour force will make it possible to step up employment rather more rapidly than hitherto, but it will not suffice to make any very noticeable impression on the upward trust of wages in the near future. In addition, further improvements in social benefits, especially family allowances and old-age pensions, are to be reckoned with at mid-year. It is also to be expected that the repatriates from Algeria and released soldiers, once definitely reintegrated into economic life, will spend part of their savings on consumer durables.

This expansion of demand will continue to stimulate industrial production quite vigorously in the coming months. Industrialists themselves reckon that roughly the same growth rate will be maintained as hitherto, although this is not to say that some branches of industry—and construction as a whole—will not temporarily feel the effects of the severe cold wave. As the EEC business survey shows, order books are at present considered much better filled than a little time ago. The danger of production bottle-necks resulting from labour shortages seems to have abated, even though a certain amount of strain may still be experienced in particular areas or callings, especially if working hours are further reduced by the introduction of a fourth week of holidays with pay. The scarcity of production capacity on the other hand seems recently to have grown rather more acute.

Imports are likely to reflect the expected growth of total demand by expanding further. In particular, increased imports of manufactured goods may be expected and imports of raw materials and semi-products could take a rather more definite upward turn.

The price level will probably again rise, even though the price of some farm products is likely to be adjusted downward later in the year. In addition to the price increases triggered off by rising wage costs, some sectors, particularly construction and the markets for certain private consumer goods, may experience upward price trends—conditioned mainly by demand. It is also possible that the tariffs of some public enterprises will be increased in the course of the year. It is true that in other sectors—semi-products, capital goods—there is an unmistakable tendency for prices to ease or for the upward push to abate, but this hardly plays any essential part in the total picture.

The last Quarterly Survey (4-1962) already included a discussion of the most important policy problems resulting from the probable shape of the economy in 1963. These problems meanwhile have not lost any of their topicality. With the national product growing on the whole satisfactorily and full employment continuing, the main question is how to keep prices stable. However, in the longer prospect—i.e. over a period of years—any continuation of the present combination of economic factors could involve growth problems. Consumption is tending to rise too fast in relation to investment and in the long run a new speed-up in the growth of investment by enterprises really seems necessary, since there might later be insufficient capacity to ensure an adequate increase in the gross national product (and thus in real private consumption). This is all the more the case as the present expansion of consumption is attributable to a trend in incomes which involves constantly rising production costs. It is true that this trend provides incentives for investment in the sectors producing goods and services for private consumption, but such incentives usually work only through rising prices in these sectors. In addition it is questionable whether they are always adequate to offset the negative effects which this cost trend exerts on profits and investment capacity in the other sectors.

What is needed in the situation is a policy which counters excessive income increases and the upward push of prices while ensuring that the growth rate of investment by enterprises does not sink any further but rather rises again. Such a policy is difficult to apply. It cannot attempt to solve the first of the above problems by means of severe general monetary or fiscal restrictions, since this would run counter to the solution of the second. On the other hand measures to curb short-term credit, the rapid expansion of which has certainly contributed to the rather precipitate growth of income, seem to be quite opportune. In fact the monetary authorities took various measures of this kind to curb expansion at the end of February when banks were recommended to restrict the increase in their total advances to 12 % during the next 12 months, without however limiting the expansion of medium-term credits—which are mainly used to finance equip-

ment and construction—and of export credits. At the same time the special minimum reserve (coefficient de trésorerie) was raised from 32 % to 35 % with effect from 31 March 1963 and interest on Treasury bills reduced to give the banks a further special incentive to use their available credit in medium-term operations.

Meanwhile, with the aim of damping down rising price trends, an endeavour should be made in the framework of the “national incomes policy” rapidly to harmonize claims on the national product, and in particular to moderate the expansion of the type of income normally spent mainly on consumer goods. This policy could be supplemented by selective measures in the most varied spheres : in the price field, by going beyond the temporary measures already taken, such as certain price controls and reduction of turnover tax, and making imports cheaper (anticipated reductions of customs duties not only for certain types of fruit or vegetables but in particular for industrial goods also); in the manpower field, by facilitating the integration of the repatriates from Algeria into the production process through a crash programme of vocational retraining; in the financial and money and capital market fields, by giving greater encouragement to saving and to closer co-operation between the money and the capital markets. These last measures would also curb the upward thrust of private consumers’ expenditure and make more finance available for long-term investment.

C. Italy

Economic growth, which had been only moderate in the first nine months of the year, probably gathered momentum towards the end of 1962. Special factors were undoubtedly in part responsible for the relative weakness in the second and third quarters and the recovery in the last quarter, the strikes themselves, their loss of strength after a time, and the working off of the production backlog they had caused; but the underlying trend also seems to have faltered and then to have picked up again somewhat towards the end of the year.

Foreign demand (apart from seasonal and random variations) remained sluggish, although in the fourth quarter the special factors referred to caused quite a distinct increase in the seasonally adjusted figures for exports: the value of merchandise exports was some 6.5 % higher than in the fourth quarter of 1961.

On the other hand a period of decline in investment was followed by a distinct recovery, at least where equipment investment was concerned. The special factors were certainly not the sole cause of this recovery, which also benefited from the vigorous increase in consumption by households that followed the appreciable expansion of mass incomes. Public consumption, too, expanded considerably.

The way demand and the factors of production developed meant that, after a fairly long interval, industrial production moved forward again clearly in the fourth quarter when, according to the national index, it was 8.5 % higher than a year earlier. The numbers in employment continued to advance appreciably.

On top of this there was a further speed-up in the growth of imports, which in the fourth quarter were as much as 23 % (in terms of value) above the corresponding figure for 1961.

At the same time, however, the upward trend of prices became steeper towards the end of the year. This was due not only to the continuing increase in costs, but even more to the fact that several important foodstuffs were in short supply owing to the weather in the summer and autumn.

The deficit on trade increased appreciably. Despite substantial net revenue from services, the overall balance of payments (as derived from foreign exchange statistics) also closed with a deficit, as once again more capital left the country than came in.

The outlook for 1963 is still decidedly expansionary. For the time being little extra boost can be expected from foreign demand, but it looks as though domestic demand will rise even more steeply, assisted by the recovery in investment already referred to.

The upswing in private consumers' expenditure will continue, albeit at a somewhat slower rate than in the second half of 1962. Since there is not likely to be much difficulty where the factors of production are concerned, industrial production will again show a distinct increase. Given normal weather conditions for the rest of the year, the real gross national product for 1963 could be some 6 % greater than in 1962. Imports will probably continue to mount vigorously and the deficit on trade might again become larger. The price level will probably be appreciably higher than in 1962, but with the help of appropriate Government measures the tendency for prices to rise will probably diminish as the year wears on.

1. Recent developments

In the fourth quarter, too, the trend in exports of goods and services again expanded only slowly and there was even a further reduction in the year-to-year growth rate for exports of goods (in terms of value), this time from 8.5 % in the third quarter to 6.5 % in the fourth. It should however be remembered that in 1961 there had been a particularly sharp increase between these two quarters. The seasonally adjusted figures for exports even showed a clear rise; but this was probably due, in the main, to special factors—fewer strikes and attempts to work off the backlog of orders left by earlier strikes.

As a result of poor harvests, the important exports of farm products fell off sharply, but exports of machinery, appliances, vehicles and clothing expanded considerably more than in the third quarter. Exports of services seem to have maintained their clear upward trend.

Domestic demand, on the other hand, again rose appreciably. Here gross fixed asset formation clearly picked up after a lengthy pause. This applies at least to equipment investment by enterprises. At any rate output and net imports of machinery and vehicles grew more rapidly in October/November than previously. Moreover, the year-to-year growth rate of receipts from the turnover tax on domestic purchases of machinery, appliances and electrical equipment, which had been falling since the beginning of 1961, rose to over 20 % in the fourth quarter. The EEC Business Surveys conducted by

ISCO-Mondo Economico during the same period revealed that the backlog of domestic orders in the investment goods industry was showing a distinct tendency to rise. Here too, however, the special factors mentioned earlier must also be taken into account.

If seasonal factors are discounted, investment in building and construction also seems to have grown further in the same period. There was some recovery in public works, where activity had even been falling off in the first half of the year. Housing probably managed at least to maintain the more pronounced growth rate that had been apparent since the third quarter, and in the fourth quarter about 20.5 % more rooms were completed than a year earlier. In industrial and commercial construction, however, the corresponding increase dwindled to a bare 3 %, compared with 18.5 % in the third quarter. Home sales of building materials were 16.5 % up on the fourth quarter of 1961, after recording growth rates of 5.1 % and 7.5 % in the second and third quarters.

Public consumption rose considerably, mainly because of wage and salary increases. The central government's outlay on behalf of active and retired civil servants went up considerably in the fourth quarter and was almost 27 % greater than a year earlier (11.5 % in the third quarter). Consumption by local authorities probably followed a similar trend.

Thanks to a further substantial rise in employment and further—though smaller—wage increases private consumers' expenditure must have expanded distinctly. The output of industrial consumer goods was, it is true, only just over 6 % higher in the fourth quarter than a year earlier, against the 9 % increase recorded in the third quarter, but the year-to-year growth rate for the corresponding imports soared from 29.5 % in the third quarter to no less than 53 % in October/November.

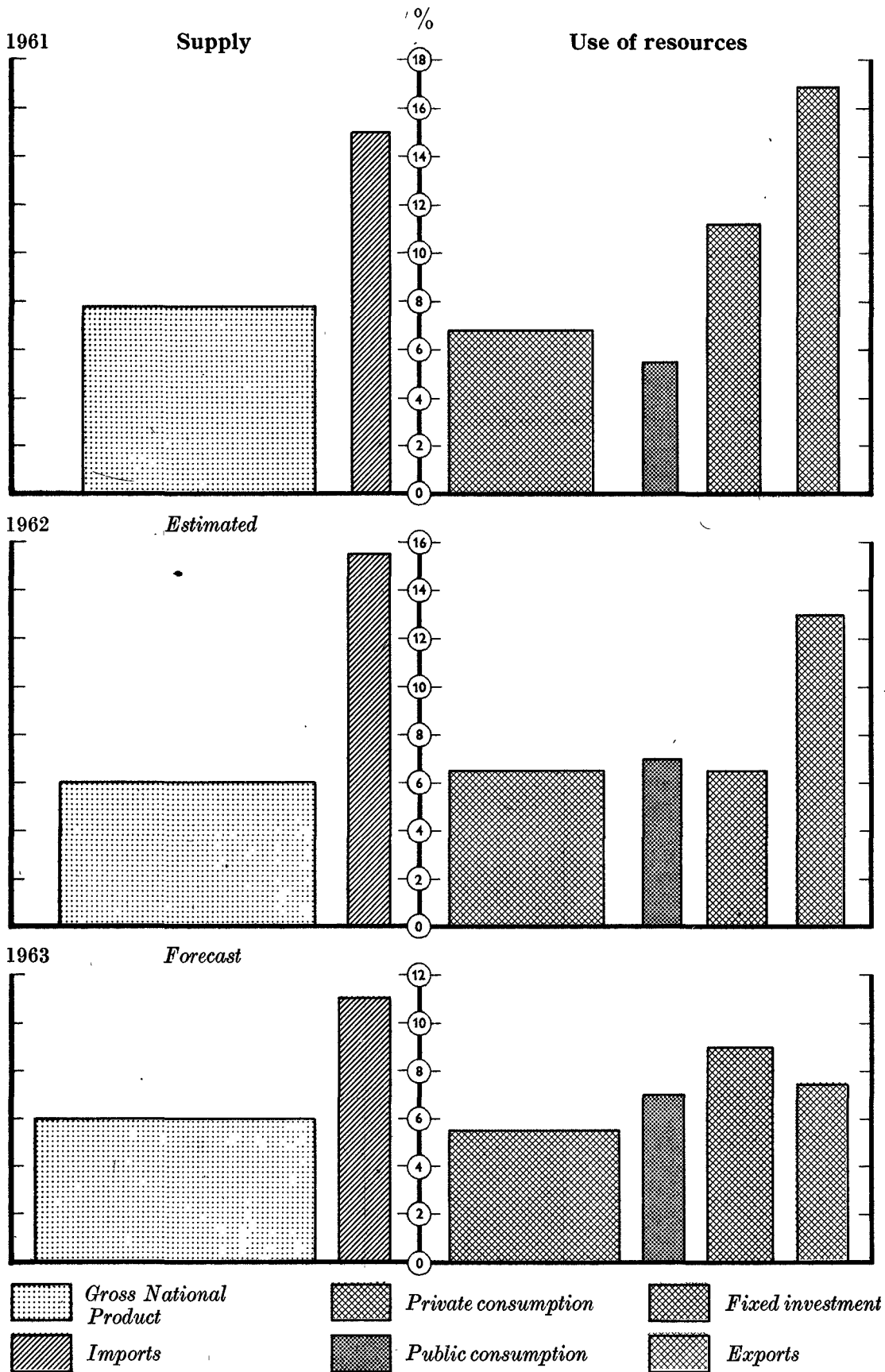
On the supply side, agricultural production suffered from the unusually bad weather, fruit and vegetables in southern Italy being particularly hard hit.

Industrial production definitely gathered momentum and was 8.5 % higher in the fourth quarter than a year earlier (7.4 % in the third quarter). The seasonally adjusted index, which had been inclined to mark time since May, recorded a vigorous increase—about 4.5 % in the fourth quarter—and was still rising clearly in January 1963. This again was of course partly due to the fact that the wave of strikes subsided and the quite considerable loss of production they had caused in the previous months was partly made up. Output of investment goods in particular rose steeply since it was in this sector that the effects of the strikes had been most severe.

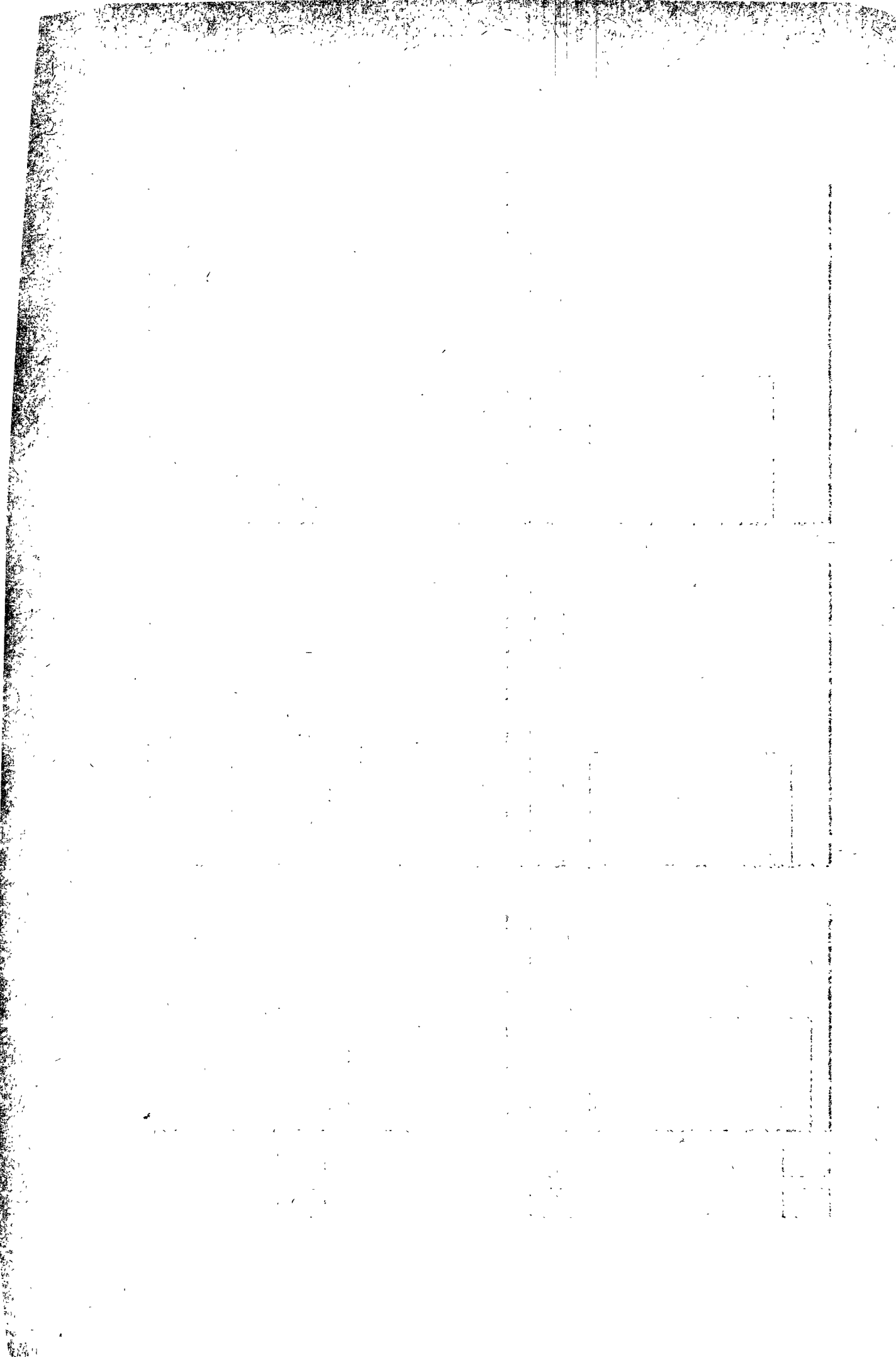
Although heavier calls were made on production capacity it would seem that by and large there is still a sufficient margin.

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Change in volume in relation to the preceding year



The width of each column corresponds to the aggregate value for the preceding year



There was a further distinct increase in employment; according to the ISTAT inquiry, there were at the end of October some 3.5 % more persons in paid employment than about a year earlier. Unemployment continued its downward trend but there were still shortages of skilled labour, and in some regions both skilled and unskilled.

Domestic supply was supplemented by vigorously expanding imports of goods and services. Visible imports expanded even more rapidly than before and, according to foreign trade statistics, were some 23 % higher both in value and by volume in the fourth quarter than a year earlier (19.3 % in the third quarter). This is all the more remarkable because growth had already speeded up appreciably in the third quarter, owing in no small measure to the tariff cuts in July and August. Imports of farm products and food-stuffs climbed very rapidly, weather conditions having led to poor results on Italian farms. The foreign exchange statistics suggest that imports of services also went up more rapidly in the fourth quarter than in the previous six months.

The upward price movement gathered pace in the fourth quarter. This trend continued into the early weeks of 1963, partly because of a fresh official increase of about 20 % in fixed rents and 15 % higher railway fares for some passenger transport.

Consumer prices went up by 2.6 % between September and December 1962 and in the fourth quarter were 5.7 % higher than a year earlier. Food cost 3.5 % more owing to the severe setback in domestic production, particularly of fruit and vegetables, caused by the dry summer and the unusually hard winter which followed. On the other hand higher costs were mainly to blame for the further marked rise in the prices of many industrial products and services. In addition the price of cigarettes was substantially increased in order to swell tax revenue. Because of the continuing upward price trend the cost-of-living allowances based on the sliding wage scale agreements were put up in November and even further in February.

With imports rising considerably faster than exports, the balance of trade deteriorated more than was usual for the time of year. According to customs statistics the deficit was \$417 million heavier in the fourth quarter and therefore almost two and a half times as large as it had been a year earlier. The foreign exchange statistics show net revenue from services as being only just at the level of the corresponding 1961 period, so that the balance of current payments closed with a substantial deficit—something which had not happened at this season for many years. On top of this there was again a small deficit on capital transactions.

Nevertheless, official gold and foreign exchange reserves mounted by \$189 million in the fourth quarter, the banks running down their net holdings of foreign exchange by

no less than \$500 million in the same period. They made ample use of the possibility, open to them again since November, of unlimited short-term borrowing abroad, and were consequently able to retransfer substantial sums of foreign exchange back to the monetary authorities in order to strengthen their own internal liquidity. Part of this, however, was the banks' customary practice of window dressing at the end of the year. The process was reversed, although on a smaller scale, in January 1963, causing official reserves to fall again by \$128 million.

The increase in official reserves and the fact that for the first time for a long while liquidity was pumped into the monetary system by government cash transactions, doubtless brought about an increase in banking liquidity which exceeded the effects of a further expansion of the volume of notes and coin in circulation. In January certain minimum reserve obligations were reduced or abolished and maturing long-term Treasury bills were paid out to the tune of about Lit.180 000 million, thus adding to the liquidity of the banking system. The bond market tended to settle down after November; the net yield on Government securities dropped from 5.3 % in September to 4.9 % in December, thus almost touching the level obtaining before quotations started to fall in May 1962. At the end of January 1963 the monetary authorities issued instructions which, by establishing stricter conditions for creditor interest rates, exerted a certain amount of pressure on the domestic level of interest.

2. Outlook

So far there is no indication that exports will pick up very briskly in 1963—at least not before next harvest. Industry's backlog of orders from abroad again dwindled considerably in the fourth quarter of 1962 and, according to the EEC Business Survey, a good 40 % of businessmen felt that orders were low. On the other hand there is no reason to expect a particularly unfavourable trend in exports : 50 % of the businessmen polled considered order-books normal and almost 10 % even rated them high. Similarly, businessmen and economic experts questioned in the Mondo Economico's "Forum" Survey at the turn of the year viewed export prospects in the coming six months with, it is true, distinctly more caution than at the beginning and in the middle of 1962, but they were still relatively optimistic. In the second half of the year the further EEC cut in internal tariffs on 1 July and the anticipated better harvests in themselves could induce some recovery in exports. At the same time there will almost certainly be an appreciable increase in exports of services, especially since there is bound to be further substantial growth in revenue from foreign tourists because in many other countries consumption is one of the most expansionary elements in the growth of total demand.

The outlook for internal demand is more expansionary. Gross fixed investment is likely to experience further appreciable growth, although probably at a lower rate than

at the end of 1962, when special factors influenced the situation. The EEC Business Survey carried out in the fourth quarter showed that producers of investment goods were more optimistic and, as things stand at present, this can only point to an acceleration in domestic demand for these goods. In addition, a special inquiry conducted by ISCO-Mondo Economico shows that businessmen intend to invest over 10 % more in 1963 than in 1962, whereas a similar inquiry a year earlier had found that an increase of only 5 % was contemplated. In any case, a lot depends on whether a start is actually made on the many public investment projects and whether those begun are carried out more rapidly; there is much to indicate that in 1963—an election year— this will be the case.

In addition, there are also signs of an appreciable increase in public consumption, such as the recent supplementary budgets and the increase of almost 20 % in the estimates of expenditure for the budget year 1963/64.

Although the outlook for mass incomes—and consequently private consumption as well—also continues to be one of expansion, the rate of growth may become decidedly slower : longer-term collective wage agreements covering important industrial sectors were already concluded last year, and although the agreement signed for the metal products industry in February provided for substantial wage increases, certain payments had in fact already been made during 1962. Nevertheless, further wage claims can be expected this year too, especially in construction, agriculture and commerce; civil servants are also due for further rises. Finally, pensions for farm workers were recently put up with retroactive effect from 1 July 1962.

This outlook for overall demand, especially domestic demand, suggests that industrial production will continue to expand appreciably. The same applies to the output of building and construction, although here the exceptionally bad weather in the early months of the year might affect the annual figures. All in all the expansion of production will probably be possible without causing undue strain on the factors of production.

Domestic supply will again be supplemented by a vigorous rise in imports. Despite the high elasticity of total supply, prices will probably still show some tendency to rise. This will be due in part to the poor output from the farms in 1962 and at the beginning of 1963, in part to the continuing rise in unit costs being passed on to the consumer. However, the rise in prices is likely to lose speed. The upward trend in costs might be somewhat weaker and at the same time it is possible, always supposing that weather conditions are normal, that the prices of important farm products will fall a little.

Given this outlook for exports and imports, a larger deficit will probably be recorded again in the balance of trade. There might even be a small deficit on current transactions

for the first time in five years. It is particularly difficult to predict how the overall balance of payments will shape in view of the uncertainty of capital movements. Nevertheless, there is a possibility that certain capital funds will flow back into the country and bring about an improvement in the balance of capital transactions. There is again likely to be a high surplus on transfer payments, mainly as a result of transfers by emigrants. However, the balance of payments will probably not make anything like as large a contribution to internal liquidity as it has done in the past few years.

By and large the latest trends have not changed the economic outlook for 1963 sufficiently to require a basic revision of the forecasts made in the last Quarterly Survey. Nevertheless some year-to-year growth rates, especially those for gross fixed asset formation and imports, will probably have to be revised slightly upward thanks to the more rapid growth seen in some sectors at the end of 1962. If weather conditions are normal for the rest of the year the real gross national product may go up some 6 %.

The main concern of economic policy must in any case still be to maintain the rate of growth of investment. This means that public investment will now have to be expanded vigorously, all the more so because this would also stimulate the private sector's propensity to invest, which may tend to be adversely affected by a further, though probably less severe, shrinkage in margins for self-financing.

Here wage policy will retain its importance, as it will, too, with regard to price trends, despite the fact that the upward wage movement is expected to level off. Recent statements by several ministers on this subject indicate that the Government realizes just how important wage policy is. But direct measures to stabilize prices are also needed to counter the upward wage drift to the extent that this is accelerated by increases in the cost of living. The Government has already enacted a fair number of such measures, including cuts in turnover tax and action to reduce the charges on specific imports. Efforts are being made concurrently to improve the system of distribution and to intensify competition in this sector; these, too, should be pressed forward vigorously.

Despite the probable trend in the balance of payments, financing of investment is unlikely to prove very difficult. Firstly, conditions on the capital market can be expected to settle down further, and as things stand this must lead to an increase in banking liquidity. Secondly, the Government budget could also contribute to liquidity provided any deficits that occur are met by drawing on the financial reserves available within the public sector itself. As a rule, the additional funds should be channelled mainly into longer-term investment. So far as the public authorities are concerned, it would clearly be wisest for them to devote most of their increased outlay to capital investment; the pro-

portion of total outlay which is devoted to consumption has expanded appreciably of late : as far as possible it should be scaled down and the actual pattern of this kind of spending should be reconsidered.

D. The Netherlands

Economic growth continued in the last months of 1962 at the faster rate maintained since the middle of the year, thanks to the steady expansion of private consumption and exports on the demand side and to higher elasticity of production on the supply side.

In the fourth quarter exports were still rising, albeit somewhat more slowly, and the value of goods exported showed a year-to-year growth rate of some 10 %. Gross fixed asset formation, however, again grew at a distinctly slower pace, owing mainly to the tendency for equipment investment by enterprises to slow down. In construction, on the other hand, the increase in employment made further progress possible until the onset of the extremely cold winter. Public expenditure on investment rose further.

Private consumers' expenditure continued its brisk rise; the increase in the disposable income of households was quite substantial as a result of pay rises in 1962, higher employment, tax cuts and larger pensions.

In spite of the fact that the increase in the active population made it possible to increase the number of employed, the labour market eased only slightly. Unemployment figures were slightly higher in the fourth quarter of 1962 and more noticeably higher at the beginning of 1963 than a year earlier, but this was caused almost entirely by the unusually severe winter.

Industrial production continued to expand in the fourth quarter—albeit somewhat more slowly than in the third—and the national index showed that there had been an increase of about 5 % on the fourth quarter of 1961.

Total imports declined, although imports of consumer goods were still rising. All in all, the value of imports was only 1.5 % more than in the fourth quarter of 1961.

There was a further increase in retail prices which, according to the index, were more than 3 % higher than a year earlier. Although the deficit on trade diminished considerably and a substantial surplus was recorded on current account, the balance of payments closed with a slight deficit in the fourth quarter. This can mainly be attributed to repayments of public debts abroad and heavy exports of private capital.

Expansion can be expected to continue in the coming months. Demand from abroad will go up again. Domestic demand is also bound to show a further increase—despite even more marked slackening in the growth of investment—because of the way in which private consumption is being boosted by the rise in the incomes of households. Generally speaking, however, consumption will have ceased to expand as rapidly as in the second half of 1962.

Although the upward trend in production may have suffered temporarily at the beginning of 1963 from the bad weather, subsequent growth will probably maintain a satisfactory pace, especially since further increases in employment and productivity can be expected. In a few sectors, however, developments will be determined more and more by an increasingly uncertain trend in demand. Imports will probably pick up again.

A further rise in prices is possible, but may be somewhat slower than hitherto. This will be helped by the greater restraint that has become apparent where wage increases are concerned.

The latest developments suggest that there is no call for any substantial alteration to the forecasts made for the whole of 1963 in the last Quarterly Survey for 1962. The real gross national product should therefore go up by about 4 % and the index of industrial production should also show a year-to-year increase of a good 4 %.

1. Recent developments

Foreign demand (i.e. effective exports of goods and services in terms of national accounting) provided quite a strong stimulus to the economy in the fourth quarter of 1962, even if its contribution was somewhat less vigorous than in the third quarter, when the increase in the rate at which exports were growing was a noteworthy feature. According to customs statistics, exports of goods alone returned year-to-year growth rates of 9.7 % in value and 9.2 % by volume, compared with about 3 % both by volume and in value in the third quarter. However, this increase is partly a reflection of the relatively weak trend in exports in the fourth quarter of 1961.

Elasticity of supply clearly contributed to the expansion of exports, since very high growth rates were recorded for exports of machinery and tools at a time when at home the propensity of firms to invest was becoming more moderate.

Domestic demand also continued to expand, although expenditure on gross fixed investment failed to show the same year-to-year growth rate as in the previous quarter (5.8 % by volume). This is particularly true of total fixed investment by enterprises—which in the Netherlands includes housing; while hardly any further expansion seems to have been recorded in housing, the growth of industrial investment proper was distinctly slower as well. Investment in building and construction declined slightly, owing to the bad weather, whereas investment in equipment increased a little. Clearly this was due in part to the propensity to invest being sluggish for the familiar reasons—weakness of world business, rising costs, smaller margins for self-financing—and in part to the continuing bottle-neck on building and construction, which was aggravated by the bad weather. For example, the number of outstanding applications for permits to build commercial and industrial premises rose considerably again; limitation on the issue of these permits inevitably has repercussions on the sales of equipment goods. Unlike investment by enterprises, public investment was probably stepped up somewhat, although not to the extent predicted.

Public consumption went ahead again, although at the same pace; the year-to-year growth rate for the fourth quarter was probably some 4 % by volume.

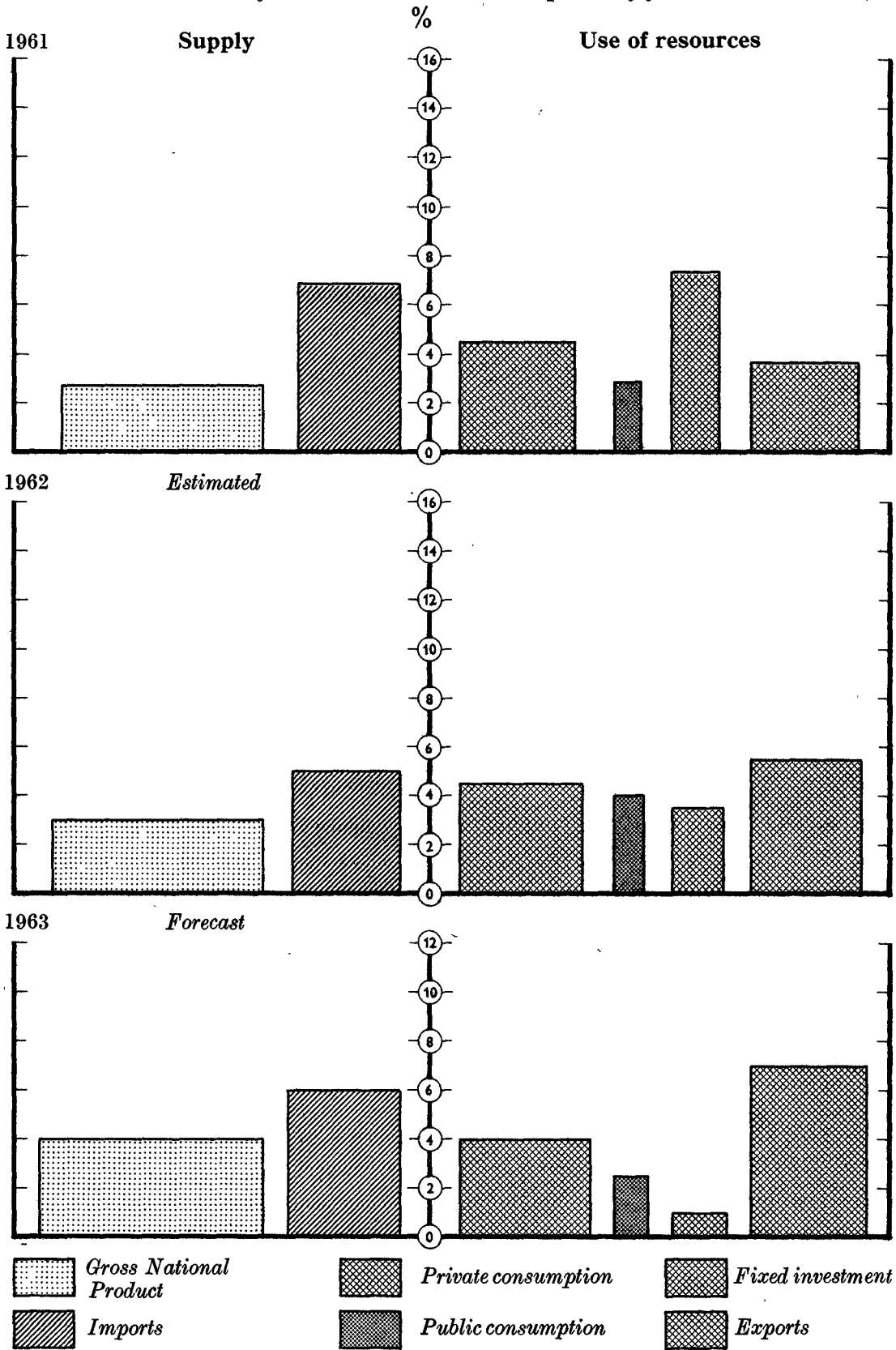
The buoyancy prevailing in private consumption since the spring of 1962 has continued. The disposable income of households expanded owing to the further rise in employment, to wage and salary increases awarded during 1962, and also to tax cuts and higher old-age pensions. After speeding up considerably in the third quarter, private consumption recorded year-to-year growth rates of about 8.5 % in value and 6 % by volume for the last three months of the year.

Strain on the labour marked eased only slightly, despite the fairly large number of young people seeking work. True, the number of vacancies tended to decline, but it still stood at over 100 000. The trend towards a drop in unemployment did not, however, continue and unemployment figures in the fourth quarter were some 1 500 higher than the monthly average of the corresponding quarter in 1961. However, extremely bad weather in the second half of December doubtless contributed to this slight increase. For the same reason the number unemployed at the end of January 1963 was as much as 11 000 higher than a year earlier. Building operators laid off because of the bad weather are not included in these comparisons.

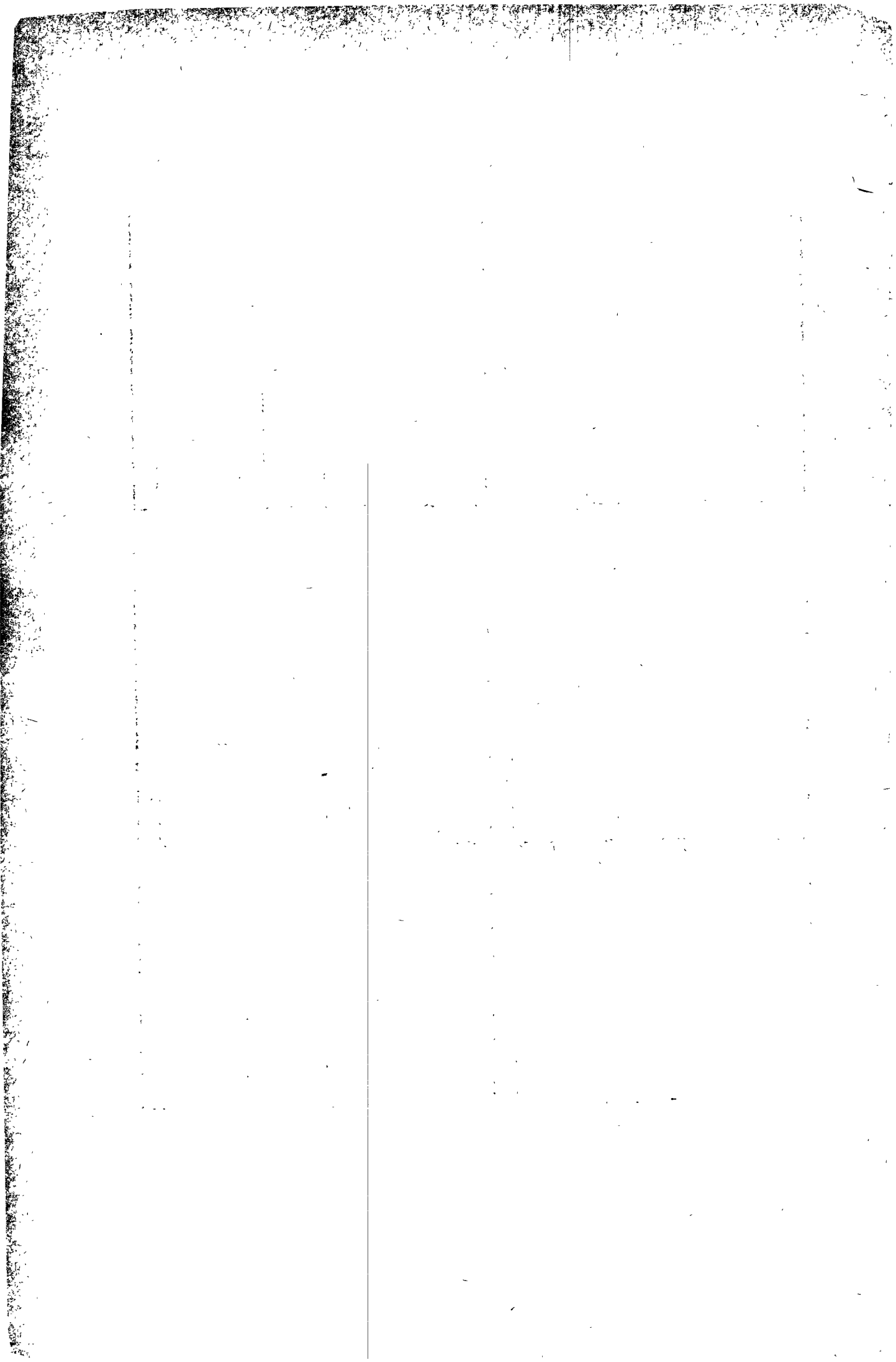
It was largely possible to meet growing demand at home by increasing domestic supply. The distinct recovery in industrial production which took place in the third quarter of 1962 may, it is true, have lost some momentum in the fourth, but this can mainly be attributed to the fact that the December figures were affected by special factors such as

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Change in volume in relation to the preceding year



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the number of working days lost around Christmas. Nevertheless, according to the unadjusted figures in the Central Statistical Office's index, there was still a substantial year-to-year growth rate of about 5 %, as in the third quarter.

Unlike domestic supply, imports failed to rise, but there too certain special factors were at work. Foreign trade statistics show that purchases of goods from abroad in the fourth quarter were only 1.5 % in value and 2.7 % by volume higher than a year earlier, compared with 6.3 % and 7.1 % in the previous quarter. After adjustment for seasonal influences, total imports of goods in national accounting terms may even have fallen off.

There was a distinct fall in the imports of certain raw materials and farm products (cereals). Imports of investment goods taken as a whole levelled off, although in some sectors, especially electrical engineering, a substantial increase was again recorded. Imports of consumer goods, on the other hand, continued to rise, while in the early months of 1963 imports of coal rose sharply.

Retail prices rose during the fourth quarter and, as in the previous quarter, were about 3 % higher than a year earlier. Until November food prices dropped slowly from the exceptionally high level reached in the spring, but in December increases in the cost of bread and the effects of the hard winter on potatoes and vegetables tended to push prices up again. This tendency became more pronounced in the early months of 1963. The retail price index at the end of 1962 was 4 % up on the corresponding period in 1961. Although prices for finished goods tended to move upwards, wholesale prices generally remained stable.

With exports rising more rapidly than imports the customs statistics registered a distinct improvement in the balance of trade in the fourth quarter. At about Fl. 400 million the deficit was a little less than half what it had been in the last quarter of 1961.

Although current transactions showed a substantial surplus of about Fl. 500 million, the gold and foreign exchange reserves of the banking system declined by about Fl. 100 million. In fact the capital transactions showed a considerable deficit because further advance repayments of public debts were made (Fl. 100 million), more foreign loans were issued on the Dutch capital market (Fl. 50 million) and exports of private long-term capital climbed steeply.

Although the balance of payments and Treasury operations did little to improve liquidity at home, the money and capital markets remained liquid. There was hardly any increase in borrowing from the banks after the middle of the year, and the perceptible

expansion in December was doubtless partly seasonal. The low level of borrowing and the tendency for investment to slacken induced the Dutch monetary authorities to give up the restrictive policy they had followed since July 1961. At the beginning of January 1963 Bank Rate was lowered from 4% to 3.5 %, while the agreement with commercial banks to limit the expansion of credit was suspended.

2. Outlook

The expansion of overall demand is expected to continue in the coming months.

Exports are likely to grow at the same rate as in the second half of 1962. Order-books are sufficiently filled in most sectors of the economy and, according to the results of the Central Statistical Office's business survey, the flow of orders for both capital and consumer goods is developing satisfactorily. The increase in production made possible by higher elasticity in the supply of some goods, combined with weaker growth of domestic demand, will probably help to push up exports. Since wage increases will probably be kept within the limits set and profits tax is no longer quite as heavy, it may be assumed that the competitive position of the Netherlands will deteriorate more slowly in 1963, although in many other countries the increase in wage costs per unit of output will be less than in the Netherlands.

It is not of course impossible that, despite the favourable trend in total demand from abroad, exports in some sectors will again be hesitant with exports of a number of products declining even further.

In domestic demand the stimulus provided by the various components is likely to vary more widely.

Gross fixed asset formation is likely to make but little progress. Although it is not impossible that in the first half of the year equipment investment by enterprises will continue to expand, the growth rates may level out and there might even be a slight decline for the full year compared with 1962. At present it does not look as though the relatively high growth rate of demand for consumer goods will lead to a further spurt in the demand for capital goods. The expected easing of the labour market, the fear of surplus capacity and the diminishing margin for self-financing are all factors that are inducing businessmen to maintain a cautious attitude. Initially the lifting of credit restrictions is sure to have only a very limited effect on the propensity to invest. On top of this, the exceptionally cold winter will entail a still worse bottle-neck in construction. This will particularly affect such building as forms part of private investment (including housing), which is therefore likely to show hardly any overall growth. Should gross fixed asset formation expand in spite of this, it will be solely due to increased public investment.

The fall in stocks at the end of 1962 combined with the increase in sales could mean that stock-building will again afford a somewhat greater stimulus to demand.

Consumer demand by households will undoubtedly continue to rise, but in the coming months its effect may be less marked, one reason being the drop in income caused by very high seasonal unemployment in the early months of the year. Consumption will nevertheless continue to benefit from the substantial growth of incomes that can be expected mainly as a result of higher employment, further increases in agreed wage rates, the raising of civil servants' salaries and larger disability pensions. The volume of consumption will, however, again be adversely affected by rising prices.

Domestic supply should continue to expand at a fairly rapid pace. The advent of young people on the labour market will probably make a further increase in employment possible, while productivity will also be making good progress. There is therefore nothing to indicate that the growth of industrial production as a whole will slacken, even if there is little or no progress in some sectors (particularly investment goods) where demand has slowed down.

Imports might again climb somewhat faster. Imports of investment goods will, it is true, fall off more sharply, but purchases of consumer goods are likely to show a further substantial increase. Imports of raw materials and semi-finished goods might also be more buoyant than hitherto.

There is hardly anything in the latest economic developments to indicate that any fundamental change needs be made in the forecasts for 1963 contained in the last Quarterly Survey of 1962. However, in view of the exceptionally hard winter it already seems fairly certain that no expansion in building and construction will be possible, except in the public sector. Total private investment is therefore likely to show little increase on 1962. The surplus on trade will probably be smaller than expected, owing to higher fuel imports, although imports of certain other goods have been temporarily slacker.

In view of the economic trends, the fact that wage increases can probably be kept within the limits fixed in the agreement between the Government and the Labour Board (Stichting van den Arbeid) is to be welcomed. Even in the metallurgical or printing industries where negotiations proved particularly difficult, all the new collective wage agreements reached so far have kept within the agreed average increase of 2.7 %.

The main problem facing those in charge of economic policy in the Netherlands at the moment is the situation in building and construction. All measures designed to ensure the best use of the factors of production, to step up output and in particular to

enable the industry to work off the backlog caused by the weather, can help to make economic growth more balanced. This would also facilitate the more generous issue of permits for industrial building apparently needed to back up the measures taken in the field of credit policy, that have already been adopted in an endeavour to counter the slackening of directly productive investment.

E. B.L.E.U.

Belgium

In the closing months of the year overall demand continued to rise, especially owing to a somewhat more rapid increase in private consumer expenditure. Though foreign demand was very high and the value of goods exported in the fourth quarter exceeded by 8 % the level attained last year, expansion (seasonally adjusted) seems to have slackened a little. Thanks to the impetus derived from investment by industry and the public authorities the growth of gross fixed-asset formation continued; housing construction showed some signs of slackening.

After a year-to-year growth rate of 6 % in the third quarter, the IRESP index of industrial production was just over 4 % higher than in the fourth quarter of 1961. The relatively modest expansion of domestic supply was accompanied by a vigorous rise of imports. The total value of goods imported in the fourth quarter was 11.5 % higher than a year ago, compared with a corresponding increase in the third quarter of 6 %.

The employment and labour market situation showed little change in the last months of 1962: seasonally adjusted, unemployment declined again. At the beginning of 1963 there was, however, a sharp rise in temporary and casual unemployment caused by weather conditions.

In the fourth quarter prices showed a slight tendency to rise. According to the index of the Ministry of Economics the level of consumer prices was 1 % higher at the end of 1962 than it had been a year before. But early in the new year Belgium, as other countries, experienced a sharp rise in prices, mainly as a result of the extremely cold winter.

The deficit on trade widened in the fourth quarter of 1962: nevertheless the overall balance of payments closed with a small surplus. This was the main reason why domestic liquidity remained easy and Bank Rate was once again reduced at the beginning of December (from 3.75 to 3.5%).

The economic outlook for 1963 is not unfavourable, though exports—especially to the Member States—cannot be expected to go on expanding at the same rate as in 1962. Private consumption and public expenditure will be the mainstay of economic expansion, whilst private investment expenditure is likely to go on losing momentum. Though it will hardly be possible to make up the loss of production caused by the cold weather during the early months of the year, especially in building and construction, the growth of the GNP in real terms from 1962 to 1963 may attain approximately 3 % as forecast in Quarterly Survey No. 4 of 1962.

1. Recent developments

In the fourth quarter of 1962 economic expansion was still largely supported by foreign demand, which, however, apart from seasonal and random variations had still been rising, though considerably more slowly. According to foreign trade statistics the value of goods exported was around 8 % above the figure for the same quarter of the previous year. Exports reached a peak in October, but in November and December the pace was more moderate.

It is noteworthy that the high level of exports is exclusively attributable to demand from the other EEC countries. The year-to-year growth rate for exports of goods to these countries rose from 17 % in the third to 23.5 % in the fourth quarter. The outstanding rises were in textiles, foodstuffs and—to a lesser extent—machinery and equipment. On the other hand the decline in exports to non-member countries persisted because of a weakening of demand in many of these countries. The value of these exports was lower by 9 % than in the fourth quarter of 1961, after the third quarter of 1962 had already seen a 4.5 % fall below the level of a year earlier.

Domestic demand rose further. Gross fixed asset formation does not however appear to have provided much more stimulus than in the preceding quarter. Though investment expenditure by firms, especially on equipment, again rose appreciably, at least according to the latest business survey of the Central Bank, housing construction seems to have suffered a slight decline. On the other hand public investment, especially in road-building, went ahead even at a somewhat quicker pace.

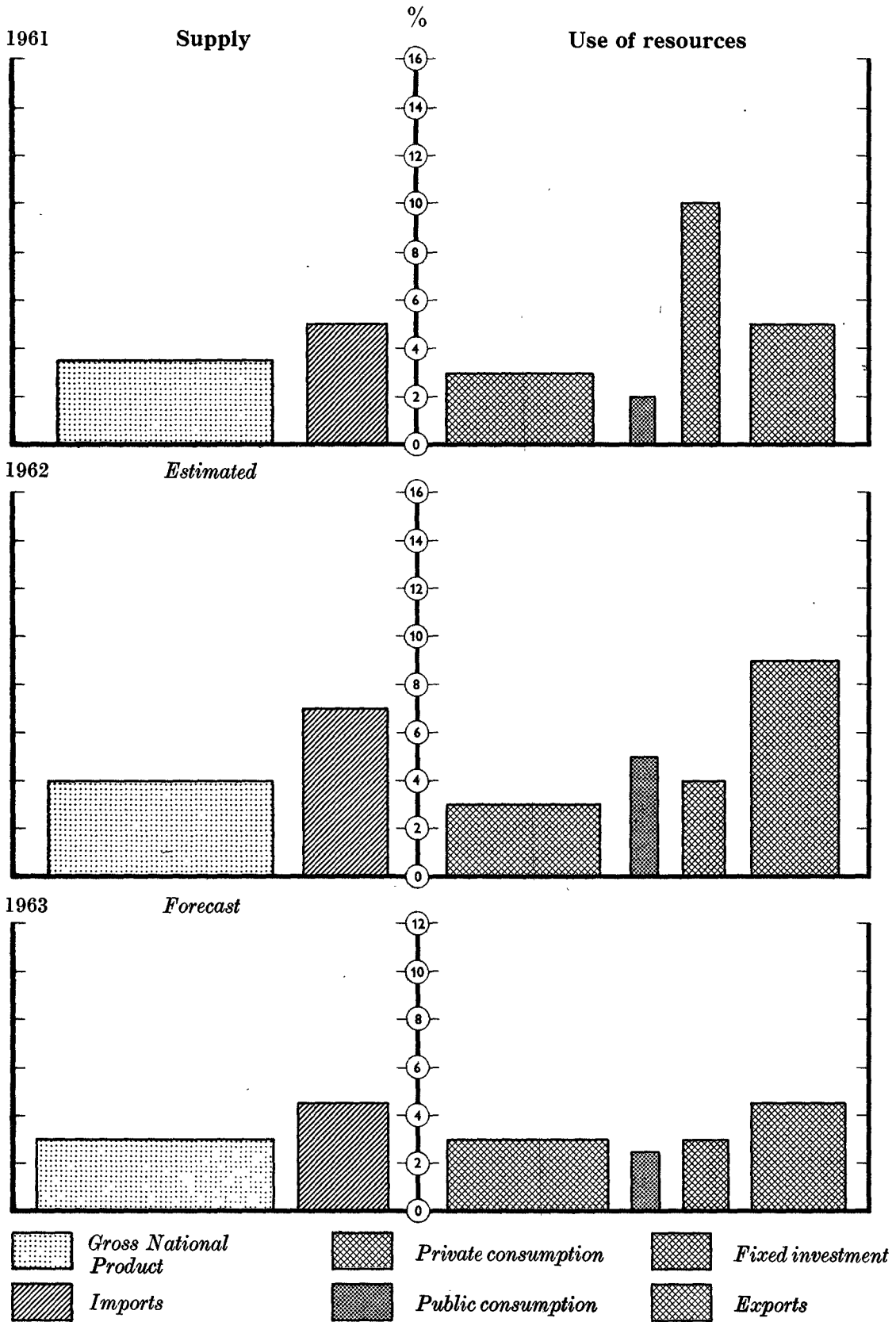
In contrast to the trend in gross fixed asset formation, private consumer expenditure seems even to have gone up more steeply in the fourth quarter. At any rate the favourable movement of certain indicators—turnover of department stores, registration of new motor vehicles, imports of consumer goods—point in this direction. In the first two months of 1963 the effects of the extreme cold on earnings in certain sectors may again have brought about a certain slowdown.

The rapid rise of consumption in the fourth quarter of 1962 was largely the result of the third quarter's increase in total wages and salaries consequent upon fuller employment and certain substantial pay increases. Also, towards the end of the year the savings rate of households may have declined slightly. Owing to higher prices consumption expanded a little less in real terms than by value.

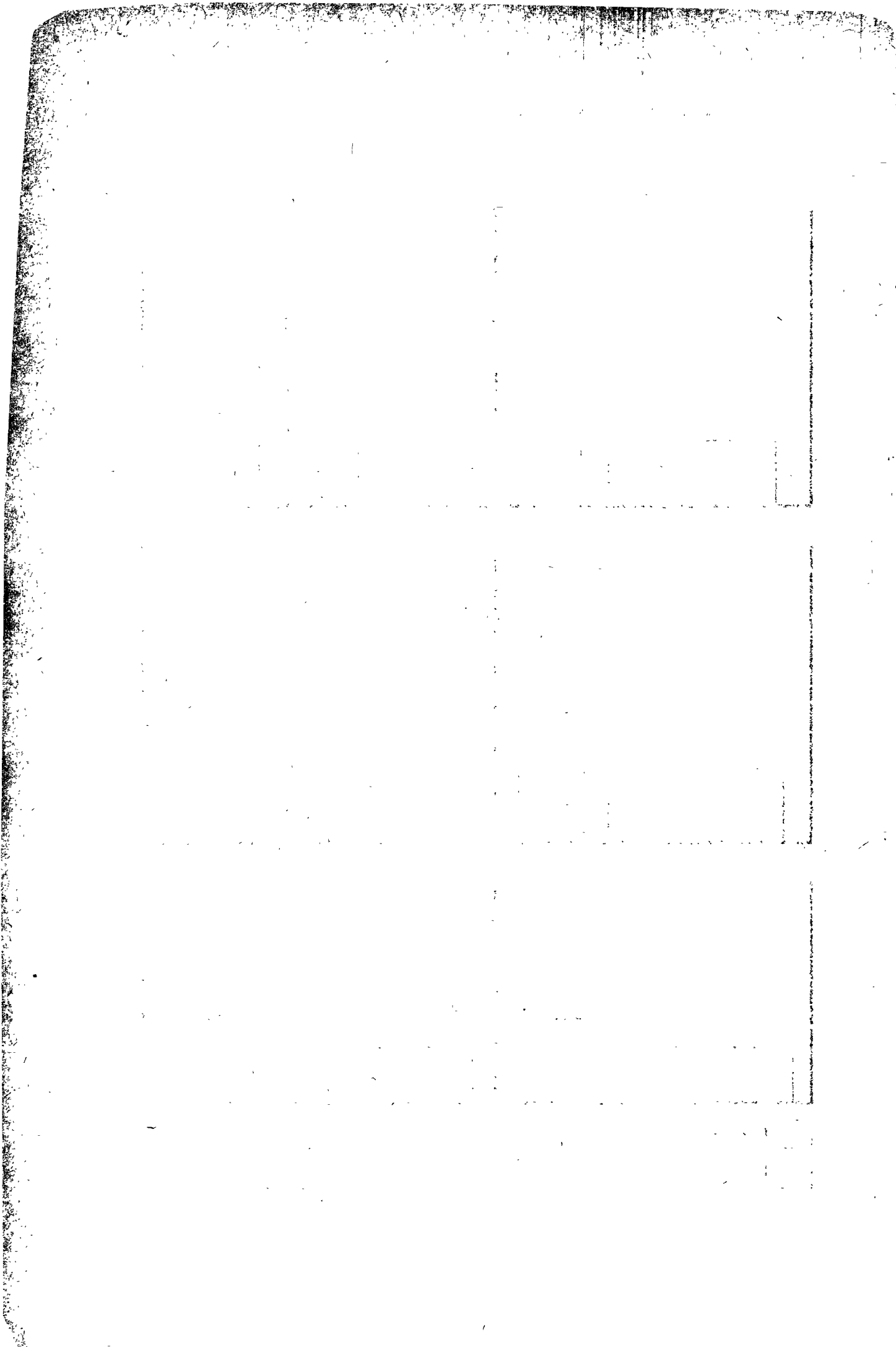
Public expenditure continued to expand, though only moderately in terms of volume.

SUPPLY AND USE OF RESOURCES — GOODS AND SERVICES

Change in volume in relation to the preceding year



The width of each column corresponds to the aggregate value for the preceding year



Not all of the rise in overall demand benefited domestic production; a considerable part of it was reflected in higher imports.

Industrial production seems to have risen again between the third and the fourth quarter, but the advance was probably very modest. The growth shown by the IRESP index over the corresponding periods of the previous year even fell from 5.9 % in the third to just over 4 % in the fourth quarter. However, a special statistical factor must be borne in mind : in the third quarter of 1961 the corrected index had been relatively low.

Nevertheless, in the fourth quarter output in some branches of industry, such as non-ferrous metals, fell below the 1961 level. Furthermore the growth rate in the production of capital goods has definitely declined.

The modest expansion of production was largely the result of progress in productivity. The total number of persons employed in industry, construction and certain services (transport) is not likely, after seasonal adjustment, to differ much from the peak reached in the spring. In some branches the shortage of skilled workers persisted during the period under review. In the fourth quarter the number of unemployed averaged 113 900, or about 9 700 below that for the previous year. More than anything else the exceptionally bad weather conditions at the end of 1962 produced a sharp rise in temporary and casual unemployment. In January 1963 the number of unemployed was about 127 000 above the level of a year before.

In the fourth quarter, as already stated, imports rose rapidly. According to customs statistics the year-to-year growth rate for imports of goods increased from 6 % by value in the third to 11.5 % (provisional figure) in the fourth quarter. One of the decisive factors may well have been the development of domestic demand for finished products (both consumer and capital goods); but imports of products of the extractive, textile and metal industries have also risen rapidly.

The year-to-year growth rate for imports from EEC countries climbed to 15 %, but the rate for imports from non-member countries also rose considerably. The volume of total imports probably rose somewhat less than their value, because prices of some imported raw materials hardened.

The level of prices rose a little, but this was due partly to seasonal and fortuitous factors (weather, the influence of import prices). In certain branches, however, cost increases occurred which were to some extent passed on in prices, especially where higher demand allowed. This is true of services in particular. The Ministry of Economics'

general index of retail prices was, on the average, 1.2 % higher in the fourth quarter than in the same period of 1961. Owing in particular to a 4 % increase in farm prices, the wholesale price index also was 1 % higher. At the beginning of 1963 the price rise became steeper, in the case of foodstuffs as a result of the severe weather, and for fuel and certain textiles because of the trend of world prices.

Since imports expanded considerably in the fourth quarter more rapidly than exports, the trade balance deteriorated markedly. The deficit amounted to around Bfrs. 4 800 million as compared to Bfrs. 900 million in the previous quarter and Bfrs. 2 600 million in the last quarter of 1961. Consequently, the current balance of payments deteriorated despite the continuing favourable trend in the balance of services and private transfers. Capital movements seem to have resulted in a net inflow which may be only partly attributed to public transactions.

The overall balance of payments is likely to have closed with a small surplus. An increase in official gold and foreign exchange reserves supports this impression. The net foreign exchange position of the banks probably deteriorated.

Payments transactions with abroad helped to keep liquidity high throughout the fourth quarter. The greater recourse of the banks to the Central Bank and the increase in day-to-day money rates noted in the second half of December were only temporary. The lowering of Bank Rate from 3.75 % to 3.5 % at the beginning of December—the sixth 0.25 % reduction since August 1961—and of the interest rates on savings deposits with effect from 1 January 1963 by the central savings institutions show that the monetary authorities consider internal liquidity to be ample. As to public finance, the total deficit for 1962 is not likely, in view of the budget transactions in the fourth quarter, to have exceeded Bfrs. 16 700 million, whereas in 1961 it had been 22 300 million.

2. Outlook

Developments in the coming months are likely to be largely as forecast at the end of last year.

The somewhat weaker expansion of exports which became apparent in November in certain sectors suggests that progress will be modest. Though the reduction of customs duties within the Community which will take effect on 1 July should benefit exports to the

other Member States, exceptionally high rate of expansion witnessed in this field in the second half of 1962 is unlikely to be attained again. Moreover, it would be wise not to count on any upturn of the very hesitant trend in exports to non-member countries. The slowdown in foreign orders indicated by the last EEC business survey seems to confirm this view.

Gross fixed asset formation is likely on the whole to expand very slowly. The general outlook for demand offers less incentive for industrial investment, especially as idle capacity seems to have increased over the past year. Only rationalization schemes are likely to have much effect on gross fixed asset formation. There is no doubt that this type of investment will rise relatively quickly, especially as the repercussions of rising production costs are in some sectors aggravated by keener competition from abroad.

In the private construction sector where, because of the unusually cold weather at the beginning of 1963, activity was severely restricted, it is unlikely that, in view of the labour shortage in this sector, all the time lost can be made good this year. In public works, on the other hand, where mechanization speeds up building considerably, and large appropriations have been made under the budget, there should be a further marked revival.

After the very sharp rise in private consumption during the fourth quarter of 1962 it is unlikely that very rapid expansion will persist, at least in the first half of 1963. In view of the effect on personal incomes of the fall in employment caused by weather conditions at the beginning of the year, it is likely that the year-to-year growth rate of consumption, which had already fallen off in the first quarter, will remain slack into the spring.

Nevertheless mass incomes can be expected to continue rising in the coming months, mainly owing to improved social benefits but partly also to wage increases in some branches.

In view of this trend of demand it is to be expected that domestic supply will continue to expand—although at a modest rate, especially as it is probable that there will again be large imports. Industrial expansion is unlikely to be hampered by difficulties connected with the availability of factors of production. In the short term, production will probably increase mainly under the pressure of demand for consumer goods, whilst there is little reason to expect any material change in the situation of the metal industries.

The outlook for the employment situation suggests that the labour force will on the whole be sufficient to ensure adequate elasticity of production. Labour supply may

tend to be slightly easier for the following reasons : the expansion of production is expected to be moderate; productivity will further increase; the numbers of school-leavers and of foreign workers will be larger; and the number of women workers will rise somewhat. The general application of the 45-hour week is unlikely to affect the elasticity of production to any appreciable extent.

Imports will go on increasing vigorously, although probably at a somewhat slower rate than in the fourth quarter of 1962, which was exceptional. Expansion in supplies from abroad is likely to be determined, particularly during the first half of the year, by the trend in the demand for consumer goods and by foreign orders.

It is uncertain whether the level of consumer prices, which rose unusually steeply in the early months of the year, will subside again. In fact, prices for several industrial products and practically all charges for services are showing a definite upward trend which, in the case of industrial products is partly connected with the hardening of world prices for certain raw materials, but also with higher costs in industry. The index will be kept high by these factors and by the effect of certain decisions such as the (belated) inclusion of increases in workers' weekly tickets on the railways.

Although the 1963 trade balance over the whole year may be less favourable than in 1962, there is no reason to expect a deterioration in the balance of current payments.

The domestic liquidity situation will probably remain relatively favourable. Even if Government expenditure exceeds the estimates, because of higher costs caused by the severe winter and because certain appropriations have been increased, the rise in the national debt is likely to be of the same order as in 1962.

Therefore, no major obstacle to private investment should arise from this quarter. It must however be remembered that profit margins in industry have probably come under some pressure through last year's trend in the wages-productivity-price relationship and through certain effects of the tax reform; as a result, the need to obtain funds from outside sources has increased. On the other hand access to such outside funds is still difficult for medium-sized and small businesses.

In view of the slackening trend of industrial investment it is therefore important as a matter of anti-cyclical policy that the proposed measures to improve the functioning of the capital market with a view to financing domestic investment be carried out rapidly.

It is also evident that policy to improve the structure of the productive apparatus will continue to be of great significance. And, last but not least, care must be taken not to jeopardize competitiveness with other countries, which had been improved so considerably in 1962. This means that efforts should be re-doubled to keep costs—and especially wage costs—within the limits compatible with that requirement.

Grand Duchy of Luxembourg

In the fourth quarter of 1962 the economy of Luxembourg was again influenced by the persistently unfavourable situation in the world market for iron and steel. It is true that the trend of output in this sector improved a little and deliveries of iron and steel products showed a slight increase, but this meant that the backlog of orders was being run down. Since the rise in domestic demand was slight there was relatively little expansion in industrial production as a whole from the third to the fourth quarter. Nevertheless the overall index was only 0.5 % below that for the corresponding period in the previous year, after it had been down 5.5 % in the third quarter.

Given the business situation throughout the world, it is unlikely that there will be a reversal of trends in Luxembourg. Though there are some indications that the fall in users' stocks of iron and steel products has ceased and will no longer affect effective demand, it is unlikely that the coming months will bring any considerable expansion of exports. The hesitant trend in domestic demand and the unusually severe winter are amongst the reasons why overall industrial production will probably fail to increase appreciably in the coming months.

1. Recent developments

Foreign demand showed little sign of reviving in the last quarter of 1962. The slight increase registered in the exports of iron and steel products over both the previous quarter and the corresponding period of last year will most likely prove to have been due to speedier execution of orders. The volume of rolled steel exports was relatively high because of the comparatively stable demand from Member States. In fact, the backlog of orders in the iron and steel industries has been shrinking. At the end of 1962 they still represented about 2 months' production as compared with about 2 1/2 months in the period from September 1961 to September 1962. Export prices, which in summer 1962 had dropped lower than at any time since the beginning of 1959, recovered a little in September and October. The downward trend of iron ore exports continued and became even more marked.

Gross fixed investment made little contribution to overall demand in the fourth quarter. Though—to judge by the number of trading licences issued to small and medium-sized establishments in trade and industry—investment may have risen in those sectors of the economy which do not form part of the iron and steel industry, the amount of money spent within this industry on modernizing plant and equipment was probably no greater

than in the third quarter. Construction, which in the third quarter had been 2.5 % below the level of a year earlier, picked up a little in the fourth quarter in terms of man-hours actually worked. According to the data so far available, this improvement was due to increased activity in the public sector. From December 1962 to February 1963, however, activity in the construction sector was greatly hampered by the severe winter.

The only moderate rise in wages incomes has probably meant that the increase in the total income of households will have been slight. The trend of private consumption probably followed that of incomes, but the stabilization of retail prices at the level of the third quarter has no doubt contributed to the higher figure for consumer expenditure in real terms. However, sales of motor-cars were again lower in the fourth quarter than a year ago (by 6 %, as compared with 6.5 % in the third quarter).

The main components of overall demand continued to move forward hesitantly—some more so, some less—and this further inhibited the expansion of industrial production. The slight quickening reflected in the seasonally adjusted index occurred mainly in October, while in November and December there was a tendency to slip below the October peak. The output of iron and steel increased slightly in the fourth quarter and touched the highest point for the year, even though the monthly average remained below the figure reached in 1961. The average monthly output of crude steel, which in the first six months of 1962 had averaged only 331 000 metric tons, mounted to 334 000 metric tons in the third quarter and attained 340 000 metric tons in the final quarter. This meant that in the fourth quarter the overall index of national production was only 0.5 % down on the fourth quarter of 1961, compared with a corresponding drop of 5.5 % in the third quarter. To judge by the latest available data, the production figure of all industries will probably be about 4.5 % lower in 1962 than in 1961.

It was largely the slowdown of employment in construction, due to inclement weather conditions in the second half of December, which caused the year-to-year growth rate of overall employment to fall off markedly in the fourth quarter of 1962, although some reduction in the number of persons employed in the iron and steel industry and in mining also played a part; whereas the numbers employed in industry and construction together were in the third quarter still 2.4 % higher than a year earlier, in the fourth quarter the gap had narrowed to a mere 0.9 %.

The cost of living, which had been moving upward in the third quarter owing to a hardening of food prices, remained practically unchanged in the fourth. However, just as food prices tended to go back to normal during that period, price increases occurred for practically all other goods and services. At the end of the year the index was only 0.8 % above that recorded at the end of 1961.

A considerable drop in corporation tax has meant that from January to December 1962 the State's ordinary revenue was about 6.5 % lower than a year before. Though

total expenditure was only slightly up, the budget situation deteriorated by comparison with 1961. The public debt mounted by LF 674 million—largely owing to increases in the last quarter—while in 1961 it had fallen by LF 477 million.

2. Outlook

In the coming months demand as a whole will continue to be governed by the relatively unfavourable situation in the world market for iron and steel products. The EEC business surveys show that the enterprises themselves, especially those in the iron and steel industry, are not optimistic about the foreign orders on their books at the beginning of this year.

The indirect effect on domestic demand of recent trends and the present outlook will probably make itself felt in the coming months. Gross fixed investment by enterprises especially in the iron and steel industry, will probably do no more than hold its own at the level attained during the last months of 1962. At the same time the shortage of labour and a slight fall-off in public investment may well mean that construction cannot expand sufficiently to make good the loss caused by the severe winter.

Private consumption will probably grow modestly. As there is little further rise in employment, as public transfer payments remain unchanged, and as some incomes of self-employed persons may even be falling, the incomes of households as a whole will probably rise appreciably only if wages and salaries are raised in the coming months. Negotiations in the "Office national des Conciliateurs" (national conciliation board) have already led to wage increases in the iron and steel industry and in iron-ore mining, and certain salary increases are proposed for the public service. The introduction of a minimum weekly wage and measures to implement the principle of equal pay for men and women workers are also being studied. Nor is it impossible that in view of the price trend there will be wage increases in accordance with the sliding wage scale, especially if milk and bread prices are raised.

Any increase in public consumption would seem to depend entirely on a rise in civil service pay.

In view of this probable outlook for the various components of demand it is hardly likely that the coming months will witness any noteworthy upward move in industrial production.

These surveys have frequently referred to the difficulties which Luxembourg faces in any policy to underpin the economy and which are due to the country's dependence on

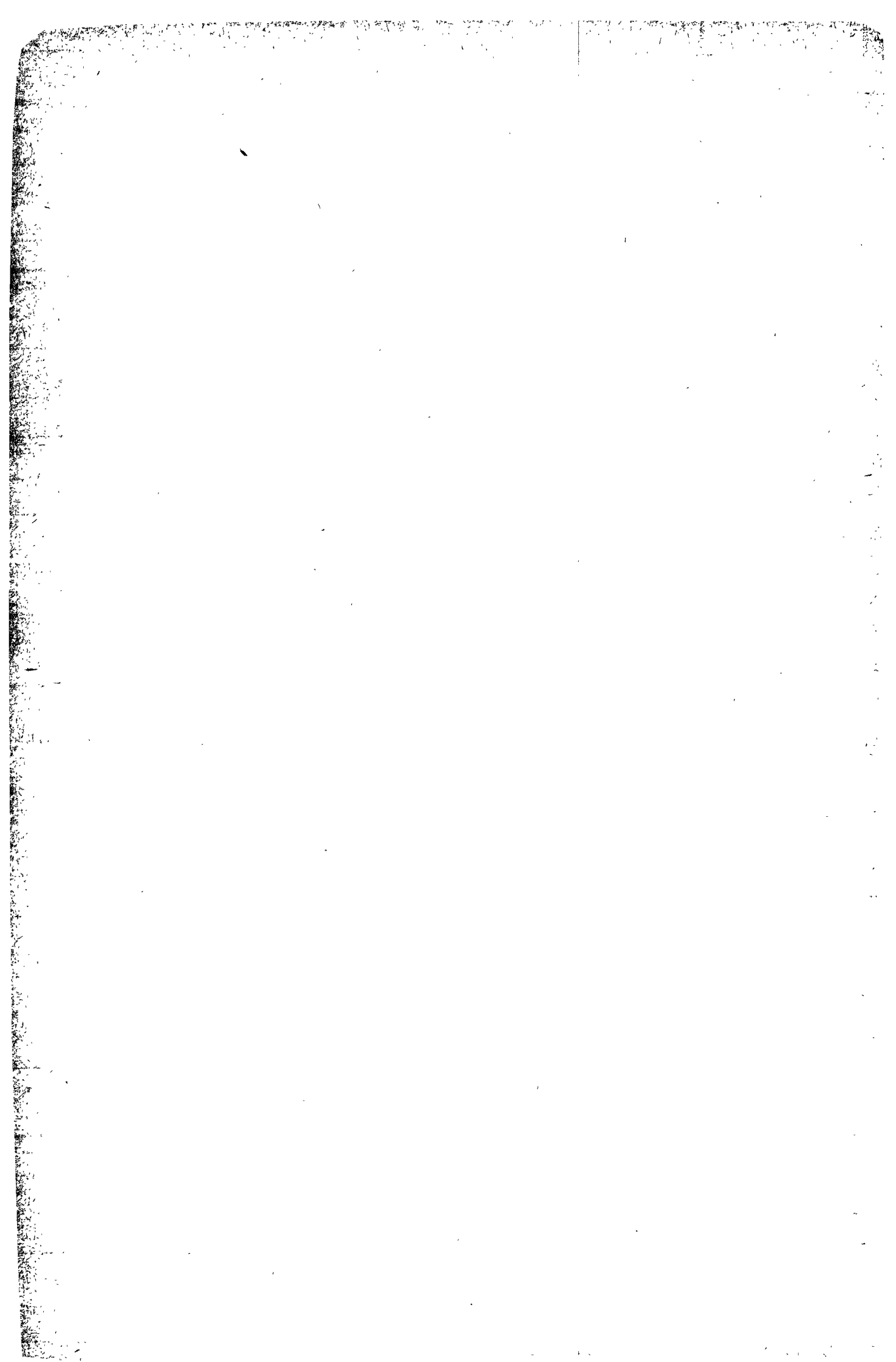
economic conditions abroad. These difficulties are especially marked at the present time when, although the economic situation abroad, or at least in the Community countries, is in general favourable, the iron and steel market—still of preponderant importance to Luxembourg—forms an exception. In addition, the shortage of labour in Luxembourg sets limits to any policy of expansion, which must of course be directed towards sectors other than iron and steel.

The surveys have however always stressed that the Luxembourg authorities had a certain margin for action by which they could at least attenuate the effects produced on the economy by setbacks in the iron and steel situation. They can at least maintain public investment at a high level, or even increase it, and at the same time intensify their support of private investment under the long-term programmes for structural improvement.

With regard to this latter point, certain measures have already been put into effect, but it would seem advisable to increase even further the preference given to this type of investment. In this context it is apparent that the lines to be followed by this longer-term policy of expansion and structural development must be more clearly defined.

But under present arrangements public investment, on the contrary, is actually to be scaled down. Under the budget estimates for 1963 the overall deficit is to be reduced in comparison with 1962. If these estimates were to be rigidly adhered to, they would to some extent represent a policy of moving in parallel with the business situation, instead of at least trying to exert a stabilizing influence. The Luxembourg authorities are however in a good position to make more effective use of their cash transactions as a weapon to deal with current economic difficulties; they should seize the opportunity.

The more such a policy is concentrated on rapid structural improvements, the less will be the risk that the resultant expansion of demand will be frittered away across the frontiers in the form of greatly increased imports. Furthermore Luxembourg's short-term economic policy should no longer be seen in isolation but in the light of the policies being followed, after co-ordination within the Community, by the other Member States.



Trends in wages, productivity and wage costs in industry

These Surveys have frequently referred to the part played by the trend of wage costs per unit of output in shaping general economic trends, and to the problems arising in this context. Though other costs are important, wage costs account for the lion's share of overall costs.

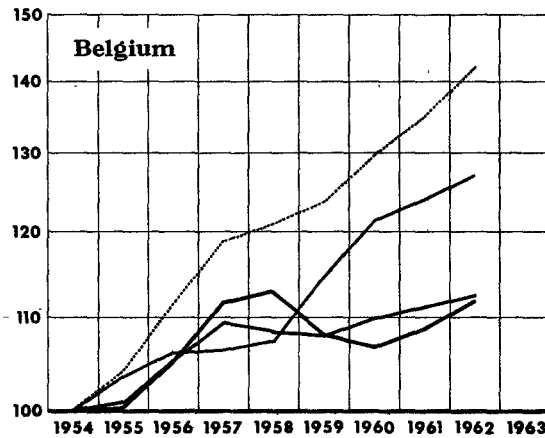
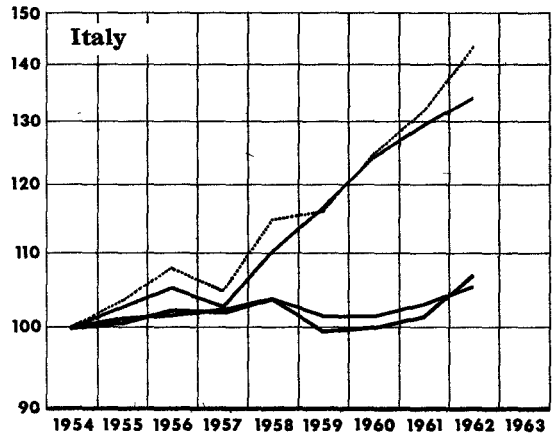
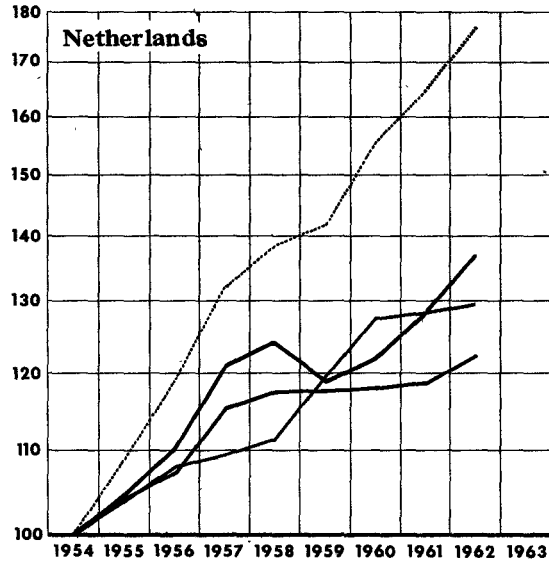
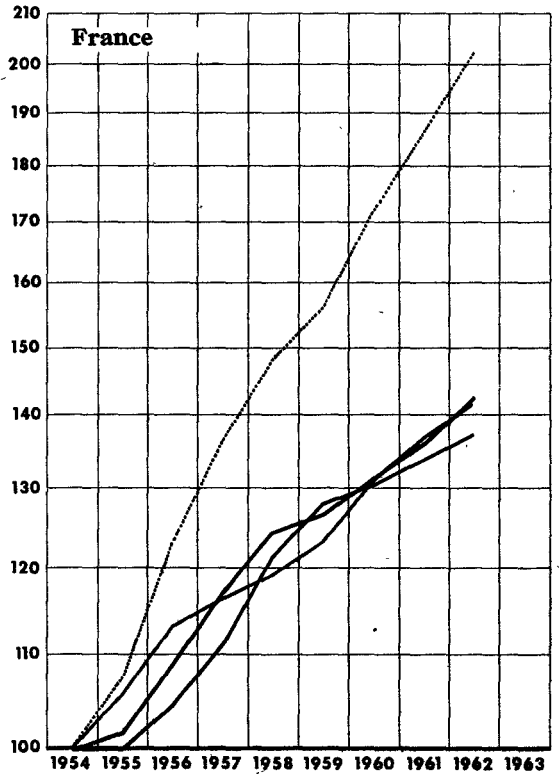
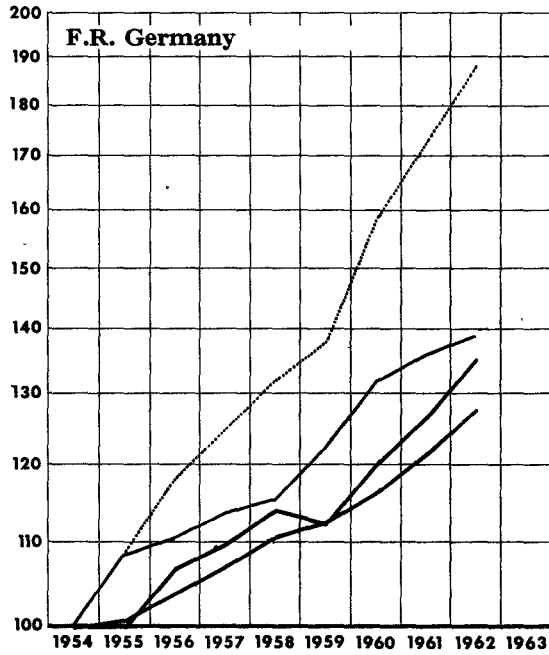
To illustrate their comments on wage costs, the Commission's services published graphs in Quarterly Survey No. 2 of 1962 showing the most important data on the trend of wage costs per unit of output in manufacturing industries (including building and construction) in the Community countries, in the United States and in the United Kingdom.

These graphs have been brought up to date below : the curves have been extended as far as 1962 and account has been taken of corrections now made for preceding years in the data for certain countries. The figures for 1962 are based on provisional national accounting estimates and are not final.

For an explanation of definitions and methods of calculating, reference should be made to the Annex to Quarterly Survey No. 2 of 1962. It should be stressed once again that the graphs are no more than an objective reproduction of the trend, and as such make no comment on the causes of changes in wages, wage costs and prices. It should be

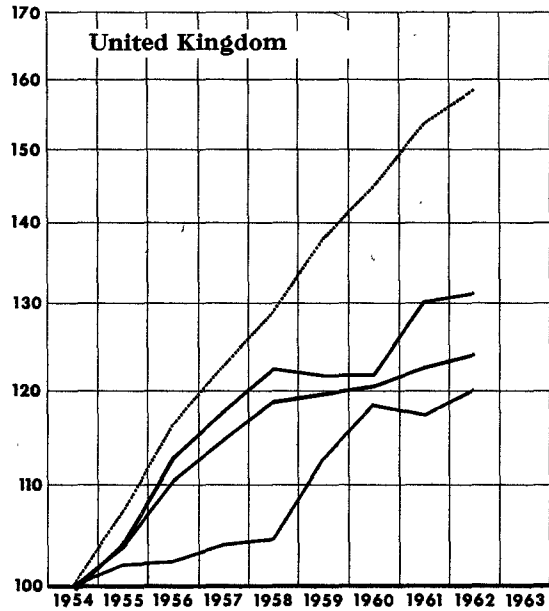
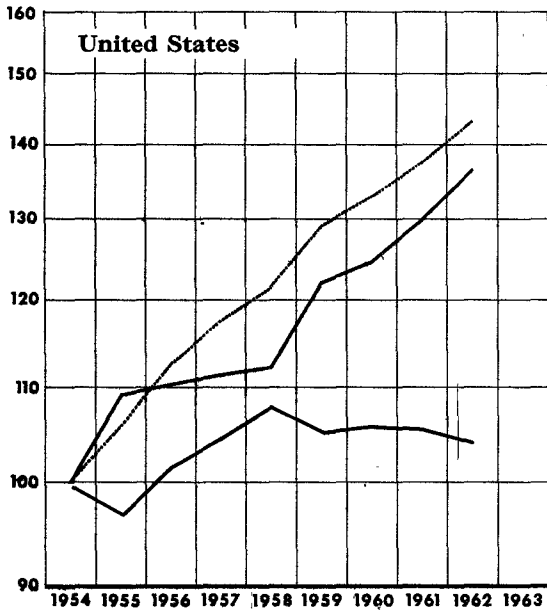
WAGES, PRODUCTIVITY AND WAGE COSTS IN INDUSTRY

1954 = 100



WAGES, PRODUCTIVITY AND WAGE COSTS IN INDUSTRY

1954 = 100



- Product per head (by volume)
- Total wages per head (in national currencies)
- Wage costs per unit of product (in national currencies)
- Implicit price index (in national currencies)

Semi-logarithmic scale

remembered, moreover, that annual figures are used in the graphs; this means, first, that the figures are influenced by the *trend* in the preceding year and, secondly, that the actual trend in the course of a given year may therefore have differed from what a year-to-year comparison of the annual figures would suggest. It seems important to remember this in the case of 1962 as well, since in certain member countries—Italy and the Federal Republic of Germany—there seems to have been some loss of momentum in the upward movement of wage costs per unit of output: the rising trend in wages slowed down a little towards the end of the year, whilst at the same time productivity was once again making more rapid progress. Lastly, it is of course essential to remember, in any comparison of the curves for the various countries, that—in absolute terms—the initial situations (1954) were completely different and also that certain exchange rates have been altered since 1954; the curves show trends in wage costs per unit of output in terms of the national currencies.

As the graphs show, wage costs per unit of output again hardened considerably in the Community from 1961 to 1962. The actual rate of increase was as high as, or even higher than, between 1960 and 1961. In the Federal Republic of Germany, in France and in Italy direct and indirect remuneration per industrial wage-earner rose in 1962 by about 9 %, in the Netherlands by 8 % and in Belgium by about 6 %. At the same time, the increase in output per wage-earner did not exceed 4 % in any Community country. In the Federal Republic of Germany, in the Netherlands and in France, where wage costs per unit of output had increased most in 1960/1961, wages and labour productivity rose in 1962 at almost the same rates—which varied from country to country—as in 1961, with the result that the rise in wage costs continued unabated. In other member countries—Belgium and Italy—wage costs per unit of output, which had developed fairly favourably until recently, rose at a faster tempo from 1961 to 1962. And this brought to an end, particularly in Italy, a fairly long period of relative wage-cost stability.

In 1963 the development of labour productivity is expected to be again a little more favourable in Italy, the Netherlands and the Federal Republic of Germany. In these countries the upward wage-cost trend might well weaken, the more so as it is reasonable to expect some flattening out of the upward trend of wages. It is still too early to say whether such an improvement can be counted on in the other member countries as well.