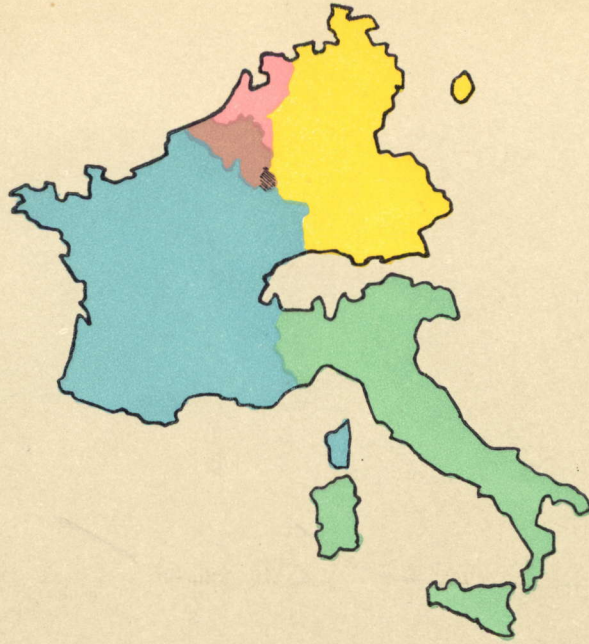


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THE ECONOMIC SITUATION
IN THE COMMUNITY

4

DECEMBER

QUARTERLY SURVEY

1965

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

EUROPEAN ECONOMIC COMMUNITY

COMMISSION

The Economic Situation in the Community

DECEMBER 1965

Contents

	<i>Page</i>
I. The overall situation	3
A. <i>The balance-sheet for 1965</i>	8
1. The world economic situation in 1965	8
2. Demand	10
3. Production	14
4. The balance of the markets	17
B. <i>Outlook for 1966</i>	29
C. <i>Short-term economic policy</i>	39
II. The situation in each of the Community countries	51
A. <i>Federal Republic of Germany</i>	53
1. Balance-sheet for 1965	55
2. Outlook for 1966	62
B. <i>France</i>	73
1. Balance-sheet for 1965	75
2. Outlook for 1966	82
C. <i>Italy</i>	93
1. Balance-sheet for 1965	94
2. Outlook for 1966	102
D. <i>Netherlands</i>	113
1. Balance-sheet for 1965	115
2. Outlook for 1966	123
E. <i>B.L.E.U.</i>	135
Belgium	135
1. Balance-sheet for 1965	137
2. Outlook for 1966	145
Grand Duchy of Luxembourg	155
1. Balance-sheet for 1965	156
2. Outlook for 1966	162

GRAPHS

1. Community trade	19
2. Economic indicators (graphs and tables)	
a) Community	47
b) Federal Republic of Germany	69
c) France	89
d) Italy	109
e) Netherlands	131
f) Belgium	151
g) Grand Duchy of Luxembourg	165
3. Businessmen's view on the industrial situation	
a) Federal Republic of Germany	57
b) France	77
c) Italy	95
d) Netherlands	117
e) Belgium	139
f) Grand Duchy of Luxembourg	157

Note :

This Survey was completed around mid-December 1965. As regards the most recent developments and where it has not been possible to take them into account because of the pace at which national statistics are prepared and the time it takes to publish the Survey in five languages, number 12-1965 of the "Graphs and Notes on the Economic Situation in the Community" can usefully complete the information supplied here.

I. THE OVERALL SITUATION

Economic expansion continued in the Community during 1965. The gross Community product grew less in real terms than in the previous year—about 4 % between 1964 and 1965, as against 5.5 % between 1963 and 1964. Nevertheless, the real gross product was up 44 % on the 1958 level, whereas in the United States the increase over the same period was about 35 %, and in the United Kingdom about 29 %.

Between 1964 and 1965 total demand in money terms rose rather less rapidly than from 1963 to 1964. The growth of external demand slowed down slightly; on the basis of external trade statistics it would appear that the value of visible exports rose some 11 %, as against 11.5 % in the previous year. Noteworthy features are the exceptionally dynamic growth of deliveries to the United States and the fact that total sales by the Community to the United Kingdom were practically the same as the year before.

The expansion of internal demand, too, seems to have slowed down somewhat, especially gross fixed asset formation, which rose 12 % in money terms and 7 % by volume in 1964 but will probably have fallen to 6 % in money terms and 3 % by volume in 1965. Within this sector, investment in construction has grown less,

partly owing to special factors, such as the weather, and partly because demand was weak, particularly the demand for housing in Italy. Expenditure on plant and equipment, too, rose less rapidly than between 1963 and 1964, mainly because in Italy there was an actual decline in this form of investment, while in France it stagnated in the private sector; public investment expenditure on the other hand again advanced quite vigorously, except in Belgium and Luxembourg.

Another important point is that in 1965, in sharp contrast to the previous year, investment in stocks in the Community as a whole made practically no contribution to economic activity or to imports.

By contrast with investment, the expansion of total consumption expenditure scarcely slackened in 1965. The expansion of public current expenditure on goods and services was even more rapid than from 1963 to 1964, especially because of the mounting pace of expansion in Belgium and Germany. In the Community as a whole, on the other hand, private consumers' expenditure rose somewhat less vigorously than between 1963 and 1964. In 1965 it was about 7.5 % (or in terms of volume 4 %) higher than in the previous year, when the corresponding increase had been 8 % in value and 4.5 % by volume. The slight slowdown is essentially due to the fact that expansion was smaller in Italy and France than from 1963 to 1964.

With the 1965 increase included, living standards in terms of real private consumption per head of population have risen by no less than one third since 1958.

In 1965 the expansion of consumer demand was once again based mainly on a continuing strong upward trend of wage and transfer incomes. Only in France and Italy was the growth of these incomes appreciably smaller than between 1963 and 1964. As against this, the increase in disposable incomes in the Federal Republic and the Netherlands was further encouraged by considerable reductions in direct taxes.

In view of the gentler expansion of demand noted in some member countries, and also—particularly in Germany—because of the constraints due to labour shortages, the growth of domestic supply in the Community was clearly weaker than between 1963 and 1964. Industrial production (as defined for the index of the Statistical Office of the European Communities) probably grew by a good 4 %, after rising by 6.5 % in the previous year. Growth rates of individual member countries showed clear differences, even though these tended to narrow as the year went on.

The expansion of the Community's agricultural output was greatly hampered by the widespread bad weather in summer. Only for services did the fairly rapid growth continue.

In some member countries in 1965 there was a more or less marked tendency for the labour market situation to ease, and in Italy unemployment rose appreciably. In Germany and the Netherlands, on the other hand, the acute manpower shortage persisted.

The Community's imports rose less strongly than between 1963 and 1964. The growth of visible imports from non-member countries does not seem to have been more than 5 % in value and 4 % by volume, after an expansion of 8.5 % (by volume 7 %) between 1963 and 1964. This more moderate growth of imports reflects the weakness of demand for imports in Italy and France, due to the business situation, and also the more or less general reluctance to build up stocks. These factors more than offset the effects of the increased flow of imports to the Federal Republic of Germany.

Visible trade between the member countries continued to be very dynamic. Their value, calculated on an import basis, expanded in 1965 by about 12 % (+ 14.5 % between 1963 and 1964). This was a factor which helped to smooth out the imbalance between the Community countries with excess demand (particularly Germany) and those with unused capacity (France and Italy).

Despite the slight reduction in the pace at which demand was expanding, and despite the growth of internal trade, prices in general rose further. This was either because supply (particularly of farm products) also expanded more slowly or because the rise in costs per unit of production continued, or again because earlier rises in costs were passed on (public utilities tariffs, rents, etc.). The underlying tendency for prices to rise became stronger in Germany, maintained its vigour in the Netherlands and in Belgium showed little sign of weakening. The upward movement of prices was slower in Italy, and only in France did it more or less cease. For the Community as a whole the rise in the price level from 1964 to 1965 was only slightly less than between 1963 and 1964.

As exports increased more strongly than imports the deficit on the Community's trade balance for the year decreased. According to the still incomplete customs returns, the figure may be only about half as high as in the previous year, when it was some 2 700 million u.a. ⁽¹⁾.

⁽¹⁾ 1 u. a. = 1 unit of account = 0.888671 gm. of fine gold = \$1 US at the official exchange rates.

For this reason, especially, the surplus on current payments in 1965 was probably higher than in 1964. At the same time the balance on capital movements was affected by a certain increase in net imports of long-term capital. Official gold and foreign exchange reserves in the member countries decreased. However, this was to some extent connected with a sharp improvement in the IMF position and a rise in the net foreign exchange holdings of the commercial banks.

Economic expansion in the Community may well speed up slightly in 1966. True, with the world business situation continuing to lose momentum, the impact of external demand is again likely to be somewhat weaker. However, total internal demand in money terms should show rather higher year-to-year growth rates than in 1965.

For one thing, a speedier growth of investment expenditures would seem to be in the offing. Here the main contributing factors are likely to be the forecast expansion of investment in plant and equipment in France, Italy and the Netherlands, and of public investment, which is expected to advance particularly in the Benelux countries and may also rise in Italy. While the increase in public expenditure on goods and services is likely to be smaller than between 1964 and 1965, private consumers' demand could rise about as quickly as in the previous year in terms of value, and by volume even more vigorously.

In particular, the probable pick-up in the expansion of domestic demand in France, Italy and Belgium—which in Italy has already been reflected in the business trend throughout 1965 and in France since the spring—justifies expectation of a speedier annual growth in the Community's supplies of domestic origin. This should rather more than compensate the likely slowdown in the expansion of production in Germany, particularly where industrial production is concerned. Assuming normal weather, there should also be a marked rise in agricultural output, and construction should increase its output at roughly the same rate as hitherto. All in all, the Commission at present considers that an increase of about 4.5 % in the real Community product between 1965 and 1966 is possible.

At the same time imports from non-member countries will certainly rise more vigorously than from 1964 to 1965, and the improvement in the Community's trade balance for 1965 could thus give way to a new, albeit moderate, deterioration. It can be assumed that the same development will occur in the overall balance of current payments.

There is nevertheless a danger that the upward movement of prices will continue. The scale of the rise may again be somewhat weaker than in the preceding year, but it

will still probably be far beyond what was aimed at in the stabilization policy. In particular the outlook for the Netherlands, Germany and Belgium offers little prospect of any great reduction in the pace of the rise—in the first two countries especially because there will still be excess demand, and in Belgium more because of costs pressure. Even in Italy the rise could still be appreciable, and in France it will be difficult further to hold down the rate at which the price level is moving up.

In these circumstances it is not yet possible to abandon the priority being given in economic policy to the stabilization of prices and costs. This does not detract from the rightness of pursuing in Italy—and to a lesser extent in France—a policy of growth which should aim first and foremost at promoting investment. In these countries such a policy, if properly guided and supplemented by stabilizing arrangements, can help to eliminate the upward trend of costs. In other member countries, however, particularly Germany and the Netherlands, fresh efforts to contain the expansion of domestic demand in money terms are unavoidable if the not very happy prospects for prices are to be put right.

A. Balance-sheet for 1965

1. The world economic situation in 1965

Economic developments in the non-member countries as a whole were less dynamic in 1965 than in the previous year, and their impact on the Community's economy was therefore somewhat less vigorous. In most industrial countries there were signs of a distinct slowdown in the pace at which demand was expanding—due partly to stabilization measures. At the same time the improvement in the external economic situation of the developing countries which had been noted in 1964 proved to be short-lived, though there was a temporary recovery in their reserves of foreign exchange partly accounted for by inflows of development aid capital.

One of the mainstays of world business was the lively, if sometimes irregular, economic growth in the United States, where the increase in private consumers' expenditure in particular continued to be very marked. In the first half-year this increase was stimulated by the after-effects of the 1964 income-tax reduction and in the second half by lower indirect taxation and higher transfer incomes (including delayed payments). Fixed investment by enterprises also expanded strongly again. According to the latest business survey its value may have been about 13.5 % higher than 1964. Movements of stocks were largely a reflection of the fluctuations caused by the advent of the wages dispute in the steel industry and then by its solution. At the beginning of 1965 the trend of public expenditure was only mildly upwards, but with the move in July to the new budget year 1965/66 growth accelerated, mainly owing to heavier defence spending. Only in housing was there no advance worth mentioning, and while in exports the seasonally adjusted figures continued to advance, the pace of advance was slower. This can be explained by the brisk expansion of internal demand and also, at times, by special factors such as strikes, and finally by the decline in business activity in some customer countries.

Supply from internal production responded quickly to the generally vigorous expansion of demand, but was also supplemented by a more rapid growth of imports. Despite weaker growth in the iron and steel industry in the fourth quarter, industrial production was probably about 8 % higher than in 1964. At the same time average utilization of technical capacity came near to the optimum, and the unemployment ratio (number seeking work expressed as percentage of total working population) fell to its lowest level for eight years.

A real increase of about 4.8 % (or 6.5 % in money terms) is to be expected in the gross national product of the United States between 1964 and 1965. As a result of the smaller export surplus, and because the February 1965 recovery programme was not

effective in the field of direct investment abroad, the overall payments balance probably improved less than the Administration had hoped. It is nevertheless likely that the deficit in 1965 was definitely smaller than in the previous year (\$3 100 million under the heading of regular transactions).

In the United Kingdom economic policy, in an endeavour to counter the overheating of the economy that had characterized 1964, was mainly geared to restoring equilibrium to the payments account, and the inhibiting effects of this policy on the economy became increasingly evident.

As the year advanced, overall demand was increasingly affected by a clear slow-down in the expansion of private consumption, brought about by the raising of duties and indirect taxes, restrictions on credit and a slower rise in incomes due mainly to the changing employment situation. With prices rising strongly (5 % in the last twelve months), this slackening was much more strongly reflected in the volume of consumption than in the trend of expenditure. In the second half of the year there was, in addition, a decline in the growth rate of aggregate public expenditure and also, though to a lesser degree, of investment by enterprises. As against this exports at first seem, after some hesitation, to have moved gradually upward, mainly as a result of the slower growth of internal demand.

In the second half of the year industrial production practically ceased to rise; indeed, the seasonally adjusted index tended, if anything, to decline, and output for the full year 1965 was probably some 3 % higher than in 1964 after a rise of 7.7 % between 1963 and 1964. From mid-year onwards there were signs that the labour market was becoming a little easier, but these were reflected less in a rise in the unemployment ratio than in a decline in the number of unfilled vacancies and a fall in overtime worked. In the early months of 1965 imports were definitely affected by the import surcharge on semi-finished and finished goods. After the reduction of this tax from 15 to 10 % imports did indeed recover somewhat, but the slowdown in the growth of domestic demand which meanwhile was becoming appreciable set fairly narrow limits to the recovery.

From 1964 to 1965 the United Kingdom's gross national product probably increased only by a bare 3 %, after a rise of 5.4 % between 1963 and 1964. The balance of payments made a distinct recovery in which both the decline in the imports surplus and the measures taken to restrict capital exports and encourage capital imports played a role.

In the other industrial countries outside the Community the business upswing continued, but generally with lessening momentum, particularly in the EFTA countries other than Great Britain; in most of these the measures of restraint, which are not in all cases sufficiently balanced, have slowed economic growth appreciably without putting an end to inflationary developments and the consequent thirst for imports. In Japan

it was not till near the end of the year that there were any signs of a tapering off of the recession noted since the autumn of 1964. Only in Canada, where the business situation was largely influenced by the vigour of expansion in the United States, is the national product likely to have grown as quickly as in the previous year.

The share of the developing countries in international trade fell off in the course of 1965. True, the upsurge in these countries' imports which resulted from higher foreign exchange receipts following the sharp rise in the value of their exports between 1963 and 1964 continued in the early months. From the summer of 1965 onwards, however, the deterioration of their trade balances and foreign exchange position that had become visible in the second half of 1964, the regressive trends of world market prices since the end of 1964, and greatly increased external debt obligations, resulted in reduced purchases by this group of countries.

As a result of the generally less dynamic business trend, the increase in the value of international trade (excluding intra-Community trade) between 1964 and 1965 is likely to have been about 8 %, or considerably less than a year earlier, when it reached 11 %.

2. Demand

Against the economic background sketched above, exports from the Community to non-member countries have developed quite favourably, and the slackening in the pace of growth seems to have been slight. At any rate the value of visible exports in 1965, as shown in customs returns, will probably have been about 11 % higher than in 1964 (in terms of volume, 9.5 % higher). The corresponding figures a year earlier were 11.5 % and 9.5 %. The Community's share in world exports, which after a decline in 1962 and 1963 had increased slightly in 1964, has again risen.

Particularly brisk was the rise in the Community's sales to the United States, which increased twice as fast as that country's purchases from the rest of the world. It was only in the fourth quarter of 1965 that the run-down of the USA's abnormally high steel stocks made itself felt in a temporary slackening of the growth of Community sales to that country.

Exports to the other industrial countries, in particular EFTA as a whole, expanded less rapidly than between 1963 and 1964. This was mainly because United Kingdom purchases from the Community in 1965 were little higher than in the previous year. Imports by the remaining EFTA countries, however, rose at a faster pace.

Sales to the developing countries grew at roughly the same pace as between 1963 and 1964—more rapidly than the total of goods imported by this group of countries. An explanation for this may perhaps be found in the structure of the exports offered by EEC and perhaps also in the supply elasticity in some member countries, which at the very least is higher than the west European average. Demand from the associated overseas countries and territories, which was hardly rising at the beginning of 1965, picked up appreciably as the year advanced; for the yearly total, however, the rise was less than between 1963 and 1964.

Community exports to non-member countries
(% change in values on preceding year)

	1964	1965			1965 ⁽¹⁾
		1st quarter	2nd quarter	3rd quarter	
United States	+ 11	+ 11.5	+ 19.5	+ 25	+ 18
EFTA	+ 11	+ 9.5	+ 6.5	+ 11	+ 8
including :					
United Kingdom	+ 15	— 5	0	+ 9	+ 1
Developing countries	+ 8.5	+ 10	+ 8.5	+ 11.5	+ 9
including :					
Associated overseas countries and territories	+ 7	+ 1	+ 4	+ 8.5	+ 4
Total all non-member countries	+ 11.5	+ 12	+ 11	+ 14	+ 11

⁽¹⁾ Commission estimates.

The expansion of internal demand between 1964 and 1965 was probably somewhat smaller than between 1963 and 1964.

In gross fixed asset formation there was even a marked slowdown in growth. The increase, which between 1963 and 1964 had been 12 % in money terms and 7 % in real terms, probably fell to 6 % and 3 %. Developments in the various member countries

contributed—some more, some less—to this weakness. The slowdown in growth was least marked in Germany, while investment expenditure in Italy may well have been as much as 8.5 % in value and 10 % in volume below the 1964 level.

In 1965, despite unfavourable weather conditions, investment in construction continued to be the most dynamic element in total investment demand, but here too growth for the year was smaller than in 1964. Building activity declined in absolute terms in Italy, mainly because of a decline in residential construction. In Belgium and Luxembourg, too, the expansion of demand in this field weakened very appreciably. Finally, the trend of expenditure in Germany, particularly in sub-surface building, slowed down to some extent. Continuing lively expansion in France and the Netherlands was not quite sufficient to offset the effects on the Community results of the trend in the other member countries.

The upward movement of investment in plant and equipment in the Community as a whole was also less steep than between 1963 and 1964. Even though the increase was very considerable in Germany and appreciable in the Netherlands, there was a distinct fall in Italy and Luxembourg, and semi-stagnation in France. In Belgium, expansion of investment in this sector has slowed down greatly and has been almost entirely carried by a few large projects, in which foreign firms have played the major part.

The weakening of expansion, the stagnation or the decline of investment in plant and equipment in 1965 is attributable to a number of factors, the importance of which varied from country to country. Considerable weight attaches to the pressure on profit margins which results from the sharp rise in costs during the last few years and which was generally felt in 1965 too. In addition there were the braking effects of a restrictive credit policy, of the greatly increased calls made on capital markets by the authorities, of the consequent rise in interest rates and—mainly in France and the Netherlands, but also in Belgium—of direct State price policy. Low utilization of capacity in some industries at the beginning of the year in Italy and—to a less marked extent—in France were a further factor damping down activity.

Public investment expenditure on the other hand has once again increased rapidly, except in Belgium, where actual investment spending by the authorities declined—a longer-term consequence of the restrictive measures taken early in 1964; expenditure approvals in this country, however, are already re-establishing a clear upward trend. In France public investment expenditure for the year increased more strongly than in 1964 partly because it was hoped that this would promote—or underpin—the recovery in economic expansion.

Investment in stocks during 1965 was smaller than in 1964. Purchases of raw materials and semi-products by industrial enterprises were relatively weak, and in many member countries stocks probably declined considerably for a time. This development

was due to the comparative weakness of world market prices in the first half-year, the fairly calm trend of the economy in some member countries and the reduction of liquid assets and of other means of financing available to enterprises. As against this, coal stocks in all member countries except Italy have risen continually, since output has not been sufficiently adapted to the structural decline in demand for this type of fuel. Furthermore, stocks of iron and steel products, especially those held by processing firms, have probably grown more rapidly. In Belgium, France and Italy, producers' stocks of manufactured goods, in which there had been a considerable amount of involuntary stockbuilding during 1964, showed distinct signs of a run-down. In France and Italy the stocks of finished goods held by dealers, which were still very high at the turn of the year, were further run down in the early months, but it seems that this was followed by a tendency to build them up again.

The increase in the Community's expenditure on consumption for the year may have been roughly as large as in 1964, with public expenditure on goods and services rising faster than before, particularly in Germany and Belgium, where this item was strongly influenced by wage and salary increases for public servants. The most rapid increases (between 12.5 % and 15.5 %) occurred in Belgium, the Netherlands and Italy.

On the other hand the rise in private consumers' expenditure in the Community as a whole was at 7.5 % rather less vigorous than from 1963 to 1964, when it was 8 %; in terms of volume, too, the increase for the year was somewhat smaller than for the previous year—4 %, as against 4.5 %.

With population up about 1.2 %, the volume of consumption per head was about 2.8 % higher than in 1964 (+ 3.3 % between 1963 and 1964). As in the previous year, the increase per head was highest in Germany and the Netherlands, at about 5 %, and weakest in Italy and France, at about 2 %.

The way in which private consumption developed during the year varied greatly from one Member State to another. There was vigorous and accelerated expansion (both in money and in real terms) in Germany, maintenance of the strong upward movement in the Netherlands, with some acceleration in the fourth quarter after the announcement of higher indirect taxes from 1 January 1966, an increase that gradually became more appreciable in Italy and France, and a certain slowdown of expansion in the Belgo-Luxembourg Economic Union.

These trends primarily reflect the development of the disposable nominal incomes of households. In Germany and the Netherlands the rise in incomes was again considerable, especially in the gross bill for wages, which in Germany was about 10 % and in the Netherlands about 14 % higher than in 1964. Along with this, however, considerable reductions in income tax on 1 January or 1 July 1965 reinforced the upward trend

of disposable incomes. In Belgium the rise in wages seems to have lost some momentum in the course of the year, and at the same time employment levelled out. The total wages bill in France and Italy climbed considerably less than in the previous year, partly because the total number of hours worked was lower. Within 1965, however, the rise was steeper than it had been in 1964. Social benefits, too, were raised sharply in all Community countries. It should however be noted that in Germany and Belgium, and perhaps also in France and Italy, the savings ratio was higher than in 1964.

There has been a change in the composition of consumption: demand for consumer durables, which was losing momentum in 1964, speeded up again in the year under review. Thus growth in the number of new passenger cars licensed in the Common Market, which was very small in the previous year, picked up again in the course of 1965. In addition, the share of food, beverages and tobacco in total private consumers' expenditure, which was about 38 % in the Community in 1964, will hardly have declined further, because of the rise in prices of some farm products caused by the bad weather.

3. Production

Within the Community there was a fairly distinct slackening in the growth of internal supply between 1964 and 1965. This was partly due to special factors and partly to a slowdown in the expansion of demand and—in the Federal Republic of Germany—to a decline in the elasticity of production.

The bad weather in the spring and summer appreciably affected agricultural production in various member countries. Because of the exceptional August rain in some areas, cereals were harvested several weeks late, and in Germany especially this led to a considerable reduction of the amounts brought in. For the Community as a whole, however, harvests were approximately the same as in the previous year, since in France there was a moderate increase, and a considerable one in Italy. Output of fruit and certain types of vegetables, too, was only moderate because of the cool spring weather. The sugar beet harvest was probably on the whole quite good, and wine production may have been above the level of the previous year thanks to the mild autumn weather. Livestock production probably increased only slightly; the number of cattle slaughtered declined in the first six months, while production of pigmeat continued to increase appreciably and milk output registered a moderate advance on 1964.

Industrial production in the Community (as defined for the index of the Statistical Office of the European Communities, i.e. excluding construction, foodstuffs, beverages and

tobacco) rose less in 1965 than in 1964; growth will have been about 4 %, against 6.5 % in 1964. The overall change for the Community was a result of sharply differentiated trends in the various member countries. The increase ranged from a minimum of about 1 % in Luxembourg to a maximum of fully 6 % in the Netherlands.

The slowdown in the growth of production in the Community occurred between the fourth quarter of 1964 and the first quarter of 1965, since when it has gone up again at a somewhat faster and fairly steady pace, with the increase from quarter to quarter just short of 1 %; growth rates in the individual member countries have been coming closer to each other. In the countries where the expansion of demand was most lively (Germany and the Netherlands) the growth of production was hampered by the limitations imposed on elasticity largely by labour shortages and certain changes in the composition of overall demand. In Italy, on the other hand, the rising trend of demand made possible a continuation of the recovery and then of the growth of industrial output, while in France real recovery began only in the spring. In Belgium the definitely hesitant or at times even recessive development of demand experienced in some branches was reflected practically throughout the whole year in very modest advances in production or even in a tendency to stagnation. In Luxembourg the weakness displayed by the world steel market in the second half of 1965 was the main cause of a slight contraction in absolute production figures.

The output of the basic materials industries in the Community as a whole showed only a slight increase in 1965. The amount of coal mined fell by 4 %, despite a considerable increase in pithead stocks (+ 55 %). While production of iron and steel was 5 % higher than in 1964, the vigorous upsurge that occurred in this sector during the early months of the year was followed by a period when output was almost completely static or even inclined to fall. The chemicals industry, which continues to be one of the branches where growth is particularly rapid, was not able to increase its output to the same extent as between 1963 and 1964; loss of momentum as the year advanced was not, however, very marked.

The aggregate production of the industries turning out consumer goods grew only moderately in 1965. Output in the textile and the leather industries, for instance, exceeded the level of the previous year only in the Federal Republic. In Italy and France the production of passenger and estate cars was declining or stagnant at the beginning of the year; a recovery nevertheless took place, first in Italy and somewhat later in France. Although this in turn gave way to a slight weakening, production for the Community as a whole will have been higher in this branch of industry than it was in 1964.

The largest rise in production was in the capital goods industries: the expansion of mechanical and electrical engineering in Germany and the Netherlands and also—during the first half-year—in Belgium more than compensated for the stagnation, or even recession, which befell this sector in France and Italy.

In 1965 output expanded somewhat more in the construction industry than in other sectors but, for the reasons mentioned in the analysis of demand (investment in construction), the increase over the previous year was appreciably smaller than it had been in 1964. In contrast to recent years, the rise in production in 1965 was hampered relatively little by labour shortages. This factor still played a role only in the Netherlands and Germany, and here, too, its importance was smaller.

In the services sector the structural trend towards a relative expansion seems to have mitigated the effects of the slower expansion of total demand. The contribution to GNP made by various service branches (commerce, tourism, servicing and repair of vehicles) was disproportionately stimulated by the generally brisk increase in private consumers' expenditure. On the other hand certain services, such as goods transport, are largely dependent on industrial production, and these were affected by the weaker trend in particular branches of production.

All in all, the gross Community product in real terms may well have risen by about 4 % between 1964 and 1965, after an increase of 5.5 % a year earlier and of 4 % from 1962 to 1963. Real expansion slowed down most in Luxembourg (1.5 %, as against 6.5 % a year earlier), in France (a good 2.5 %, as against 5.3 %) and in Belgium (about 3 %, compared with 5.2 %). Even in the member countries where economic expansion was still high the falling off was appreciable: in Germany 5 %, compared with 6.5 %, and in the Netherlands 5 %, as against 8.2 %. It should, however, be noted in the latter case that the high rate of growth in the Netherlands between 1963 and 1964 was partly due to special factors.

According to the still incomplete figures available, the total number of persons gainfully employed does not seem to have risen in 1965 above the previous year's level and may even have declined slightly. The average number of unemployed throughout the year was noticeably higher than in 1964 and, in addition, the active population of the Community has grown considerably less strongly than in the previous year, partly because of an absolute decline in Italy.

In view of the almost unchanged number of persons in employment, the slacker growth of production means that the advance in productivity throughout the economy (in terms of real value added per person in employment) was somewhat smaller between 1964 and 1965 than from 1963 to 1964.

The number of persons in paid employment is also unlikely to have been higher than in 1964. The shrinkage of paid employment in agriculture, which has been an established feature of the Community, probably continued everywhere except in Italy, where the migration of agricultural workers to other trades has temporarily ceased or

even been reversed. In the other sectors the fall in overall figures for the Community is largely a result of the contraction of employment in Italy. This affected in particular the employment figures in the Community's construction industry, where, however, the drop was also due in part to a slight decline in Germany. In the rest of industry the rise in the number of persons in paid employment was even smaller than before, but in the services sector it has again been appreciable.

For the Community as a whole the total number of hours worked in 1965 will probably have been lower than in the previous year. The trend towards longer annual holidays continued, while the adaptation of production to the slower growth of demand led, especially in France and Italy, to certain reductions in the working week which affected the annual aggregate. However, the pick-up of economic activity which occurred in Italy during the year caused a return to longer hours; in France, too, there were signs of a similar if less general development.

The average number of unemployed in the Community rose between 1964 and 1965, but the increase was very appreciable only in Italy, where it resulted mainly from dismissals, particularly in the building trades, but also in industry and—on a much smaller scale—in the services sector. In France, too, the number of persons seeking work increased, the ratio of unemployment rising from 0.6 % in 1964 to an estimated 0.8 % in 1965; in this country, however, the increase was due less to any fall in numbers employed than to the arrival on the labour market of the more numerous children born in the post-war years and to the unabated stream of immigrants. Finally, a slightly easier trend could be observed almost throughout the year in Belgium, the weaker growth of production being reflected mainly in a reduction of the number of hours actually worked in individual branches of industry, while the number of persons seeking employment rose only insignificantly. Labour markets in the other member countries continued to be marked by very severe tightness. In Germany the imbalance even worsened as the year advanced and, despite the stream of foreign workers that continued to arrive, the average number of unemployed has fallen to an extraordinarily low level. In the Netherlands a very mild increase in the average number of unemployed has hardly affected the general labour shortage. Here, and even more in Germany, the number of vacancies notified was again several times as high as the number of unemployed.

4. Balance of the markets

The growth of the Community's imports from non-member countries—in each case compared with the previous year—which had already been lower in 1964 than in 1963 again declined in 1965.

This is true at any rate for visible imports, which were probably no more than 5 % in value and 4 % in volume higher than in 1964, after an increase of 8.5 % (value) and 7 % (volume) between 1963 and 1964. The trend was, however, marked by weakness only in the second half of 1964 and the first quarter of 1965, since when there has been a distinct recovery in the expansion of imports.

This development is attributable to different factors: the after-effects of the weakening of business activity in the spring and summer of 1964 in Italy, and in France the repercussions of a similar, although by no means so pronounced, weakness towards the end of 1964 and in the first quarter of 1965. The slackening of growth in the Belgo-Luxembourg Economic Union also played a role. To this must be added, in all member countries except possibly Italy, the effect of a more or less severe reduction of investment in stocks or even of a run-down in reserves of imported raw materials and semi-products in the first part of 1965. Growth for the year was down despite the increased pace at which exports were expanding in Germany and despite the greater pull on imports exerted in the second part of the year by economic developments in the other member countries and by the general replenishment of stocks.

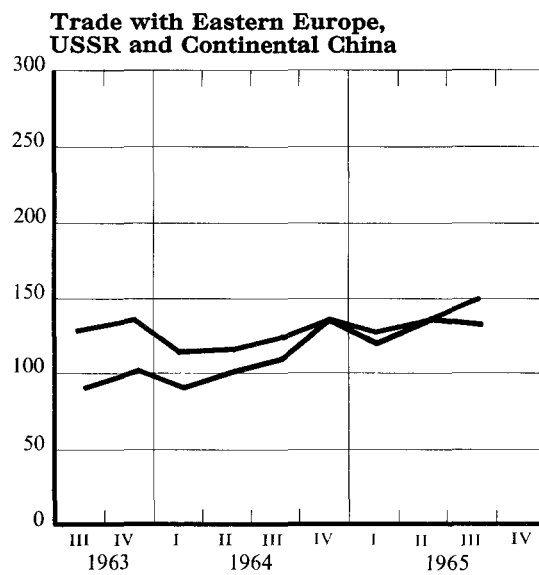
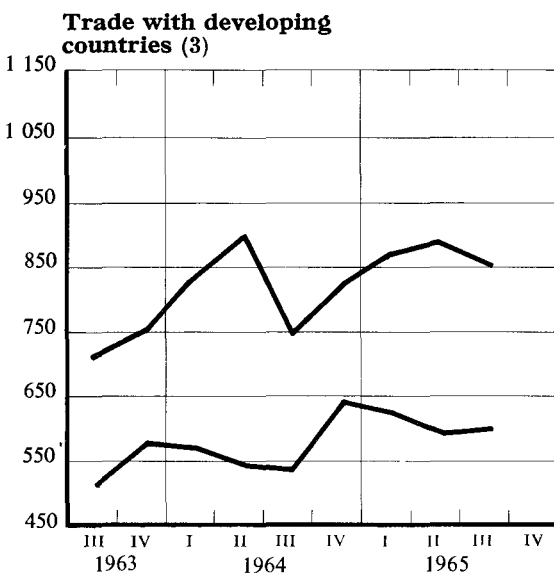
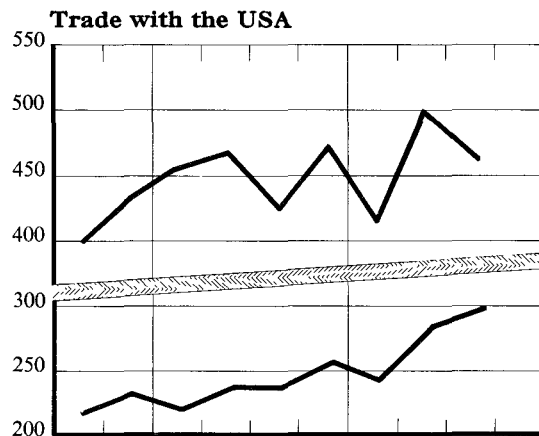
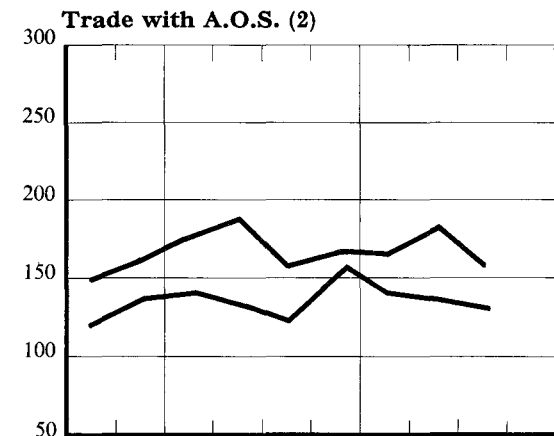
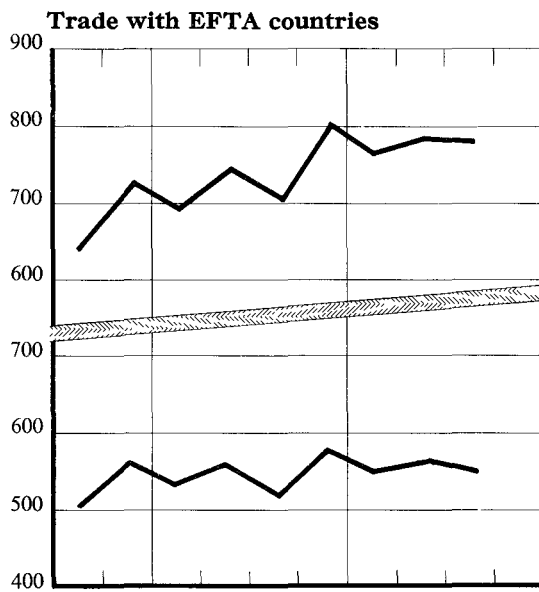
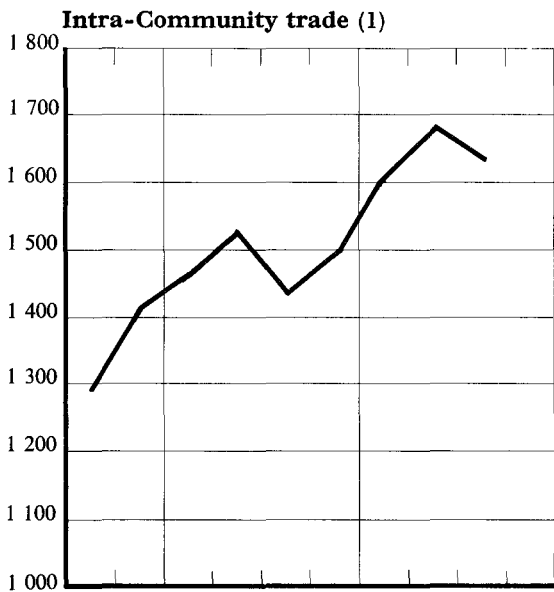
The statistics—still very incomplete—showing imports by class of goods confirm the trends sketched out above. Between 1964 and 1965 imports of raw materials will have risen little if at all, and imports of capital goods apparently in no more than moderate measure. Finally, the increase in imports of farm products was smaller than in the previous year, mainly because the 1964 harvest had been so good. As against this, the expansion of private consumers' expenditure, which continued practically unabated, was reflected in a more than average increase in the rate at which consumer goods were imported, with the upsurge of purchases by Germany largely compensating for less dynamic markets in other member countries.

Changes in demand, and thus in the pattern of imports, naturally had their effect on the way in which the Community's visible imports were broken down by supplying country or group of countries. The expansion of imports from the developing countries was weaker—largely because of the trend, already referred to, in purchases of raw materials and semi-products. Here, however, special factors—in particular the trend of trade with Algeria—played a role which even caused the Community's imports from the associated overseas countries and territories to be lower in 1965 than they had been in 1964. That the growth of purchases from EFTA fell off was certainly due in part to the slight slowdown in the expansion of demand in the Community, but the decisive factor was a weakening of the United Kingdom's exports to the Community; this in turn was probably largely the outcome of economic developments within the United Kingdom and of its limited ability to compete industrially in Europe. Finally, as regards the Com-

COMMUNITY TRADE

Monthly averages

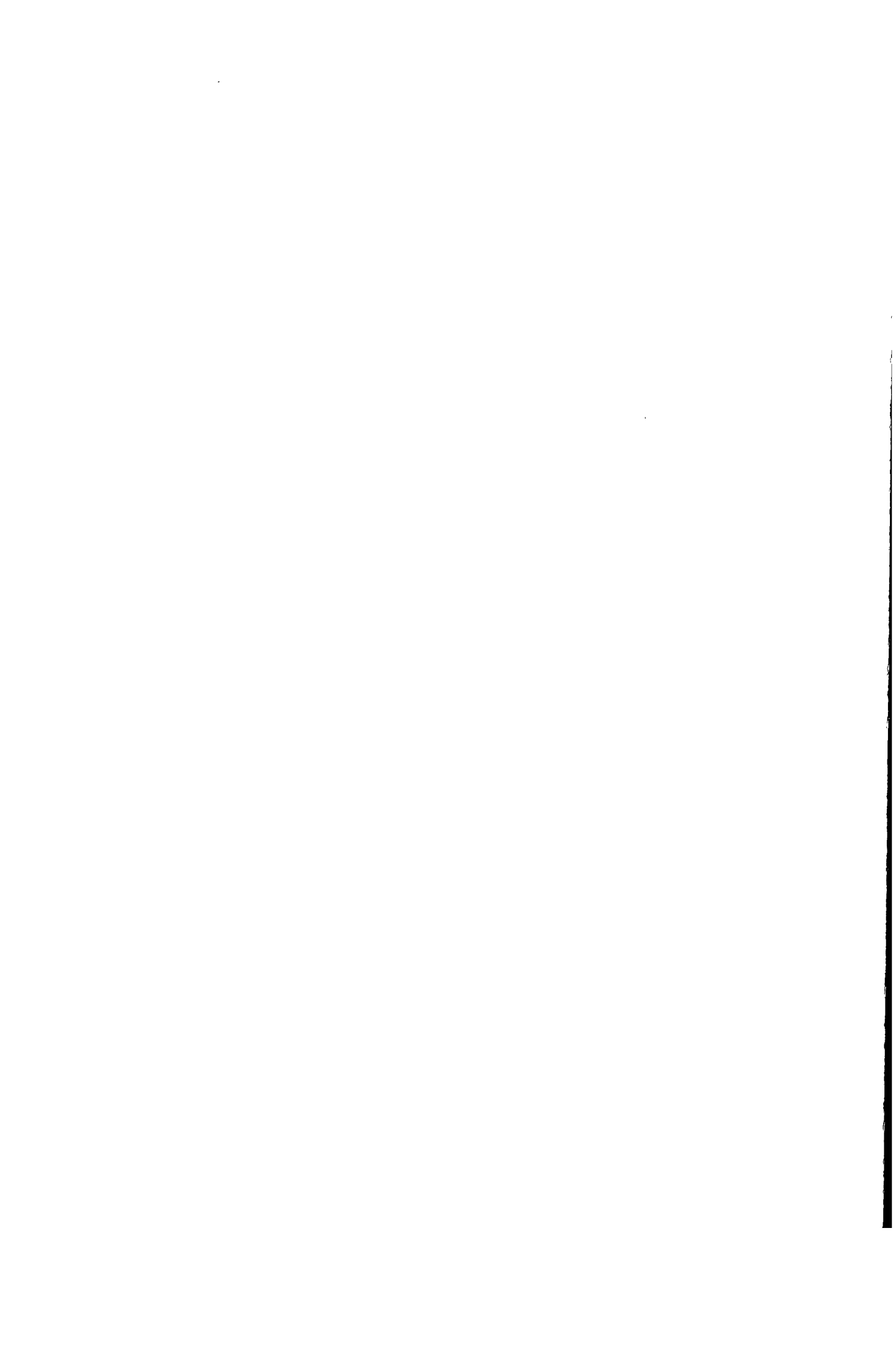
In millions of U.A.



— Exports

— Imports

(1) According to import returns.
 (2) A.O.S. : Associated Overseas States (overseas departments, countries and territories).
 (3) According to GATT classification : non-industrialized regions other than A.O.S.
 1 unit of account = 0,888671 gramme of fine gold.



munity's imports from North America, growth remained considerable, even though it was adversely affected by the weaker expansion of the Community's demand for raw materials and farm products on the one hand, and the extremely brisk rise of domestic demand in the United States and Canada on the other.

Community imports from non-member countries

(% change in values on preceding year)

	1964	1965			1965 ⁽¹⁾
		1st quarter	2nd quarter	3rd quarter	
United States	+ 7.5	— 8	+ 8	+ 8.5	+ 4
EFTA	+ 7	+ 4	+ 1	+ 6.5	+ 4
including :					
United Kingdom	+ 5.5	— 1.5	— 5.5	+ 2	— 1
Developing countries	+ 11.5	+ 3.5	+ 1	+ 14	+ 6
including :					
Associated overseas countries and territories	+ 8	— 4	— 3.5	+ 0.5	— 2
Total all non-member countries	+ 8.5	+ 0.5	+ 3	+ 11.5	+ 5

⁽¹⁾ Commission estimates.

The rapid growth in trade between member countries continued. True, the total value of this trade in 1965 grew, as a result of the slower expansion of total demand, somewhat less than in 1964 (an estimated 12 %, on the basis of imports, as against a rise of 14.5 % between 1963 and 1964). The ratio of the growth of intra-Community trade to the growth of the GNP has even risen.

In 1965 the Community's internal trade fulfilled to a particularly high degree its function as an element of balance in the current demand-supply relationship between member countries with excess demand (in particular the Federal Republic of Germany)

and those with reserve capacity (France and Italy). These equalizing flows were even so strong that longer-term surplus positions (Germany) and deficit positions (particularly Italy) have for a while been inverted—at any rate for 1965.

One leading factor in this development was the liveliness with which demand expanded in the Federal Republic of Germany. Since this expansion was accompanied by a decline in the elasticity of domestic supply, it exerted a strong influence on imports. These had already been expanding in Germany a little more rapidly in the second half of 1964, and showed a further vigorous advance throughout almost the whole of 1965; it is only in the last months that the trend seems to have lost something of its momentum, and the value of Germany's imports for the full year will probably be about 30 % higher than in 1964.

As against this, purchases by the other member countries rose but little from 1964 to 1965 although—particularly in the Netherlands—the speedier expansion of private consumption had some effect as the year advanced. Imports to the Belgo-Luxembourg Economic Union from other Community countries also fell short of their 1964 growth rate largely because of the quite appreciable weakening of the rise in demand for capital goods and semi-products. In France, the hesitant economic trend in the early months of the year was reflected in a very moderate rise in imports from member countries; this, however, grew somewhat more lively after mid-year. Italy's purchases from the Community were, in relation to the preceding months, low at the end of 1964, and despite a pick-up in the course of the year, they were probably smaller in 1965 than in 1964.

The vigour of demand from the Federal Republic of Germany coupled with reserves of productive capacity at home made it possible for Italy to step up the value of its exports by 25 %, and France 15 %, above the levels reached in 1964. Italian sales to Germany alone probably rose by about 40 %. As against this the relatively small ability of the French and Italian markets to absorb imports clearly acted as a brake on the expansion of Benelux exports to the rest of the Community; certain special factors relating to exports to Germany also played a part in this. In addition to the stagnation or weakness of demand from Italy and France, the strong increase in domestic demand and the decline in production elasticity also helped to curb sales by Germany.

In the intra-Community trade accounts of the individual member countries (as shown by customs statistics), the surplus so far usual for the Federal Republic of Germany probably gave way to a considerable deficit for the first time since the establishment of the Common Market. The deterioration of this country's balance on intra-Community trade between 1964 and 1965 could amount to 1 000 million units of account. As against this, the distinct improvement in the Italian balance continued, so that it has closed with a surplus for the first time since 1958. France and the Belgo-Luxembourg Economic

Union also appreciably improved their trading position with the other member countries, B.L.E.U. probably even having a surplus of some 500 million units of account. The Netherlands deficit on intra-Community trade seems to have been somewhat lower than in 1964.

Between 1964 and 1965, prices again rose appreciably despite the slowdown in the expansion of total demand—a very slight slowdown where final demand is concerned. In the Community as a whole the rise was only a little smaller than between 1963 and 1964. It should however be noted that in the course of 1965 there was a more or less obvious slackening in the upward thrust of prices in some member countries, the main exception being Germany, where excess demand was if anything even higher and tended at times to strengthen the forces making for rising prices. Only in France, where the price trend had already become considerably quieter in 1964, was no change to be discerned.

The trend towards the approximation of wages costs per worker within the Community seems to have continued in some cases during 1965. Between 1963 and 1964 the sharpest advance in wages had been in the manufacturing industries of those member countries which hitherto had the lowest labour costs. The absolute level of labour costs per man hour (including social charges) amounted in this sector in 1964 to 1.06 units of account in the Netherlands, about 1.20 u.a. in France, Italy and Belgium and about 1.40 u.a. in Germany. In 1965 the Netherlands probably tended once again to come closer to the middle group for, as in the previous year, it was in this country that total wages per employee (including social charges) increased most strongly. On the other hand, the rise in gross hourly earnings in Germany leads to the conclusion that the gap between pay in this country and in the countries of the middle group has at least not narrowed any further.

Of course, it is not possible to draw conclusions from these differences as to the existence or the causes of cost differences per unit of output and so about price differences between the member countries, since the differences also largely depend on the level of productivity in each country.

In 1965 the upward movement of unit costs generally continued to be quite appreciable. The rise in hourly wages was distinctly smaller than in 1964, particularly in Italy and France, and also—but far less—in the Benelux countries too. Against this, however, the growth of production was relatively moderate or at any rate slower. At the same time the upward movement of wages in Germany has run further ahead of productivity. In several member countries, employers' contributions to social insurance have been appreciably increased. Finally, average prices of imported raw materials rose between 1964 and 1965.

As far as the level of demand permits, increased unit costs will normally be reflected—after some considerable while—in the prices asked for final products, and so the higher costs of 1964 continued to influence prices during the year under review.

In any case, the actual price trend indicates that in those member countries where the expansion of demand slowed down appreciably, only part of these higher costs could be passed on to the consumer in the services sector, while in industry practically none of the higher costs could be passed on. In France, moreover, the maintenance of direct price controls worked in the same direction. Even in the Netherlands—where, as in Germany, excess demand was still exerting an inflationary pressure—direct price controls have had a moderating influence. A further factor in Germany was that competition from imports increased with such exceptional vigour that even in this country only part of the increased costs could be passed on to prices. The natural consequence was pressure on profit margins; in Germany this was a change on the previous year, in the other countries it was merely a continuation of the 1964 trend, but weakened in France and reinforced in Belgium.

The bad weather in the spring and summer of 1965 led for a time to very considerable price rises for potatoes, vegetables and fruit in the greater part of the Community; in various member countries prices of these products did not return to their previous level later in the year. Producer prices for livestock products were also considerably higher on average than in 1964 : this was largely attributable to continuing imbalances on the beef and veal market, which only began to ease towards the end of 1965. As against this, pigmeat prices fell in almost all the member countries during the first half year. However, in the second half year, the normal course of the pig cycle, coupled with the continuing strong expansion of consumer demand, brought a fresh rise.

The changes in the prices paid for industrial finished goods very clearly reflect the differing economic situation in the individual member countries : continuing upward movement of prices in Germany and the Netherlands, semi-stability at producers' level and a slower increase at retail level in the other member countries. Prices of services rose appreciably in all member countries, in some cases even more rapidly than in the previous year.

The changes in consumer price indices or cost-of-living indices compared with 1964, suggest that these price movements were responsible for an accelerated upward push which affected consumer prices in Germany and for the still very vigorous—albeit somewhat smaller—rise of consumer prices in the Netherlands and Belgium, for a distinct easing of the upward push observed in Italy and for the persistence of a very moderate upward trend in France.

In October 1965 the year-to-year rise in the indices of consumer prices or in the cost-of-living indices for the various countries was : Netherlands, c. 4.5 % (a year earlier :

c. 6.5 %); in Belgium 3.8 % (4.5 %); in Germany 3.8 % (2.5 %); in Italy 3.6 % (5.7 %); in Luxembourg 3.4 % (2.6 %) and in France 2.3 % (2.6 %).

Since exports expanded appreciably more than imports, the Community's balance of visible trade with non-member countries further improved between 1964 and 1965, and considerably more than between 1963 and 1964. On the basis of external trade statistics, the deficit probably contracted to about 1 300 million units of account, or about half the 1964 figure.

The improved trend flattened out, however, during 1965, had practically ceased to exist from the second quarter on, and even gave way to a slight deterioration once more. The current payments account developed along similar lines, and here the surplus for the full year may have been about 1 500 million u.a. higher than in 1964.

For the time being it is not possible to make any conclusive statement concerning the balance of capital movements between the Community as a whole and non-member countries. It would seem, however, that the net inflow of capital—other than definitely short-term funds—will be distinctly lower than in 1964; this is a consequence of the defensive measures taken by the authorities in Germany (particularly the withholding tax) and in France, and also of debt repayments made by the latter country before the due date. The fact that direct investment of external capital in the Community has again increased, and probably on a considerable scale, does not seem to have completely offset this development.

Short-term capital movements have also shown contradictory trends: against the impact on bank credits of the United States programme to redress the payments situation must be set changes under "errors and omissions" (particularly terms of payment) and—for a while—speculative inflows due particularly to lack of confidence in sterling.

At any rate the gross gold and foreign exchange reserves of the monetary authorities in the member countries declined by 440 million u.a. between the end of December 1964 and the end of October 1965, whereas a year earlier they had increased by 750 million u.a. in the same period. At the same time, the member countries' net position with the IMF improved in the first ten months of 1965 by about 1 000 million u.a. The net foreign exchange position of the commercial banks probably improved, and here the outstanding feature was the complete liquidation of the short-term net external indebtedness of the Italian banks.

Transactions with abroad continued to boost internal liquidity in all member countries except Germany. Their influence was smallest in the Netherlands and—despite the high surplus on the balance of payments—in Italy, where the liquidation of the net external indebtedness of the banks worked in the opposite direction. In the Federal Republic of Germany the payments balance exercised appreciable restrictive effects.

Much more important, however, in most member countries was the great contribution to liquidity—in some cases even considerably greater than in the previous year—made by the cash transactions of the public authorities and the way in which their deficits were financed. This applies particularly to Italy, but also to Belgium, the Netherlands and Germany and—to a much smaller extent—to France. In general the expansion of expenditure either speeded up or remained very vigorous, whereas current revenue, partly because of the slacker business situation and partly as a result of tax reductions, lagged behind the growth of spending.

As against this, the trend of bank advances to business and private borrowers—at any rate the short-term advances—contributed on the whole less to the expansion of total internal liquidity than in the previous year. The reason for this is partly to be found in the restrictions imposed by credit policy but partly also in the relatively low level of economic activity and in the small or declining propensity to invest in some member countries, with one factor progressively giving way to the other—in Italy even before the end of 1964 and in France and Belgium at the end of 1964 and early in 1965. This led the monetary authorities to alter course (as early as 1964 in Italy) or gradually to relax their measures of restraint (spring 1965 in France and Belgium).

In Germany and the Netherlands, on the other hand, the restrictive monetary and credit policy was maintained or even intensified somewhat in 1965. Since mid-year all longer-term credits in the Netherlands have been subject to special rules. The expansion of credit slowed down somewhat in this country, at least till early autumn; until then it conformed on the whole more closely with the standards agreed upon than in 1964. In Germany, Bank rate was raised in two stages by 1 % per annum to 4 % and with effect from 1 October the banks' rediscount quotas were reduced. Whereas in the previous year, mainly because of the high liquidity reserves of the banks, the credit policy measures did not bite, this state of affairs changed fundamentally in the course of 1965, thanks in the main to the deficit on the payments balance. The expansion of credit, which was even gathering momentum till some time in the third quarter, has since definitely tended to slow down.

In 1965 the trend of capital markets in the Community was not uniform. This was due to differences in domestic economic situations, to the balances of payments, to the calls made by the public authorities and to the monetary and credit policies applied

in the various countries. In France and Italy the increase in the supply of capital available on the bond markets already observed in the previous year continued; on the whole, therefore, there was if anything a tendency for interest rates to fall slightly while enterprises—in Italy, however, only in the public sector—and the public authorities were able to raise considerably increased amounts of capital. A contrary trend could be observed in Germany. Here, with interest rising steeply (the yield on new issues increased by over 1 % to 7.4 %) pronounced imbalance occurred on the bond market, caused especially by excessive demands made on the market by the issue of public loans, by the decline in banks' purchases of securities, resulting from scarcity of liquidity, and by a certain wait-and-see attitude on the part of private investors; in addition the withholding tax helped to throttle back the inflow of foreign capital. In the Benelux countries easier trends prevailed in the first half year, but strains subsequently developed on the bond market as a result, in the main, of appreciably higher public and private demand for capital. From the spring onwards interest rates on capital were therefore again clearly moving upwards in the Netherlands, and in Belgium the slight tendencies towards lower rates which had marked the first half of the year again gave way to some upward movement in the second half. In both countries certain difficulties were experienced in placing public loans.

Supply and utilization of goods and services

	1963 ⁽¹⁾	1964	1965 ⁽²⁾	1966 ⁽³⁾
	At current prices (in '000 million u. a. ⁽⁴⁾)	% change by volume on preceding year ⁽⁵⁾		
Gross Community product	249.9	+ 5.6	+ 4	+ 4.5
Private consumption	153.0	+ 4.4	+ 4	+ 4.5
Public current expenditure	37.2	+ 1.7	+ 4	+ 4
Gross fixed asset formation	57.1	+ 7.2	+ 3	+ 4.5
Balance exports ⁽⁶⁾ less imports ⁽⁶⁾ (in '000 million u. a. current prices)	+ 0.6	+ 1.4	+ 3.0	+ 2.7

⁽¹⁾ Source : General Statistical Bulletin, 1965, No. 11, Statistical Office of the European Communities.

⁽²⁾ Commission estimates.

⁽³⁾ Commission forecasts.

⁽⁴⁾ 1 u.a. = 1 unit of account = 0.888671 gm of fine gold = \$1 US at official exchange rate.

⁽⁵⁾ Community aggregate based on official exchange parities.

⁽⁶⁾ Goods, services and factor income.

In 1965 the stock markets of all member countries reflected pronounced factors of weakness. In several countries the psychological reaction to political and economic developments generally, and in particular to the profit outlook for companies, was anything but favourable. In addition, where investors did not confine themselves entirely to liquid forms of savings, they often preferred the more attractive fixed-interest securities. Although the trend of quotations was by and large recessive, business undertakings in the Community were on the whole able to obtain more capital through the stock markets in 1965 than in 1964.

B. Outlook for 1966

The expansion of overall demand in money terms in the Community as a whole between 1965 and 1966 could well be roughly the same as between 1964 and 1965, with a slightly more rapid increase in internal demand going hand in hand with a rather slower expansion of external demand.

External demand (defined as actual exports of goods and services by the Community) might in fact rise rather less than between 1964 and 1965. This is mainly because the upswing of world business will probably lose some momentum in 1966, although economic expansion is likely to continue unabated.

In fact, the outlook for all important components of demand in the United States is clearly one of expansion. Public spending can be expected to mount, one important factor being an appreciable rise in military expenditure. In addition, enterprises seem again to be planning a considerable increase in outlay on plant and equipment. This is because of optimistic expectations of sales and profits coupled with the fact that utilization of productive capacity is nearing the optimum; in this situation, the shortage of skilled workers makes it advisable to step up certain rationalization operations. From the spring of 1966 the movement of stocks will again be contributing to expansion once the metal-working industries have run down to normal the heavy stocks of steel they had built up pending agreement between the two sides of the steel manufacturing industry; this process, with its inhibiting effect on the output of steel, may be completed relatively quickly. In view of the outlook for demand in important industries using steel and of the likely price trend—it is widely expected that steel prices will rise—there may even be a fresh wave of stockbuilding. Given these developments in important elements of demand, the improvement occurring on the labour market, the expansion that is expected in wages and salaries and the effects of the further reduction of indirect taxes, private consumers' expenditure may once again, despite the rise in social security contributions due to occur at the beginning of 1966, give a strong boost to business. For exports, however, expansion is not likely to be particularly vigorous in view of the slower growth of demand for United States' products and of the strong pull exerted by domestic demand.

On the production side, extensions of capacity and greater efforts to improve the structure of manpower supply might well not prove quite sufficient to maintain elasticity at its previous level. Imports may therefore expand more rapidly than before, and there

could be some strengthening of the upward push of prices, though it should be nothing like as sharp as in many other industrial countries today. The United States gross national product in current prices could rise between 1965 and 1966 roughly as fast as between 1964 and 1965. In terms of volume its growth might however be somewhat weaker than in the previous year, with a bare 4.5 %. New balance-of-payments problems seem to be in the offing; at any rate no new easing of the situation is to be expected either from the probable trend of current items (particularly the trade balance and tourism) or, if trends remain as at present, from capital movements. Unless fresh measures are taken, the 1966 deficit could therefore be even heavier; action under the programme to redress the payments balance has, in fact, been intensified.

In the United Kingdom a continued weakening of economic growth is to be expected in 1966. The restrictive financial and credit measures taken in April and July 1965 will probably become increasingly effective, and the pressure of demand is likely to ease further. In view of a continuing if somewhat weaker rise in wages, private consumers' expenditure will probably slow down least, at any rate less than investment in plant and equipment; with costs rising faster than prices, the profit margins of enterprises have narrowed in recent months, and the propensity to invest, which in any case seems to have been damped down recently by the uncertainty of the economic outlook, could be further discouraged; the restrictive measures taken in the credit field naturally affect investment spending; and finally stimulus from public and semi-public investment is likely to abate.

On the whole, internal demand will probably expand no more than moderately. In view of the persistent although perhaps less steep cost rises, it is even quite possible that demand may stagnate. True, this will result in increased pressure to export; but in view of the relative cost and price situation, of the somewhat slower expansion that will after all be registered by world demand, and of the relatively poor structural adaptability shown by British firms it can hardly be expected that the expansion of actual exports will be strong enough to offset the slowdown in domestic demand. This being so, the growth of production will probably be quite small, and in real terms the aggregate GNP is likely to rise between 1965 and 1966 by 1-1.5 %. For imports also the chances of expansion are only slight, the more so as there seem to be no plans for early cancellation of the special surcharge on imports (at present still 10 %). In these circumstances, it might be possible for the United Kingdom's payments balance to reach the point of equilibrium again towards the end of 1966.

In the other EFTA countries the expansion of demand is likely to lose further momentum, either because of a fall-off in investment by enterprises as a result of rising costs or because increasing inflationary imbalances have caused the authorities to intro-

duce restrictive measures or at least to consider postponing other measures intended to stimulate demand; in addition, the United Kingdom's situation cannot fail to have an impact on its EFTA partners. For these countries a fairly uniform rate of expansion of GNP, probably just short of 4 % in terms of volume, is to be expected. The expansion of their imports, too, could decline somewhat.

For the developing countries the consequences that may stem from the probable slackening of growth in important markets (EFTA) are likely to be at least offset by a firmer demand for raw materials from the Community and the United States. The chances for their exports would therefore seem to be if anything more favourable than in the previous year, at least in terms of volume. The trend of prices could, however, be on balance downward: there are signs of a further considerable expansion of productive capacity in the primary producing countries, while the beginning of 1966 may see the end of the speculation which was touched off mainly by expectations of heavier purchases for military use by the United States and affected world demand for raw materials and commodity prices in the second half of 1965. It is probable, nevertheless, that in value too exports from the developing countries will expand more in 1966 than in 1965. With import prices certainly firmer, however, the terms of trade may well shift to the disadvantage of these countries and this may well lead them to be fairly cautious over imports; the rise in their currency reserves in the previous year was in part the reflection of just this more cautious policy, though in the main it was based on (temporarily) easier terms for the servicing of their external debts and higher royalties obtained by the few petroleum-producing countries among them.

In view of this outlook for economic activity and demand throughout the world, it must be expected that the additional stimuli from abroad which affect the business situation in the Community will again have somewhat less impact than in 1965; the forecasts are none the less that the Community's exports of goods and services may again expand more strongly than the corresponding elements in world trade. Several factors justify this opinion: the Community's export structure, more extensive development aid by several member countries, production capacity still available in France and Italy despite the further pick-up in internal demand, the success achieved by these countries in stabilizing costs and prices, and more generous credit terms. The fact that in the Federal Republic of Germany the elasticity of production and of exports is likely to be somewhat smaller than in the previous year (in the case of exports because of excess domestic demand) does not seem sufficient to offset the impact of the other factors. The Commission at present estimates that the aggregate value of the Community's visible exports to non-member countries could rise by about 8 % between 1965 and 1966 (after about 10.5 % between 1964 and 1965).

In all probability internal demand in money terms will expand at a somewhat faster pace than in 1965, with speedier growth both of private and public investment expenditure accounting for the acceleration.

According to Commission forecasts, gross fixed asset formation in the Community as a whole could expand about 8 % in value and 6 % by volume, after corresponding increases of 6.5 % and 3 % in the previous year.

Building investment will contribute little to this speed-up; in the Community as a whole it is unlikely to grow more than between 1964 and 1965. In keeping with the outlook for business investment in plant and equipment—to be sketched out below—it is probable that expenditure on industrial building will increase at a slightly faster rate, with a distinct recovery in Italy especially and a slight one in France. As against this, actual outlay on housing for the year will probably rise at a definitely slower pace than in 1965. The trend of building permits in France during the last twelve months suggests that the exceptionally rapid increase in actual expenditure on housing noted between 1964 and 1965 will not be matched; the figures for Belgium point to a very modest expansion, and the outlook in this sector is very uncertain in Italy, though here there might be some recovery in the course of 1966, particularly in view of the special support measures already taken; it will, however, certainly not suffice to produce a higher aggregate output for the year. In the Federal Republic of Germany and the Netherlands housing may well be expected to expand further, but perhaps only at a slower rate.

Public investment—most of it investment in building—will probably continue to expand vigorously. In the Netherlands, Belgium and Luxembourg the budget estimates already provide for increased expenditure under this head. In Italy the funds provided in the 1966 budget for investment purposes are, it is true, no higher than in the previous year, but it is quite conceivable that the growth rate of actual expenditure will, in view of the time limits normally allowed for the implementation of investment programmes, be even higher than before. Only in Germany and France is some slowing down in the expansion of public investment expenditure to be expected: in Germany it will result from the drive to curb the expansion of public spending and of the limited funds which the capital market can make available for financing.

In the Community as a whole a slightly more rapid expansion of business investment in plant and equipment can perhaps be expected. The unfavourable investment climate in France, Italy and the Belgo-Luxembourg Economic Union might again improve—in differing degrees from country to country—although in the present state of available information, and in view of various political uncertainties, of which those which

concern the future shape and policy of the Community itself are not the least important, the extent of the recovery is still difficult to predict. In France and Italy at any rate the investment plans of public and semi-public enterprises make a very considerable growth of actual spending likely. In the private sector in these countries investment could be stimulated by the pick-up in the expansion of overall demand which began in 1965, and by its positive effects on the utilization of productive capacity. The relative widening of profit margins in 1965 and the measures taken to facilitate investment financing would strengthen these trends. In Belgium developments in the other elements of total demand are unlikely to have so great an impact on investment as in Italy and in France, but the implementation of large-scale investment projects by foreign firms in this country is an important factor of expansion. Only in Germany is any flattening out of the upward movement of actual investment in plant and equipment to be expected. To judge by the trend of orders received in the capital goods industries it will, however, be moderate.

Finally, investment in stocks is likely to contribute more to business activity than in 1965. In France and Italy, because of the more favourable outlook and the evidently low level of stocks held by manufacturers, the replenishment of raw materials reserves will doubtless be pressed ahead more rapidly. In the Netherlands and Belgium, too, stocks will increase considerably. As against this, the weaker growth of production in Germany will probably be reflected in a further fall in the pace at which reserves of raw materials and semi-products are built up, though they had already been reduced in the closing months of 1965.

The expansion of total outlay on consumption in the Community could be of roughly the same order of magnitude as in the year now ending. Forecasts—based in the main on the budget estimates made by the various Governments—point, it is true to a smaller increase in public current expenditure on goods and services than in 1965 both in Germany, where efforts are being made to moderate the very rapid expansion of public expenditure, and in the Netherlands, where wages and salaries in the public sector, having been adjusted to bring them into line with incomes in the private sector, should not now rise any faster than corresponding incomes in that sector. In Italy, however, the expansion of public current expenditure is, if anything, likely to increase, and in France also the rate at which this expenditure is growing may well rise somewhat. In Belgium, the rate of increase is likely to be but little smaller than before. If on balance this augurs a slight slowdown for the Community, it must immediately be pointed out that experience so far indicates that it is just the forecasts of public current expenditure made at the beginning of the year which are likely to be exceeded as the year advances—although most probably no longer to the same extent as in 1965 (a year of elections or change of government in various member countries).

Private consumers' expenditure will doubtless rise about as much as in 1965. Here the main factor will be that, in the train of economic recovery in Italy and France,

the aggregate income of households will be stepped up by the more favourable trend of the total number of hours worked (in particular the return to a normal working week) and also perhaps by a fresh acceleration of the increase in wage rates; such a development would inevitably speed up the expansion of consumption expenditure. A similar trend is expected in Belgium. In Germany and the Netherlands, on the other hand, private consumers' expenditure for the year might rise somewhat more slowly than in 1965; the rates of about 8 % in Germany and 9 % in the Netherlands would however still lead the field of member countries in 1966. The slight reduction of growth in Germany could be due to very slight slowdown in the expansion of wages, a more moderate advance of transfer incomes and a further slight rise in the rate of savings; in the Netherlands it would be due essentially to a smaller expansion of wages and salaries in the public sector and of transfer incomes. In addition, both in Germany and in the Netherlands, the expansionary impact of the 1965 reductions in direct taxes will tend to diminish.

The present forecast for the Community is, then, that private consumers' expenditure will rise by about 7.5 % between 1965 and 1966. Consumption in real terms will again increase less than in money terms, since prices will also be rising, but even so the increase is likely, at 4.5 %, to be somewhat greater than in 1965 (4 %). The difference between the trend of consumption expenditure and that of the volume of consumption will be particularly marked in the Netherlands and Belgium, even if it is perhaps somewhat less appreciable in the Netherlands than in the previous year.

With the expansion of demand probably recovering in some member countries—France, Italy, the Belgo-Luxembourg Economic Union—total supply from internal sources in the Community will undoubtedly expand more strongly in 1966 than it has done in 1965, despite limited elasticity in several industries in the Federal Republic of Germany and the Netherlands.

Assuming normal weather, a distinct rise in agricultural output can be forecast: after the moderate 1965 harvests, a noteworthy increase could occur in the output of crop products in most member countries, particularly Germany and the Netherlands, while in livestock production an improved rate of growth can be expected, in particular since a trend to run larger herds made itself felt in 1965.

Industrial production (as defined for the Index of the Statistical Office of the European Communities, i.e. without building, food, beverages and tobacco) is likely to increase by 6 %, after rising 4 % between 1964 and 1965. Its annual growth in France could rise to about 6 % (as against 2 %), in Italy to about 9 % (as against 4 %), in Bel-

gium to 3 % (as against 1.5 %), in the Netherlands to a good 6.5 % (as against 6 %), while in Germany it might fall to 5 % (compared with 6 %).

Apart from a continuing rapid growth in chemicals and the petroleum industry, the basic materials industries are, however, unlikely to show any considerable production advances. In fact, given the probable decline in exports of steel, it must be expected that at the beginning of the year output in this industry will be stagnant, while in coal-mining the volume of pithead stocks at the end of 1965 is in itself a pointer to further reduction of activity. Production in the capital goods industries, on the other hand, might rise appreciably, at least in France and Italy, probably also in Belgium, where demand is expected to revive. Meanwhile the increase in Germany will largely depend on expanding the capacity available. A distinct rise in the growth of production is also to be expected in most consumer goods industries.

Granted normal weather, building production could expand roughly to the same extent as between 1964 and 1965, with a certain slowdown in France compensated by a progressive revival in Italy. In the services' sector, in general, an appreciable rise in the real net contribution to the Community product is to be expected.

In the aggregate, real gross Community product could rise by about 4.5 %, i.e. somewhat faster than in 1965, when the increase was 4 %.

This trend of production is hardly likely to cause any material changes in the labour market situation. In Germany and the Netherlands the very pronounced shortage of labour—i.e. the situation of overemployment—will probably continue. In France, the level of employment will be high, although the easier trends that became apparent in 1965 might well continue, since a revival in business activity has been found to lead first to a rise in output per person employed and only subsequently in the number of employed, and since the labour force will be expanding fairly rapidly. In Italy, too, the total number of hours worked is likely to advance more rapidly than in 1965. In the comparison of annual totals, however, this advance will be due in the main to a reversal of the 1965 fall in hours worked per head, while the numbers at work may not yet resume their rise; but between the beginning and the end of 1966 there will almost certainly be a rise in the total numbers in employment and so a decline in unemployment. Italy is the only Community country where, for both structural and cyclical reasons, unemployment is at present decidedly high.

Not only supply of internal origin but also the Community's imports are likely to rise faster in 1966 than they did in 1965. The value of visible imports from non-member countries may grow by about 8 %, with Italy and France registering considerable increases as a result of the recovery expected in Italy's domestic situation and of the acceleration of

activity which should occur in France. In addition, it must be expected that Dutch and—to a less marked extent—Belgian imports will rise more rapidly than between 1964 and 1965, especially imports of raw materials and semi-products. The Federal Republic of Germany is likely once again to show a distinct increase in purchases of finished goods. Because of the somewhat less rapid upswing of domestic demand and especially because of the slower build-up expected in stocks of raw materials and semi-products, the pace at which total German visible imports from non-member countries are expanding can be expected to slacken; but this will probably not suffice to offset the increased pace of imports in the other Community countries.

Since in 1966 the rise in imports is likely to be somewhat higher than that of exports, the deficit on the Community's trade balance with non-member countries, which declined appreciably in 1965, will no doubt be heavier again, though the deterioration is unlikely to be very appreciable. The tendency for the deficit on trade to expand again was already noticeable in 1965.

These forecasts imply a further slight slowdown in the average rise of prices in the Community. The price index of the gross Community product will, according to present forecasts, rise by some 3.5 %, after increases of 3.8 % between 1964 and 1965 and 4.2 % between 1963 and 1964. Although the many statistical inadequacies in aggregate estimates of this sort no doubt limit greatly the actual significance of the rates of change that emerge, their comparison over a period can yield conclusions as to trends. It would at any rate seem that in 1966 there will again be a tendency to stabilization, but it may be weaker than in 1965.

It is not of course possible simply to conclude from the price trend that there still is or will be persistent—although less severe—excess demand everywhere; the situation and outlook differ from one country to another. To simplify, it may be said that there is demand inflation in the Federal Republic of Germany and the Netherlands, and cost push—still partly a consequence of earlier demand inflation—in Italy, France and Belgium. Though this is a simplified picture of the situation, it hits off the essential features; but it is also true that in the member countries with demand inflation some measure, probably an increasing measure, of influence is exerted by the current cost push and by price adjustments made to take account of earlier rises in costs, while in the cost-push countries some sectors are still affected by demand-inflationary factors provoked, for instance, by heavy increases in public spending.

The adjustments made in state-controlled prices (for instance rents) and in the rates charged by public transport and utilities, are in the last resort direct or indirect consequences of demand inflation, and are intended to align these prices on increased

costs. Even the heavier taxation to be levied in some Community countries could to some extent be considered in a similar light, inasmuch as it reflects the higher prices that must be paid for goods and services purchased by the administrations and the increases in other costs (such as wages and salaries) due to inflation. There is, therefore, no justification for treating such cost and price rises as completely "autonomous" and simply deducting them from the total price rise.

It can none the less be argued that such price, tariff and tax increases—which in most cases are not part of a current inflationary process but are after-effects—must be looked upon as something other than current price rises brought about by the business situation. Their effect is largely inhibiting, inasmuch as they reduce the actual deficits of public or semi-public budgets or, at any rate, make it possible to keep these deficits smaller than they would otherwise have been. If these increases are to act as a brake on domestic demand and thus on the underlying trend of prices, it is essential that the upward thrust of incomes should not be reinforced from other quarters. With ample funds available to business, over-lively expansion of total demand and consequent disequilibrium on the labour market, it is perfectly possible that autonomous price and cost rises might even start a general spiralling of wages and prices.

Autonomous price and cost rises will play a role in 1966, especially in the Netherlands and Belgium. In the Netherlands the aggregate effect of increased rents and the planned increase in indirect taxation can together be estimated to represent a rise of about 2 % in the level of consumer prices, and in Belgium the increase in indirect taxes is likely to push this level up by 1 % to 1.5 %. True, the general economic outlook in these two countries points to some little abatement of the current price push, but consumer prices as a whole may none the less rise by 4 % to 5 %. In France and Italy also, autonomous price and cost rises are to be expected; but in these countries the upward pressures on prices caused by developments in the business situation should—in view of the idle production capacity and the manpower reserves available at least in Italy—remain so weak that in France no strengthening of the price rise as a whole is to be expected and in Italy it may even level off further. Here an important factor is the more rapid rise in productivity which has been found to occur in the first phase of recovery after a period of weakness. On the other hand, the increasing liveliness of demand could after all mean that in some cases earlier cost rises were eventually passed on. The overall rise in Italian price levels for the year may still be more or less appreciable—one reason being, incidentally, that the trend followed by prices in 1965 will still have an impact on the overall result for 1966. In the Federal Republic of Germany, the slight slowdown in the expansion of demand suggests a possibility that the extent of the price rise could decline slightly; but the extreme tightness of the labour market involves a risk that the rise in costs may continue to be so strong that the slacker trends stemming from developments in the demand/supply situation will be largely cancelled out.

Finally, it is important to note that the forecast of a slight slowdown in the pace at which prices in the Community will rise is in part based on the assumption that the weather will be more normal than in 1965 and that this will lead to an appreciable rise in the production of the many farm products which, being in short supply, went up considerably in price. This means that the slackening of the upward price movement forecast in sectors other than foodstuffs is even smaller than is apparent from the aggregate figures. It also means a considerable margin of uncertainty in the forecasts, not only because weather conditions cannot be predicted, but also because steps taken as part of agricultural policy could hinder the return to normal of unduly high prices.

C. Short-term economic policy

In view of the economic prospects outlined above, there can hardly be any real doubt that the problem of stabilizing costs and prices must remain in the foreground of overall short-term economic policy in the Community. This in no way means that other aims of importance for the Community's economic policy will be neglected. It is more or less generally accepted that, in the longer run, satisfactory economic growth can be achieved only if costs and prices in the Community are more stable than they are today. If costs and prices continue to rise unabated, they will in the end bring a threat of recession, or the economy will be faced with a prolonged period of stagnation.

In addition, the forecasts point as it is to a fresh acceleration of economic growth in 1966, and all previous experience goes to prove that this would continue into the following year. Should the desire to achieve a still higher rate of growth before the end of 1966 lead to the adoption of new short-term measures to encourage general expansion, those responsible for economic policy could conjure up the danger that by 1967 at latest very obvious demand-inflationary pressures would again haunt the Community. Even without such measures, the budgets of various member countries are in 1966 likely to make too great rather than too small a contribution to expansion.

Nor has the objective of a high level of employment been in any way neglected, either because of the priority accorded to the objective of price and cost stability or for any other reasons. In three member countries at least—Germany, the Netherlands and Luxembourg—and probably even in Belgium, too, the underlying trend will continue to be if anything in the direction of overemployment, not of underemployment (the number of completely unemployed who are fully capable of working will continue to be an extremely small percentage of the labour force); here a consistent policy of stabilization would lead to a rate of employment which would still be high but would no longer be marked by widespread manpower shortages with their inflationary effects on costs and prices. Employment in France seems to be settling down at this sort of level.

It is true that in all the countries mentioned pockets of relatively appreciable underemployment concentrated in particular regions, trades or age groups can exist alongside overstrain on the labour market in many other regions and callings. But it should be clear that this underemployment should not be tackled by a policy of general economic expansion, as this would inevitably lead to a general new aggravation of strains and so of the upward thrust of prices. Measures to deal with structural weaknesses, particularly more speedy vocational training or re-training, would be far more appropriate. Only in Italy do we have widespread unemployment of a cyclical character coupled with still considerable structural unemployment. But it is precisely in Italy, where the

accelerated expansion of total demand is expected to continue, that some improvement can be expected in 1966.

Finally, the objective of equilibrium in the Community's payments balance in no way conflicts with the requirement that stabilization in general shall be the first aim of short-term economic policy in the Community. True, the surplus on the Community's current payments grew between 1964 and 1965, but it will certainly not have reached even 1 % of the gross Community product in terms of value; moreover, it has already resumed a slightly recessive trend. Such a surplus is entirely appropriate in a highly industrialized area like the Community, which must of course be able to make net capital exports and in the long run cover them in terms of goods. The fact that the Community still has no net capital exports that could be set against the surplus on current account is a phenomenon which must in no circumstances lead the authorities deliberately to seek a reduction of the surplus or even to aim at a deficit—perhaps by adopting a policy of intensifying the expansion of nominal domestic demand and so, no doubt, of rising prices and costs. For such a policy of keeping alive or even stepping up internal inflation would not only have incalculable social consequences—one need only think of the completely unjustified and immense losses which would face all persons whose savings would be depreciated—but it would in the end also lead to recession.

The fact that the Community is not on balance an exporter of capital may well be in part due to the fact that it exports too little capital; this is why the Commission never ceases to urge the removal of artificial obstacles to capital exports, measures giving greater access to the capital markets of those member countries which are still lagging behind in this respect and steps towards the establishment of an effective European capital market. Still more important, however, is the fact that too much capital is flowing into the Community from outside. Some member countries have taken certain protective measures of their own, and corresponding measures (in the reverse direction) taken by the United States have proved effective. But this system is uncoordinated and incomplete. While other items in the capital balance were having a restrictive effect, further direct investments of foreign capital in the Community were rising sharply, with the result that in the first half of December 1965 the United States authorities tightened up their programme for placing the payments balance on a sounder footing, hoping to reduce these outflows to a volume compatible with the requirements of balance-of-payments policy.

In connection with the net inflows of capital, an important problem both for the Community and for the United States is that of the short-term economic policy mix—i.e. of the package of measures by which costs and prices are to be stabilized here and rapid economic expansion to be maintained in the United States. Sometimes this problem is formulated in the following simplified fashion : so far too little use of fiscal policy has been made on both sides—in Europe it has still contributed too much, and in the USA still too little, to expansion, while excessive use has been made of credit policy. In Europe (because of the shortcomings of budget policy in some countries) its aim was in

general strongly restrictive, in the United States it was too much used to promote expansion. The interest levels resulting from this on both sides show a differential which encourages the outflow of capital from the United States, and an inflow into the Community.

It must be pointed out, however, in this connection that the Community recognizes the problem and is giving it due attention—as far as the Community is in fact concerned. In one Member State (France) the policy mix has, since the end of 1963, already increasingly changed in the right direction and in most of the others it has so far not been lack of understanding but domestic political factors which have largely made it impossible to achieve the necessary restrictive effects in budget policy. Here it must not be forgotten that in the Community a very strong upswing occurred in the private sector between 1959 and 1962, and that credit policy and budget policy, which in most member countries were still quite conservative, were more or less powerless to do anything to restrain it, as considerable inflationary influences were affecting the Community from outside. After this, the public authorities had to catch up on the private sector in certain respects—in civil service salaries, infrastructure, social policy, etc.

Even when these particular circumstances have been allowed for, however, budget policy in most Member States has become too strongly expansionary; consequently the Council of the Community, when on 15 April 1964 it issued its recommendation on a harmonized stabilization policy, laid the main emphasis on restraint in public spending, whereas the simultaneous recommendations with regard to credit policy were considerably more elastic—precisely in order to avoid the sort of increase in interest differential which could provoke considerable new inflows of capital.

It must be stated with regret that the 1965 recommendation on budget policy was also very imperfectly followed in most member countries, particularly in those countries where the danger of further price rises was most marked at the beginning of the year.

Thus public expenditure in Germany and the Netherlands has probably far exceeded the standard laid down in the recommendation, whereas under the original budget there would have been little or no overstepping of the limits recommended. The trend in Belgium has been the same, though here the disadvantages for internal balance are somewhat less pronounced because of the simultaneous slowdown in some other elements of total demand. The reorganization of public finances undertaken in recent years with the aim of promoting more long-term growth, which *inter alia* lays the accent on achieving significant net savings in the public budgets, seems none the less to be in jeopardy. What is more, the expansion of public spending occurred mainly in consumer expenditures and transfer of incomes, whereas the Council had recommended that the emphasis in any fresh expansion should be shifted to public investment. Only in France did the trend of public budgets in 1965 conform in the main with the recommendation.

One consequence of the way budgets developed in most member countries was that monetary and credit policy had to be tightened up, especially as there is evidently in some member countries a connection between the ability of the public authorities to borrow—a factor which can be influenced by credit policy—and the extent to which public spending can expand. Had credit policy not worked against the ability to borrow, there can be no doubt that inflationary trends in the Community would have retained even more of their vigour.

Be that as it may, the brakes on credit policy were taken off completely, or nearly so, as soon as economic developments permitted or suggested that it could be advisable—at an early stage and almost completely in Italy, later in the year in France and Belgium. Only in the Federal Republic of Germany and the Netherlands did the central banks hold to their restrictive course; in the Netherlands the quantitative limitation on the expansion of credit was maintained—and was more strictly observed than previously; in Germany it was some time before the restrictions began to bite—in fact only once the payments balance had begun to exert a considerably restricting effect on bank liquidity. In both these countries, public and private calls for credit (capital demand) rose sharply and simultaneously, and interest rates were inevitably forced up. However, the limits of possible restrictions now seem to have been reached in both countries. Certain inflows of capital have recently been registered and, in this connection, it must be noted that for the Netherlands the threshold for such inflows is lower than for the Federal Republic of Germany. An elastic credit policy in these two member countries is now probably unavoidable if the authorities are to prevent the measures taken from being largely self-defeating.

It seems therefore all the more important that, in 1966 at least, budget policy should be applied in conformity with the requirements of the current situation. Unfortunately the chapters of this survey dealing with the individual countries make it evident that despite the efforts of Governments to moderate the expansion of expenditure and, in some countries, to increase revenue, budget policy appears unlikely to play its part in short-term economic policy very much better in 1966 than in 1965. In the Netherlands, Belgium and the Federal Republic of Germany, it is certainly more likely to make its own contribution to the upward pressure on prices, although in Germany and the Netherlands no doubt less than hitherto. France will once again be the only country where it will be possible to speak of a budget policy which is, on the whole, neutral in this respect.

Except in France, the budget policy planned for 1966 in these countries still can and ought to be altered. In this connection, it must be recalled that the short-term Economic Policy Committee in its opinion of 8 July 1965 (published in the last Quarterly Survey) emphasized the need for both the Federal Republic of Germany and the Netherlands to continue in 1966 holding strictly to the budgetary standard laid down in the

Council's Recommendation of 15 April 1964. This rule, moreover, in no way excludes an increase in cash expenditure of more than 5 % between one year and the next; the only condition is that the amount spent in excess of the 5 % rise must be fully covered by extra revenue (but not borrowing); the yield of non-inflationary tax progression (i.e. the additional revenue which would accrue from the progressivity of taxation when the nominal growth of GNP and its real growth are equal) counts as part of the cover. Any increase in expenditure beyond what is covered by the 5 % plus extra revenue would have to be met by higher rates of taxation and/or higher charges for public services. Tax reductions are considered as increased expenditure.

In France, all State expenditure has since 1965 had to be covered from current revenue, and this principle is being applied to the 1966 State budget also. Current trends in France being what they are, a more restrictive policy would certainly not be appropriate; on the contrary, it is in the circumstances even right and proper that the implementation of the budget in 1966 is likely to make some positive contribution to the growth of business activity.

Italy is the only country in the Community where there is unquestionably still a case for the national budget to exert a massive and expansionary impact on all elements of demand. Reinforcement of this policy is not, however, advisable; on the contrary, a reduction of this unselective contribution to growth could be recommended as economic expansion takes firmer root again—for with a large part of the deficits being financed by short-term borrowing and the payments balance exerting a strongly expansionary influence on liquidity, the problem of an excessive expansion of liquidity could arise, and this would later make it more difficult to bring the economic upswing under control and avoid new inflationary strains. It therefore appears advisable to limit the expansion of expenditure, to shift the emphasis of spending to direct and indirect investment, which can if necessary be quickly manipulated—instead of continuing to give direct and vigorous support to the expansion of consumption—and to change to an increasingly classical method of financing the deficit (i.e. from savings).

For Belgium and Luxembourg, where the pattern of effective State spending has shifted fairly rapidly in the direction of consumption expenditure and of transfers engendering consumption, and where not only the balance between current expenditure and current revenue is in danger but even the overall deficit is threatening to rise considerably further as a result of yet another increase that can be expected in investment spending by the State, strict application of the principle of equilibrium between current disbursements and current income is for 1966 essential, and should be achieved mainly by sharper limitation of the rapid increase in current outlays. It is also imperative that the expansion of capital expenditure be harmonized exactly with the possibilities of financing it which the capital market can offer out of genuine savings within the country but without undue neglect of business demands for capital.

It is clear that if these principles are to be respected in the member countries there will have to be further considerable efforts on the part of the competent authorities.

If certain of the Community countries achieved a really efficient budget policy that was properly geared to the economic situation, interest rates in these countries would almost certainly decline from the extremely high point they have reached, especially as monetary and credit policy would then also have freer play.

It is interesting in this connection that in the United States the domestic economic situation has recently led to a hardening of the very low interest rates in that country. If credit and finance policy do not counter this trend—and the increase in the discount rate from 4 to 4.5 % on 5 December is evidence that this is not happening, or not as fully as before—the incentives to export money and capital to the Community will considerably decline on this account too. In fact, it does seem that in the field of money and credit policy, and perhaps recently even in that of fiscal policy in the United States, an approach so very conducive to expansion as that followed in recent years is no longer appropriate. The latest price and cost trends in the United States and developments in its balance of current payments perhaps counsel prudence. An acceleration in the upward movement of prices and costs in the United States—a movement that has so far been extremely moderate—would certainly not help stabilization policy in the Community either.

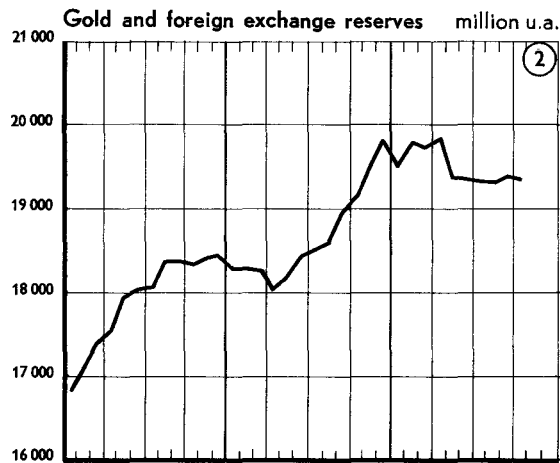
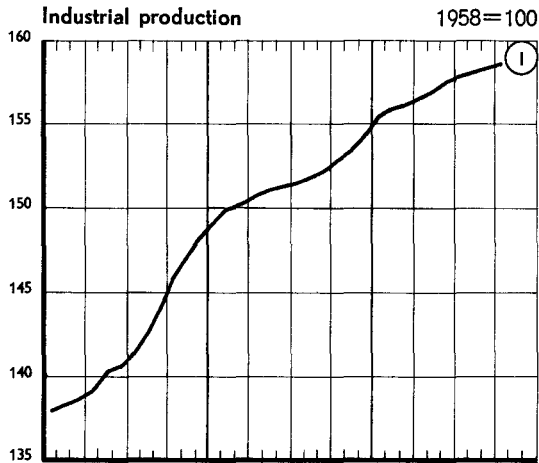
The continuing labour market strains in most member countries of the Community are the chief reason why the Council's recommendations of April 1964 on incomes policy—these were repeated a year later—have not been followed. It is, however, a fact that even in those member countries where the labour market is no longer under strain, only relatively modest successes have so far been achieved. Here Governments must do more than has so far been done to make use of the present situation, and must endeavour to induce the two sides of industry to conclude agreements which will halt the rise in unit costs. Only in Germany and the Netherlands is there little chance of such a policy succeeding until such time as the state of overemployment is really cured by measures of general economic policy with an impact on demand. However, this does not mean that even in these member countries greater endeavours in the field of incomes policy should not be made *pari passu* with the requisite economic policy.

Finally, the possibility might perhaps be considered of underpinning those tendencies which contribute towards stabilization in the Community by further advance reductions of duties in inter-Community trade and, as far as still possible in certain member countries, on imports from outside countries. This could do much to prevent the recovery of business in Italy and France from leading to new upward pressures on prices. The surpluses on Italy's current payments account call for just such a move, and those of France at least permit it. In the Federal Republic of Germany, advance reductions

in duties would make a distinct contribution to curbing the upward thrust of prices and also of internal demand, and they would thus be able in the end to contribute to a recovery in the balance of current payments.

In conclusion it should be pointed out again that, in all member countries of the Community, everything possible should be done to arrest the erosion of the internal purchasing power of their currencies, an erosion which has gone on too long already, and is no longer creeping but advancing in bounds of between 3 % and 5 % yearly. Economic transactors—and the States—will otherwise become so accustomed to inflation, and such defensive measures will be adopted by different sections of the population (extension of sliding price clauses of all types, the linking of incomes and State spending with the nominal volume of other incomes, and finally—there are already many signs of this in Belgium and elsewhere—the linking of the steps of progressive tax systems with the index of prices), that as time goes on major built-in stabilizers and policy instruments will be rendered completely ineffective.

ECONOMIC INDICATORS



NOTES:

Source: Statistical Office of the European Communities.

Graph 1. The trend curves represent estimates which have been established on the basis of indices (excluding construction, food, beverages and tobacco) adjusted by the SOEC for seasonal and fortuitous variations.

Graph 2. Total gross reserves of gold and foreign exchange held by the monetary authorities of the Community countries at the end of each month.

Graph 3. Three-monthly moving averages of the seasonally adjusted value of exports to non-member countries (fob) and imports from these countries (cif), as shown in customs returns.

Graph 4. Three-monthly moving averages of the seasonally adjusted value of trade between EEC countries, as shown by customs returns for exports.

u.a.: one unit of account = 0.888671 gm. of fine gold = US \$1 at the official rate of exchange.

EEC

TABLE 1: Basic data (1964)

Total area ('000 sq. km.)	1 167,5
Total population ('000)	179 243
Density of population per sq. km.	153
Working population ('000)	73 964
Working population, breakdown by main sector (%)	
— Agriculture	18
— Industry	44
— Services	38

TABLE 2: Some elements of Community product and expenditure
(annual rates of growth)

	% change by volume on preceding year						Volume indices (1958 = 100)	Contri- bution (in %) to 1964 GNP
	1959	1960	1961	1962	1963	1964	1964	1964
Gross Community product	5.2	7.8	5.4	5.5	4.2	5.5	139	—
Industrial production	6.3	11.9	6.9	5.8	5.2	7.1	152	—
Visible imports	5.1	20.5	6.0	11.3	10.2	6.9	176	—
Private consumers' expenditure	3.7	6.3	6.3	6.4	5.7	4.4	138	60
Gross fixed asset formation	8.2	10.7	10.2	6.8	4.9	7.3	158	23
Visible exports	12.5	11.1	3.0	1.0	3.8	9.3	148	—
Intra-Community visible trade	24.2	22.0	15.0	13.9	16.0	13.2	261	—
Gross product per capita	4.2	6.9	4.4	4.3	3.0	4.4	131	—

TABLE 3 : Basic monthly indicators

	Year	Jan.	Feb.	Mar.	Apr.	May	June	July	Aug.	Sept.	Oct.	Nov.	Dec.
Industrial production (1958 = 100)	1964	147	152	156	156	159	155	143	121	154	159	164	157
	1965	154	159	157	163	164	163	147	128	160	166		
Imports from non-member countries (cif, million u.a.)	1964	2 238	2 186	2 237	2 381	2 192	2 320	2 254	1 886	2 085	2 270	2 238	2 460
	1965	2 243	2 090	2 420	2 368	2 380	2 352	2 404	2 157	2 386			
Exports to non-member countries (fob, million u.a.)	1964	1 891	1 878	1 959	2 088	1 866	2 036	2 053	1 731	2 030	2 252	2 113	2 291
	1965	1 936	2 068	2 413	2 172	2 249	2 192	2 349	1 998	2 289			
Balance of trade (million u.a.)	1964	- 397	- 308	- 278	- 342	- 326	- 288	- 201	- 155	- 55	- 18	- 125	- 169
	1965	- 307	- 22	- 7	- 196	- 131	- 160	- 55	- 159	- 97			
Intra-Community trade (million u.a.)	1964	1 436	1 452	1 496	1 577	1 415	1 576	1 532	1 243	1 512	1 654	1 510	1 623
	1965	1 442	1 573	1 796	1 680	1 661	1 692	1 735	1 437	1 734			

NOTES

Source : Statistical Office of the European Communities.

Table 1

- Total population at mid-year.
- Population in employment at mid-year. Netherlands: 1961.

Table 2

- The final column of the table gives a % breakdown of GNP at market prices by main categories of expenditure. The calculation of the Community's GNP has been made on the basis of official rates of exchange.
- Industrial production: index of the Statistical Office of the European Communities, excluding construction, food, beverages and tobacco.
- Imports of goods (cif) from countries which are not members of the EEC, as shown by customs returns.
- Exports of goods (fob) to countries which are not members of the EEC, as shown by customs returns.
- Trade between EEC member countries, as shown by customs returns relating to imports.

Table 3

- See note to table 2.
- Values in the last column of the table are expressed in million units of account. Conversion into units of account was effected at official exchange rates (1 unit of account = 0.888671 gm. fine gold = US \$1 at the official rate of exchange).

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

A. Federal Republic of Germany

In 1965 the rapid expansion of overall demand in monetary terms continued: strains in the economy and their effects were more severe than in the previous year.

Because of a generally calmer economic climate in countries which are Germany's customers, but also because of the pull exerted by domestic demand, the growth of effective foreign demand lost a little momentum; none the less the value of merchandise exports in 1965 was probably 10 % higher than in 1964.

The growth of gross fixed asset formation also declined a little: where it had been 14.5 % for 1964, it was only 9.5 % for 1965 (value). The key to this trend was a substantial decline in the rate at which investment in construction expanded. This decline was partly due to restrictive measures, which particularly affected public works, and partly to differences in weather conditions between the two years.

The expansion of public current expenditure on goods and services gathered considerable momentum, and private consumers' expenditure, which had already grown appreciably faster in the previous year, again spurted, mainly as a result of a sharper rise in wages. In general, the expansion of private consumption for 1965 was probably about 9.5 % in monetary terms and about 6 % in real terms.

Declining elasticity was a feature of the domestic supply trend, and the reason for this was not only the labour shortage, which grew more severe despite the continuing heavy inflow of foreign workers, but the fact that many industries were already operating at full capacity. In all likelihood industrial production, as measured by the monthly index of the Federal Statistical Office, was up on the 1964 figure by about 5.5 %. Taken overall, real gross national product will have risen by about 5 % (for 1964 the figure was 6.6 %).

The discrepancy between overall demand in monetary terms and real domestic supply produced so sharp an increase in imports that the current account deteriorated appreciably; including unrequited payments, there was a deficit under this heading for the first ten months of 1965 of DM 5 900 million, which contrasts with a surplus of DM 1 000 million for the corresponding period of 1964. It also led to a more rapid upward movement in prices. The cost of living was almost 4 % higher in the third quarter than in the third quarter of 1964; but for the sharp revival in the external balance, the upward thrust of prices would certainly have been substantially stronger.

Relatively vigorous economic expansion may be expected in 1966, and once again there will be little idle capacity in industry. The trend in export orders supports the assumption that exports are once again likely to expand a little faster.

The expansion of monetary demand at home must, in general, be expected to slow down a little. Among the main components of domestic demand, investment in plant and equipment is likely once again to lose a little pace, though investment in construction should grow at least as fast as in 1965. The expansion of incomes will slow down only slightly; although the savings ratio is likely to increase once again slightly, a further substantial increase in private consumers' expenditure can therefore be expected. In addition, public consumption should expand again fairly vigorously, even if the proposed reductions in the increase of Federal expenditure announced for 1966 are fully implemented.

As the total number of hours worked is, if anything, declining and technical capacities are in general fully utilized, domestic supply seems likely to grow somewhat less in 1966 than it did in 1965. For industrial production, an average yearly growth rate of about 4.5 % is likely, and for the economy as a whole, real gross national product could well show an increase of about 4 %.

The outlook for the development of overall demand and of production suggests that the disequilibrium in the German economy will become slightly less marked in 1966. Imports are none the less likely to grow again relatively vigorously, albeit a little more slowly than in 1965. The balance of current payments, having reached its lowest point so far at the end of the past summer, is unlikely to deteriorate further, apart from seasonal variations; the total deficit in 1966 might, however, be a little heavier than in 1965.

The upward price increment will perhaps be a little smaller than from 1964 to 1965, but prices will still tend to rise more than is compatible with the stabilization that is being pursued.

In these circumstances it looks as if there is a strong case for curtailing public expenditure fairly sharply: in 1965 it had soared, and much of the spending undertaken entailed commitments for the future. The Federal Government has taken decisions on the right lines, but it is distinctly doubtful whether the curbing of the expansion of expenditure and the measures to increase revenue will be such that the

public budgets can play their proper role in the policy of stabilization. Further efforts appear necessary if in 1966 there is to be a decisive improvement in the outlook both for prices and for the current account without the conditions for further economic growth being compromised by the use made of other economic policy instruments.

1. Balance-sheet for 1965

Although effective demand from abroad had at some period in 1964 ceased to be the mainspring of domestic activity, the growth of exports in 1965 was again considerable; this achievement is all the more remarkable in view of the trend of world business, which was quieter than in the previous year, and the slackening of demand from certain member countries (notably Italy and France), which affected German exports in the second half of 1964 and in the early months of 1965. As the year went on, the general trend of exports flattened somewhat, the heavy pull of domestic demand having no doubt also worked in this direction.

Visible exports, as shown in the customs returns, had scarcely moved up at all in the first half of 1965, but gathered strength once again in the second half. The year-to-year growth rates for the third quarter were 10 % (volume) and 12 % (value). It can now be estimated that the value of visible exports in 1965 will have grown about 10 % (volume 8 %) compared with 11.3 % (volume 10.2 %) in 1964.

Although in the first half of the year exports to the rest of the Community showed little improvement on the figure for the first half of 1964, expansion picked up a little in the third quarter, when the year-to-year growth rate was 6.5 %; in this same quarter, the year-to-year growth of exports to non-member countries was, however, 15 %.

Exports of services also rose appreciably in 1965, although less rapidly than in the previous year. The total volume of goods and services exported (as defined for the national accounts) was probably 7.5 % up, compared with a growth of 9.6 % in 1964.

Gross fixed asset formation, the expansion of which was already playing a decisive role in business trends in 1964, continued to advance in 1965, although not quite so rapidly

as before. In total figures it was probably some 9.5 % up in terms of value and about 6.5 % up in volume on 1964, compared with increases of 14.5 % and 11.7 % for 1964. The slight slowdown in the upward movement of investment was mainly due to a loss of momentum in building investment, where the growth rate was not even half as high as in 1964 (it must however be remembered that the weather had hit the building industry badly in 1963 and favoured it a year later). The expansion of public works declined relatively sharply in 1965; in residential and business construction, the loss of momentum was, on the other hand, less pronounced. The number of dwellings completed may again have reached the figure of about 600 000 achieved in 1964. At all events, the prolonged and grave disequilibrium between building demand and supply seems to have grown less serious.

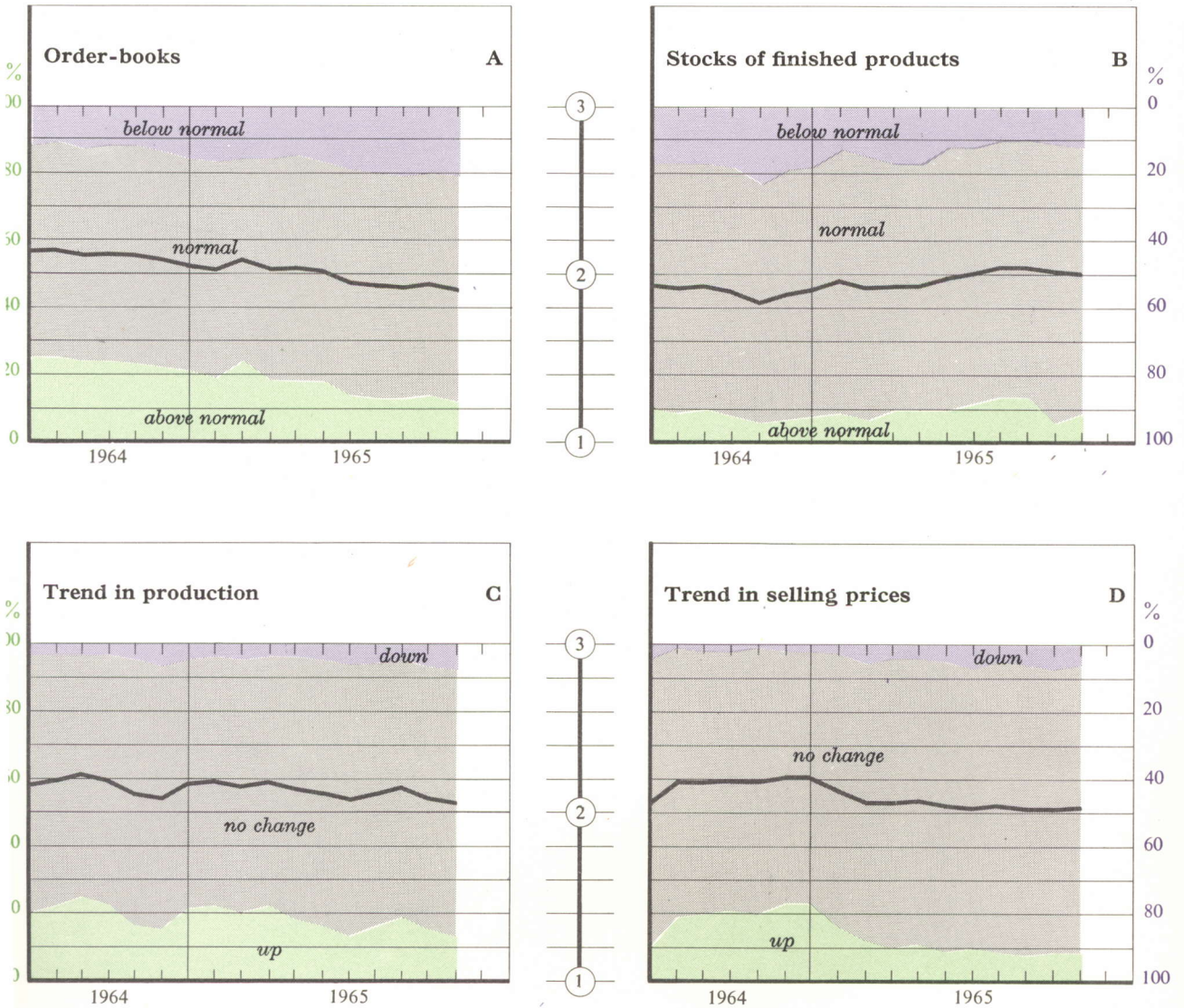
In contrast with building investment, expenditure on plant and equipment again rose very sharply; in volume it will have increased about 9.5 %. During the first nine months of the year, domestic sales of mechanical engineering products were 14 % up in value on the corresponding figure for 1964, and there was a considerable increase in machinery imports. The trend in the expansion of investment in plant and equipment would seem, however, to have lost some vigour in the course of the year, one reason being the existence of certain limitations on the extent to which domestic supply could expand; another factor was that rising costs per unit of output and soaring imports eroded profit margins, and this, together with the growing effect of the credit squeeze, made it difficult for managements to finance new investment.

In general, the contribution to expansion made by investment in stocks was somewhat weaker in 1965 than it had been in 1964. A certain tendency for firms to run down their stocks of raw materials became apparent as the year advanced; this was probably in part due to the fact that world commodity prices were for a time expected to fall. The results of the EEC Business Survey suggest that stocks of finished manufactures rose a little — they had previously been described as below normal by many managements. In mining, pithead stocks of coal and coke again rose sharply; they totalled about 16 million tons at the end of November 1965, compared with about 8 million tons a year earlier.

Mainly as a result of an appreciable increase in the wage and salary bill in the public sector and of a substantial expansion of defence expenditure, public current expenditure grew appreciably more rapidly than it had done in 1964.

What is, however, of particular importance is that the growth of private consumers' expenditure was once again more rapid than in the previous year; for the full year 1965, the increase is estimated at about 9.5 %, following an increase of 8 % for 1964. But prices also rose faster—partly because of the more rapid expansion of personal

BUSINESSMEN'S VIEWS ON THE INDUSTRIAL SITUATION



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

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

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

expenditure—so that for 1965 the real increase in consumption, at about 6 %, was only a little greater than for the previous year (5.2 %).

The more rapid expansion of private consumers' expenditure reflected—although not completely, for the savings ratio moved up again—the faster pace at which the disposable income of households was rising: the wage and salary bill continued to climb rapidly (once again the increment was approximately 10 %), mainly because of the labour shortage. A second factor contributing to the increase in disposable income was the reduction in the wage tax that came into force in January 1965; net wages and salaries rose—at least in the first six months—even faster than gross earnings. Lastly, income transfers from public sources were stepped up quite appreciably. The only item to record relatively slow growth was the amounts withdrawn from their businesses by self-employed persons; here the trend followed that of profits. As indicated above, the savings ratio moved up again, rising from 10.8 % of the net income of households in 1964 to 11.5 % in 1965.

The number of persons in paid employment grew faster once again, mainly because a larger number of workers were recruited abroad. At the end of September, more than 1 200 000 foreign workers were employed in Germany, about 23 % more than in September 1964. At 21 800 000 the numbers of persons in paid employment will have been some 1.4 % higher than a year before.

The expansion of demand was, however, so vigorous that the pressures on the labour markets—already very severe—grew even sharper. The number of persons unemployed at the end of September 1965 was—at 85 000—15 000 less than at the same time in 1964, and the unemployment rate had dwindled to 0.4 % of the labour force (excluding the self-employed). At the same time the number of vacancies reported to employment exchanges reached—at 700 000—a new peak for this time of the year.

As the reserves of production capacity were called into use and the scope for productivity increases narrowed, there was a distinct decline in the elasticity of industrial supply from domestic sources. Despite the heavy and continuing pressure of demand, the output of many industries increased less rapidly than in 1964, and from the spring of 1965 onwards the pace of its growth slackened. Total industrial production for 1965, as shown in the monthly index of the Federal Statistical Office (which is not adjusted for differences in the total number of working days in the year), probably rose by 5.5 %, compared with a growth rate of 9.3 % for 1964.

Agriculture made only a modest contribution in 1965 to the increase in the gross national product: bad weather having caused crops to be considerably poorer than in 1964. On the other hand, further notable progress was made in livestock production.

Including the contribution made by services, the increase in real gross national product in 1965 may be estimated at about 5 % (the corresponding figures for 1963 and 1964 are 3.2 % and 6.5 %). This growth rate would correspond to the forecast made in the Quarterly Survey a year ago.

Domestic supply failed to keep abreast of the expansion of demand, and there was therefore an unexpectedly vigorous growth of imports. Customs returns show the value of goods imported in the first ten months of 1965 to have been 21 % (and their volume 18 %) higher than the corresponding figures for 1964. This relief for the domestic markets came mainly from the other member countries, where—partly because business activity there had lost momentum—capacity was available to step up exports.

Invisible imports also grew further, the main factors here being higher interest payments on capital and a further considerable rise in the expenditure of Germans traveling or holidaying abroad; the growth of overall imports of goods and services (as defined for the national accounts) is estimated at 13.5 %, compared with 10.7 % in 1964.

Even this expansion of imports did not quite suffice to bridge the gap between the growth of real domestic supply and that of overall monetary demand, with the result that the upward movement of prices gathered strength.

Industrial producers' prices, which rose in 1964 by 1.1 %, were up 2.2 % in October 1965 on the October 1964 figure.

Building and construction provided the only exception to the general rise, and here there was in fact a fairly general weakening of the upward movement. Prices for building services in residential construction were none the less 4.4 % up in August on the comparable figure for the previous year, after a year-to-year rise of as much as 5.2 % in February. The decline in prices for civil engineering, which had begun in the middle of 1964, continued.

The rise in agricultural producers' prices was unquestionably sharp. In October 1965 the year-to-year growth rate was 9.5 %; the poor weather was responsible for fairly sharp rises in the prices of crop products, particularly during the summer, but in the case of livestock products as well, notably meat, prices were raised steeply to contain the substantial increase in demand. Services, too, became more expensive as wage rates mounted rapidly.

The growth of consumer prices was consequently greater than in the previous year. The general cost-of-living index was up 3.8 % (3.2 % without food, beverages and tobacco)

in October on the corresponding figures for the previous year. For the full year, prices to the ordinary consumer probably rose by 3.3 %, compared with 2.6 % in 1964.

National product and expenditure

	1963 ⁽²⁾	1964 ⁽²⁾	1965 ⁽³⁾	1966 ⁽³⁾
	At current prices (in DM '000 million)	% change by volume on preceding year		
Gross national product	376.8	+ 6.5	+ 5	+ 4
Imports ⁽¹⁾	70.0	+ 10.7	+ 13.5	+ 8.5
Private consumption	215.1	+ 5.2	+ 6	+ 5
Public current expenditure	59.2	— 0.1	+ 5	+ 4
Gross fixed asset formation	95.3	+ 11.7	+ 6.5	+ 4
Exports ⁽¹⁾	75.0	+ 9.6	+ 7.5	+ 7.5

⁽¹⁾ Goods, services and factor income.

⁽²⁾ Statistical Office of the European Communities; General Statistical Bulletin, No. 11, 1965.

⁽³⁾ Commission forecasts.

Note :

(a) The difference between the figures for product and those for expenditure is accounted for by movements in stocks.

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

With imports of goods and services growing appreciably faster than exports, the surplus on external trade—the “external contribution” as defined for the national accounts—dwindled sharply, and from DM 5 000 million in 1963 and DM 5 300 million in 1964 it will have fallen to about DM 300 million in 1965.

According to balance-of-payments returns, there were very heavy monthly deficits on current account (including unrequited payments), particularly from the spring

onwards. In the first ten months there was a total deficit of DM 5 900 million, compared with a surplus of DM 1 000 million over the same period of the previous year. The key to this development was the deterioration of the trade balance, which from the spring onwards, began, after a long spell of surpluses, to show quarterly deficits. The heavy deficit on current account was also due in part to an appreciable deterioration of the services balance. On the other hand, a surplus emerged on capital transactions (including foreign exchange movements reflected in errors and omissions, but not including the change in the foreign exchange position of the commercial banks), contrasting with the deficits in the previous year, which had been due to the influence of the withholding tax. One of the reasons for the improvement in the capital balance was that in 1965 direct foreign investment in the Federal Republic was considerably heavier than in 1964. Evidently, too, managements were being forced by the lack of liquid funds and the need to finance the heavy increase in imports to borrow more heavily abroad.

All in all, the gold and foreign exchange reserves of the banking system (Bundesbank and commercial banks) declined less sharply than the deterioration in the current account would lead one to expect; the decline from January to October 1965 was DM 240 million. The reserves of the Bundesbank contracted by DM 1 500 million and the net foreign exchange position of the commercial banks improved by about DM 1 300 million.

However, it is only recently that the narrowing of the liquidity margin has led to some slackening in the expansion of bank credit. At first the growth of lending gathered further momentum; in particular, short and medium-term advances to business customers built up appreciably faster than in the previous year. The maintenance of a high level of industrial investment combined with the slower growth of firms' own resources available for financing increased the shortage of funds at their disposal; and for various reasons, one of them being that the excessive demands made by the public authorities rendered the capital market relatively tight and expensive, industry looked more and more to the banks and other sources for accommodation.

2. Outlook for 1966

On the whole it looks as if overall demand will continue to develop very vigorously in 1966. The expansion of domestic demand could well, however, slow down a little.

The contribution made by demand from abroad is unlikely to diminish. Though some loss of momentum is to be expected in 1966 in several non-member countries, there

is a good chance that this will be more than offset by the revival of economic activity in Italy and France which was already stepping up the demand for German merchandise in the second half of 1965.

Apart from this factor, the reduction in the EEC internal tariffs due at the beginning of 1966, having already been brought into operation by the Federal Republic, will tend to favour German exports. Despite the upward movement of costs, the competitiveness of German export firms does not so far seem to have suffered appreciably. At any rate it appears that for some time past export orders for manufactures have been expanding more sharply again; in the third quarter of 1965 they were 10 % higher than a year before.

In general, the Commission's staff now forecasts a 1966 growth rate of 7.5 % in terms of value for exports of goods and services (as defined for the national accounts).

The expansion of expenditure on gross fixed asset formation is, on the other hand, expected to slow down. At present the Commission's staff predicts a growth rate of about 6.5 % (volume about 4 %).

A number of important factors will tell against industrial investment in 1966. Not only will growing pressure on profit margins leave less scope for self-financing, but it will also be difficult to procure funds elsewhere—a factor which could also hamper the implementation of many public investment programmes. At the same time the shortage of manpower—which is certain to continue—and keen competition from foreign suppliers is likely to be putting pressure on firms to streamline their production methods.

In view of these factors the growth of investment will presumably be less buoyant in 1966 than hitherto. The general trend in domestic orders received by the mechanical engineering industry has in the last few months held less promise of expansion; in the third quarter these orders were still as much as 5 % higher than a year earlier, but only slightly higher than actual sales to the home market in the same period. An overall estimate is that investment in plant and equipment will increase in 1966 by about 3.5 % (volume).

Expenditure on construction should grow in 1966 at least as fast as before; on the assumption that the upward price movement eases slightly, growth in terms of volume could actually be a little more rapid than in 1965. The flow of orders for new building picked up again from the middle of 1965 onwards; the estimates for the new public buildings (the actual costs of building) for which permits were issued had scarcely increased at all during the first half of 1965, but in the third quarter were 29 % above the corresponding figure for the same period of the previous year; in residential construction, the corresponding year-to-year growth rate was 14 %, while in industrial construction the estimated costs of work for which permits were issued was just under 7 % above the figure for the third quarter of 1964.

In view of the announcement that cuts would be made in the growth of expenditure, it can be assumed that public current expenditure will grow a little less rapidly in 1966 than in 1965. Even if the limits on expansion are strictly applied, the growth of expenditure will still be appreciable.

As in 1965, the biggest contribution to the development of economic activity may well stem from the growth of private consumers' expenditure. The rate of expansion might, however, weaken slightly; the narrowing of profit margins and the resultant stronger resistance of employers to heavy wage increases is a factor which could slow down the expansion of incomes derived from paid employment, although tightness on the labour markets will preclude any really substantial deceleration of the upward wage movement; transfer incomes, which rose sharply in 1965, should also advance more slowly; and lastly, withdrawals from profits by self-employed persons will probably again grow more slowly. Assuming a further, but smaller increase in the savings ratio, the Commission's staff now estimate that private consumers' expenditure will grow in 1966 by about 8 % (by volume, about 5 %).

Pressure on the labour market may well become even more acute than it has been in 1965. Two factors here are, firstly, a smaller increase in the number of persons in paid employment—due in part to natural shrinkage of the labour force—and, secondly, a further reduction that is expected in the average working week. In addition, the number of foreign workers is unlikely to increase as much as it did in 1965. All in all, the total number of hours worked might even prove to be rather smaller in 1966 than it was in 1965.

How far production expands will consequently depend on progress in productivity (the increase in output per hour worked). But it is doubtful if much can be achieved in the way of speeding up improvements in productivity, given the limits set by capacity—which is admittedly expanding, but at a relatively moderate pace; the rate of improvement is, in fact, more likely to slow down. The most, therefore, that can be expected is that industrial production (including construction, but without adjustment for differences in the total number of working days in the year) will grow by about 4.5 %. The growth rate for total real gross national product may also be smaller; it will probably be about 4 %.

As the slight drop which is on the whole expected to occur in the expansion of demand may be offset by a weakening in the growth of domestic supply, there should be a further vigorous expansion of imports, though the actual rate of increase is likely to be lower. The Commission's staff at present estimate that imports of goods and services (as defined for the national accounts) will expand by about 8.5 % in volume.

Of visible imports, raw materials and semi-manufactures are expected to increase less in 1966 than in 1965, while the flood of imports to Germany from certain countries will probably tail off as the situation improves in these countries. As this happens,

however, part of Germany's growing imports will be drawn from non-member countries. Imports of finished manufactures, notably consumer goods, should continue to rise steeply. Imports of agricultural produce, too, may for a time grow even faster than before.

Since imports will continue to increase more rapidly than exports, the trade balance (as defined for the national accounts) must be expected to deteriorate once again and could even show a deficit. In balance-of-payments terms, this means that the total current account (including the balance of unrequited payments) could well close with an even heavier deficit than a year before. The deterioration should, however, be appreciably less pronounced than in 1965. When the month-to-month trend is considered, it would seem that no further deterioration is to be expected beyond the level reached towards the end of the third quarter of 1965; there should, if anything, be a slight tendency for the situation to improve.

A rather narrower gap between overall demand and overall supply is to be expected, and this could mean a somewhat weaker upward price movement, since it is the demand/supply disequilibrium that has been forcing prices up. However, the after-effects of a development that has so far been merely sharply inflationary, in particular the delayed passing on of increased costs to the consumer, should be borne in mind. In general the current upward trend in prices is still too strong to be compatible with stabilization objectives.

Those responsible for economic policy should endeavour to improve, by appropriate measures, the outlook for prices and the balance of current payments, which is far from being altogether satisfactory.

Essentially, such an improvement will be possible only if measures are taken to curb the expansion of monetary demand at home. At the same time, it will be useful to allow the deterioration of the current account—in substance the increased flow of imports—to make the maximum impact in the internal economic situation and on prices. It would be entirely out of place if an attempt were made to achieve a recovery in the current account by measures which hampered imports or encouraged exports. Action on these lines would only aggravate the disequilibrium between overall supply and overall demand and strengthen inflationary pressures within the country.

Budget policy is of vital importance in any efforts to limit the expansion of domestic monetary demand. It was budgetary policy which, despite the recommendations of the EEC Council, served in 1965 to strengthen domestic demand considerably. Federal expenditure rose by 11-12 %, and the expenditure of the Länder and local authorities almost as much. In addition, tax reductions meant that revenue from this source was far less than it would otherwise have been. Consequently, budget policy should be set on a more restrictive course, at least in 1966.

The Federal authorities have in fact made provision for an appreciable reduction in the expansion of expenditure and have adopted a number of minor measures to increase revenue. But the reduction of about DM 7 200 million has been calculated on a total made up from departmental estimates partly through the extrapolation of increases in expenditure, partly in the light of recent legislation, and this total would have entailed an increase of about 20 % over the budget of 1965. The cut reduces this increase to between 8.5 and 9 %.

Despite the fact that certain further items have merely been transferred out of the budget and that a further sum of DM 750 million has been deducted which, as in the previous year, will not actually be paid out but will none the less be credited to social security institutions in the form of claims on the Treasury, this reduction, provided it is fully implemented, must be regarded as an appreciable achievement, especially as it entails the amendment of recent legislation providing for additional expenditure. If the 1966 budget, including the special arrangements, is compared with the estimates of actual disbursements for 1965, the rise in Federal expenditure will in fact be only about 6 %. If account is taken both of the increased revenue due to progressivity of taxes when the growth of real GNP and the growth of GNP in money terms are equal, to heavier taxes on spirits and sparkling wines, and to the expected increase in rail tariffs, it can probably be claimed that in 1966 the budget policy of the Federal Government will be much closer to the EEC Council's recommendation than in 1965.

This will however be true only if the expenditure reductions are fully implemented in practice and supplementary expenditure is not authorized later in the year. Experience shows how difficult it is to compare budget estimates for one year with the actual expenditure of another. However, the Federal Government has announced firmly that it intends to accept no more decisions entailing supplementary expenditure unless the additional funds to finance their execution are available. Moreover, and this is the decisive factor, the state of the capital market will almost certainly not allow expenditure to be stepped up to any great extent unless taxation is increased appreciably.

Even if the proposed cuts are fully implemented, the Federal budget will still be far from ensuring that public budgets generally will exert an anticyclical effect. Moreover, the expenditure of the Länder will still tend to grow faster than Federal expenditure, particularly since the Länder apparently still dispose of certain financing reserves. The degree of success that will attend the efforts of the Federal Government to induce the Länder and local authorities to pursue a policy in line with central policy remains an open question, but financing difficulties will certainly force the local authorities to reduce the expansion of their expenditure.

In these circumstances, the policy of restricting credit must be maintained for the time being, particularly since the relatively close interdependence in Germany of banking liquidity and the capital market would mean that, in the event of a relaxation, funds

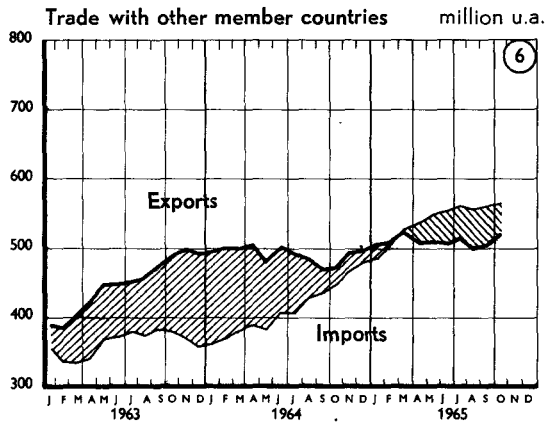
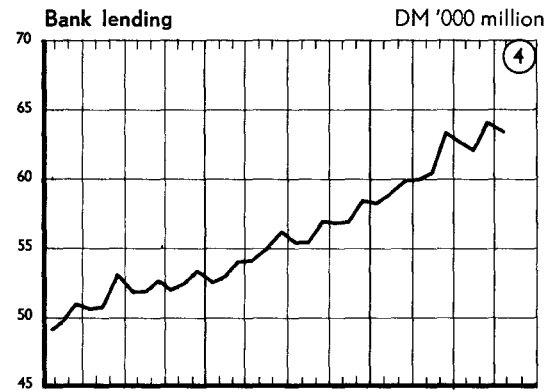
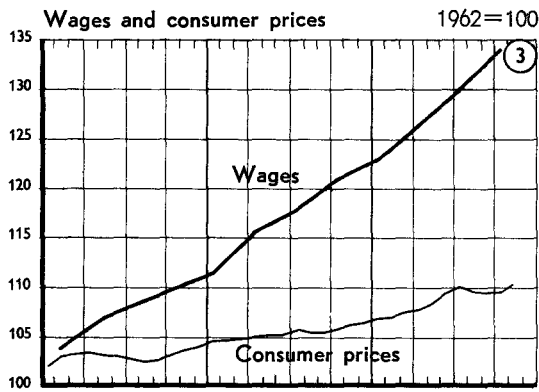
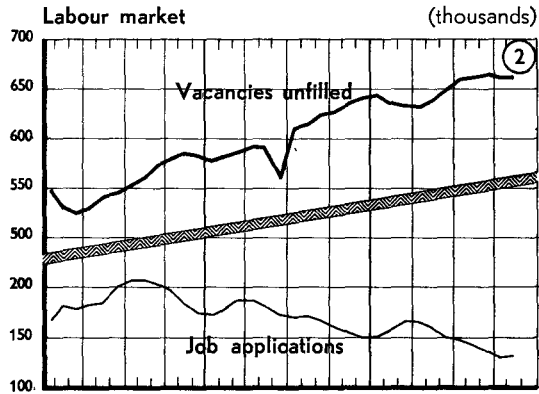
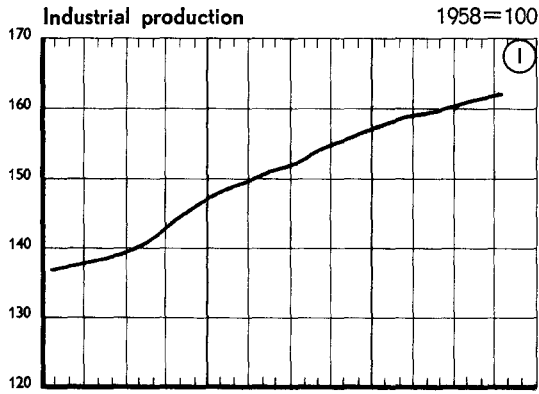
would become available on the capital market and would be creamed off by the public authorities, with resultant heavier increases in expenditure.

This does not mean that credit policy should be completely inflexible; it should, on the contrary, be regularly adjusted to the effects produced by balance-of-payments deficits and the restraints placed on the expansion of public expenditure, and it should in particular avoid provoking a further heavy influx of foreign capital, as this would rob the policy of its value. The limited reduction made in minimum reserve rates in December 1965 shows that the Bundesbank is not in fact applying a rigid policy in this respect. If adjustment of the budgets of the public authorities in accordance with the requirements of economic policy were assured, and if the industrial investment boom really loses momentum, so that the impact of the stabilization drive becomes apparent both on the labour market and in prices, wages and the balance of current payments, a corresponding adjustment could be made to credit policy in the course of 1966.

Note :

Since the national accounts include West Berlin, and the Fourth Quarterly Survey is essentially a report on the whole year, no special section has been devoted to the economic situation in West Berlin. This follows the practice pursued in previous years. In the first three Quarterly Surveys of 1966 there will again be a section on West Berlin.

ECONOMIC INDICATORS



NOTES:

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

Graph 1. The trend curves represent estimates which have been established on the basis of indices (excluding construction, food, beverages and tobacco) adjusted by the SOEC for seasonal and fortuitous variations.

Graph 2. Series seasonally adjusted. Moving averages of 3 months.

Graph 3. Source: Statistisches Bundesamt. Cost-of-living index at middle of month; index of average hourly gross earnings in industry (including construction).

Graph 4. Short-term loans to business and private customers within the country.

Graphs 5 and 6. Series adjusted for seasonal and accidental variations (moving averages of 3 months). Exports fob, imports cif. Conversion at official exchange rates.

Federal Republic of Germany

TABLE 1 : Basic data (1964)

Total area ('000 sq. km.)	248.5
Total population ('000)	58 267
Density of population per sq. km.	235
Working population ('000)	26 979
Working population, breakdown by main sector (%)	
— Agriculture	11.4
— Industry	48.3
of which : Construction	8.1
— Services	40.3
Percentage share of gross domestic product	
— Agriculture	6.1
— Industry	50.8
of which: Construction	7.8
— Services	43.1
Gross product per capita (DM)	7 095

**TABLE 2 : Some elements of national product and expenditure
(annual rates of growth)**

	% change by volume on preceding year						Volume indices (1958 = 100)	Contri- bution (in %) to 1964 GNP
	1959	1960	1961	1962	1963	1964		
Gross national product	7.0	8.8	5.4	4.2	3.2	6.5	141	—
Industrial production	8.3	10.7	6.3	4.5	2.8	8.6	159	—
Total imports	17.2	16.9	8.1	11.4	8.0	10.7	197	18.9
Private consumers' expenditure	5.4	6.9	6.8	5.9	2.6	5.2	138	56.2
Public current expenditure on goods and services	8.7	7.6	7.8	11.5	7.5	— 0.1	151	15.0
Gross fixed asset formation	12.9	11.3	9.4	5.9	2.9	11.7	167	26.4
Total exports	12.5	13.0	3.5	3.9	9.0	9.6	164	20.1
Gross national product per capita	5.8	7.7	4.0	2.8	2.0	5.3	131	—
Gross national product per person gainfully employed	6.1	6.8	4.1	3.4	2.8	6.2	133	—

Federal Republic of Germany

TABLE 3 : Foreign trade (at current prices)

	% change on preceding year						Indices (1958 = 100)	Million u.a.	% of the total
	1959	1960	1961	1962	1963	1964	1964	1964	1964
Visible exports									
Total	11.3	16.4	11.1	4.5	10.2	10.9	184	16 215	100
Intra-EEC	13.5	23.3	19.6	20.9	20.8	8.4	246	5 910	36.4
To non-EEC countries	10.5	13.8	7.6	1.0	4.7	12.5	161	10 305	63.6
Exports of food, beverages and tobacco									
Total	11.2	9.3	4.3	7.3	16.0	20.5	190	348	2.1
Intra-EEC	13.7	10.2	1.0	8.1	23.9	22.1	207	136	0.8
To non-EEC countries	9.8	8.8	6.3	6.9	11.5	19.5	181	212	1.3
Exports of raw materials and manufactures									
Total	11.3	16.6	11.3	4.5	10.1	10.8	184	15 867	97.9
Intra-EEC	13.5	23.6	20.1	12.2	20.8	8.1	247	5 774	35.6
To non-EEC countries	10.5	13.9	7.6	0.9	4.6	12.3	161	10 093	62.3
Visible imports									
Total	15.2	19.2	8.3	12.2	6.0	12.2	199	14 613	100
Intra-EEC	29.8	22.9	13.3	16.6	8.7	17.4	269	5 097	34.9
From non-EEC countries	10.1	17.7	6.1	10.3	4.7	9.7	174	9 516	65.1
Imports of food, beverages and tobacco									
Total	15.2	4.1	7.9	20.1	- 8.3	8.3	155	3 003	20.5
Intra-EEC	25.2	13.9	15.8	15.9	- 0.0	9.3	209	1 054	7.2
From non-EEC countries	11.7	0.3	4.4	22.2	-12.2	7.8	135	1 949	13.3
Imports of raw materials and manufactures									
Total	15.1	24.6	8.4	9.9	10.7	13.3	214	11 610	79.5
Intra-EEC	31.4	26.0	12.5	16.8	11.5	19.7	290	4 043	27.7
From non-EEC countries	9.5	24.0	6.7	6.8	10.3	10.2	188	7 567	51.8

TABLE 4 : Basic monthly indicators

	Year	Jan.	Feb.	Mar.	Apr.	May	June	July	Aug.	Sept.	Oct.	Nov.	Dec.
Industrial production (1958 = 100)	1964	134	141	148	148	153	151	142	137	153	159	166	155
	1965	150	152	152	163	163	162	147	143	(153)	(166)		
Total orders received (1958 = 100)	1964	160	164	171	185	165	178	177	154	181	192	185	179
	1965	166	173	198	190	188	182	180	165	197	(197)		
of which :													
home orders	1964	153	158	168	182	163	174	177	154	179	190	181	172
	1965	161	167	193	188	185	178	176	165	197	(196)		
foreign orders	1964	190	193	187	200	176	193	173	156	190	203	203	206
	1965	187	195	222	199	201	200	193	173	205	(207)		
Building : number of permits issued (DM '000 million)	1964	2.49	2.58	2.89	3.34	3.32	3.62	3.82	3.87	3.72	4.01	3.55	3.46
	1965	2.68	2.61	3.25	3.61	4.04	3.85	4.45	4.39	4.27	4.17		
Private consumers' expenditure: Retail turnover (1958 = 100)	1964	126	122	143	147	142	137	149	131	139	167	168	223
	1965	134	129	154	170	156	150	167	143	155	(179)		
Total visible imports (million u.a.)	1964	1 078	1 058	1 158	1 231	1 097	1 233	1 311	1 141	1 246	1 370	1 368	1 419
	1965	1 331	1 247	1 492	1 396	1 479	1 484	1 523	1 375	1 542	1 566		
Total visible exports (million u.a.)	1964	1 240	1 239	1 362	1 423	1 281	1 350	1 368	1 172	1 329	1 487	1 390	1 538
	1965	1 364	1 353	1 626	1 396	1 543	1 407	1 554	1 299	1 480	1 533		
Balance of trade (million u.a.)	1964	+ 162	+ 231	+ 204	+ 192	+ 184	+ 117	+ 57	+ 31	+ 83	+ 118	+ 22	+ 118
	1965	+ 32	+ 106	+ 135	+ 1	+ 65	- 77	+ 31	- 76	- 63	+ 17		
Official gold and foreign exchange reserves (million u.a.)	1964	7 012	7 206	7 114	6 968	6 921	7 158	7 049	7 024	7 059	7 052	6 944	6 969
	1965	6 604	6 702	6 860	6 825	6 486	6 393	6 295	6 211	6 303	6 335		
Money supply (DM '000 million)	1964	63.5	64.2	64.3	65.3	66.7	67.7	67.8	68.7	68.4	69.0	71.5	72.9
	1965	69.4	70.4	70.1	71.4	73.3	74.0	74.1	74.2	74.2	75.1		

Federal Republic of Germany

NOTES

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

Table 1

- Total population at mid-year, including West Berlin.
- Working population in employment. Source : Statistisches Bundesamt. Yearly average.
- Breakdown of gross domestic product at factor cost.

Table 2

- GNP at market prices.
- Industrial production : value added at market prices.
- Total exports and imports : goods, services and factor income.

Table 3

- Exports fob, imports cif. Conversion at official exchange rates. The products have been regrouped on the basis of the Statistical and Tariff Classification for International Trade (CST) : food, beverages and tobacco (groups 0 and 1 CST), raw materials and manufactures (groups 2-9 CST).

Table 4

- Industrial production. Source : Statistisches Bundesamt. All industries, including construction, adjusted for varying length of months.
- New orders. Source : Statistisches Bundesamt. Value index manufacturing industry (excluding food).
- Construction. Source : Statistisches Bundesamt. Building permits, estimates of construction costs (excluding civil engineering).
- Private consumption. Source : Statistisches Bundesamt. Index of value of retail trade turnover.
- Exports fob, imports cif. Conversion at official exchange rates. Source : Statistisches Bundesamt.
- Official gold and foreign exchange reserves. Bundesbank's gross reserves of gold and convertible currency at end of month.
- Money supply. Notes and coin circulation, excluding cash holdings of credit institutions. Sight deposits of non-banks and of private residents (excluding public authorities' deposits with the Bundesbank). End-of-month figures.

B. France

After the decline in economic activity which occurred during 1964 and persisted through the early months of 1965, the year as a whole was marked by the progressive revival of overall demand and industrial production.

In this, the impetus given by demand from abroad—which gained strength from the spring of 1965 onwards—undoubtedly played a part. Visible exports rose so sharply that the increase in value for 1965 as a whole, compared with 1964, reached an estimated 11 %.

The decisive factor was, however, the reversal, after the early months of 1965, of the trend in domestic demand, which had been steadily losing momentum since the beginning 1964. The change was caused in the first place by a tendency to replenish depleted stocks and was reinforced by greater expenditure by the government and public enterprises. In view of the higher incomes, which were largely the outcome of an increase—after a period of contraction—in the total number of hours worked, private consumers' expenditure showed a marked tendency to rise. In contrast to this, there were by the end of 1965 still very few signs of a recovery in expenditure on fixed assets by private enterprises, particularly industry.

With this recovery in overall demand, industrial production began to mount again from April onwards. However, as the level of production at the end of 1964 and the beginning of 1965 was relatively low, the increase in production (as defined in the INSEE index) for 1965 as a whole, compared with 1964, should prove to have been only about 2 %, following an increase of 6.6 % for 1964. The real contribution to GNP made by services rose once more and agriculture surpassed the exceptionally high level of output that it had achieved the previous year, so that the total gross national product in real terms for 1965 should be at least 2.5 % up on 1964, compared with an increase of 5.5 % for 1964 as compared with 1965.

It was only after the summer holidays that imports began to reflect the revival of domestic demand. For 1965 as a whole, the volume of goods imported should therefore turn out to have risen only slightly (by about 1 %). There was a considerable improvement in the overall balance of goods and services with abroad (including factor income, national accounts definitions). After a deficit of some FF 400 million in 1964, 1965 should show a surplus of over FF 3 000 million.

There will again have been a considerable surplus on the balance of payments, in spite of the fact that net inflows of private capital declined and a public foreign debt was repaid in advance.

As the elasticity of supply was relatively high, demand was satisfied without the upward trend of prices being strengthened. According to the INSEE indices wholesale prices were 1.3 %, and retail prices 2.3 %, higher in October 1965 than a year before.

The business upswing which began in 1965 can be expected to continue in 1966. It is, however, at present hard to foresee how general the new phase of expansion will be, or what proportions it will assume. Demand from abroad could continue to exert quite a powerful influence on internal business trends in France. The growth of domestic demand should become firmer, more rapid and better balanced. There is a definite possibility not only that investment in stocks will rise but also—and this is more important—that the increase in gross fixed asset formation will become more pronounced. The probable slowdown in the growth of capital expenditure by the government, by public enterprises and on residential construction might be satisfactorily offset by a correspondingly vigorous upsurge of investment by private industry. At the same time public current expenditure can certainly be expected to expand more rapidly and, now that the other types of demand are increasing once again, private consumers' expenditure should also go up faster than in 1965.

In view of these prospects for demand, it is expected that, with productivity and employment both rising, industrial production will expand considerably. All in all, the gross national product in real terms should increase by at least 4.5 % for 1966.

Although imports, too, are likely to rise more vigorously, the year-to-year comparison is unlikely to show any substantial decline in the current account surplus in 1966.

The probable upward movement of prices will be influenced, firstly, by the factors favouring stability, such as the high degree of elasticity of supply and the rapid and steady progress made by productivity. Secondly, structural and "autonomous" factors such as deferred adjustments to previous cost increases will continue to force prices up. Thirdly, as the business situation recovers, new forces may develop which will encourage the upward tendency, if wage increases are not still kept within the bounds required by the economic situation.

The last factor is also important because investment by private industry, which has now been sluggish for quite some time, is still a weak point; fresh increases in unit costs would check the recovery that can otherwise be expected in this field.

Although the economic and structural measures so far adopted to stimulate investment are almost bound to yield results, at least to a limited extent, additional inducements—whose effect would be above all psychological—might nevertheless be advisable. These would also include provisions whereby certain precautionary measures adopted from August 1963 onwards as part of the stabilization programme would be withdrawn, thus enabling the price mechanism to function effectively again. This would hardly jeopardize price stability if at the same time efforts to increase competition on the domestic market were intensified wherever necessary—possibly even by suspending certain duties—and if at the same time credit policy and especially budget policy continue to conform to economic policy objectives.

1. Balance-sheet for 1965

In the first few months of 1965 business activity was still at a very moderate level, but the pace of overall economic growth quickened appreciably as the year went on. The progressive revival of domestic demand was the key to this development, but at times—especially in the early summer—production and employment were also boosted by demand from abroad.

Exports, in fact, forged ahead in 1965. The favourable world economic situation, on the one hand, and increased competitiveness and abundant production capacities in French industry, on the other, led to a substantial increase in visible exports. On the basis of customs returns, this is estimated at about 11 % in value and about 10.5 % in volume, compared with 1964. (For 1964, the value increase had been 11.3 % and the real increase 7.2 %). Exports to the other EEC countries, particularly the Federal Republic of Germany, expanded far more than the average, but sales to non-member countries, especially the United States and the franc area, also increased quite vigorously once again.

In 1965 exports of services also continued to rise, although probably a good deal more slowly than in the previous year, with receipts from travel and tourism showing a smaller gain. Factor incomes from abroad probably also grew considerably more slowly, so that the increase in total exports of goods and services (as defined for the national accounts) should be about 9 %—rather less than in 1964 (10.5 %) despite substantially increased visible exports. By volume, however, the increase was greater than in 1964—8.5 % as against 7.5 %—because export prices are now almost stationary.

In the course of 1965 there was a marked reversal of the previous trend in domestic demand, which had been slackening appreciably since early in 1964; the change was due in the first place to a tendency to replenish depleted stocks and was reinforced by the revival of private consumption.

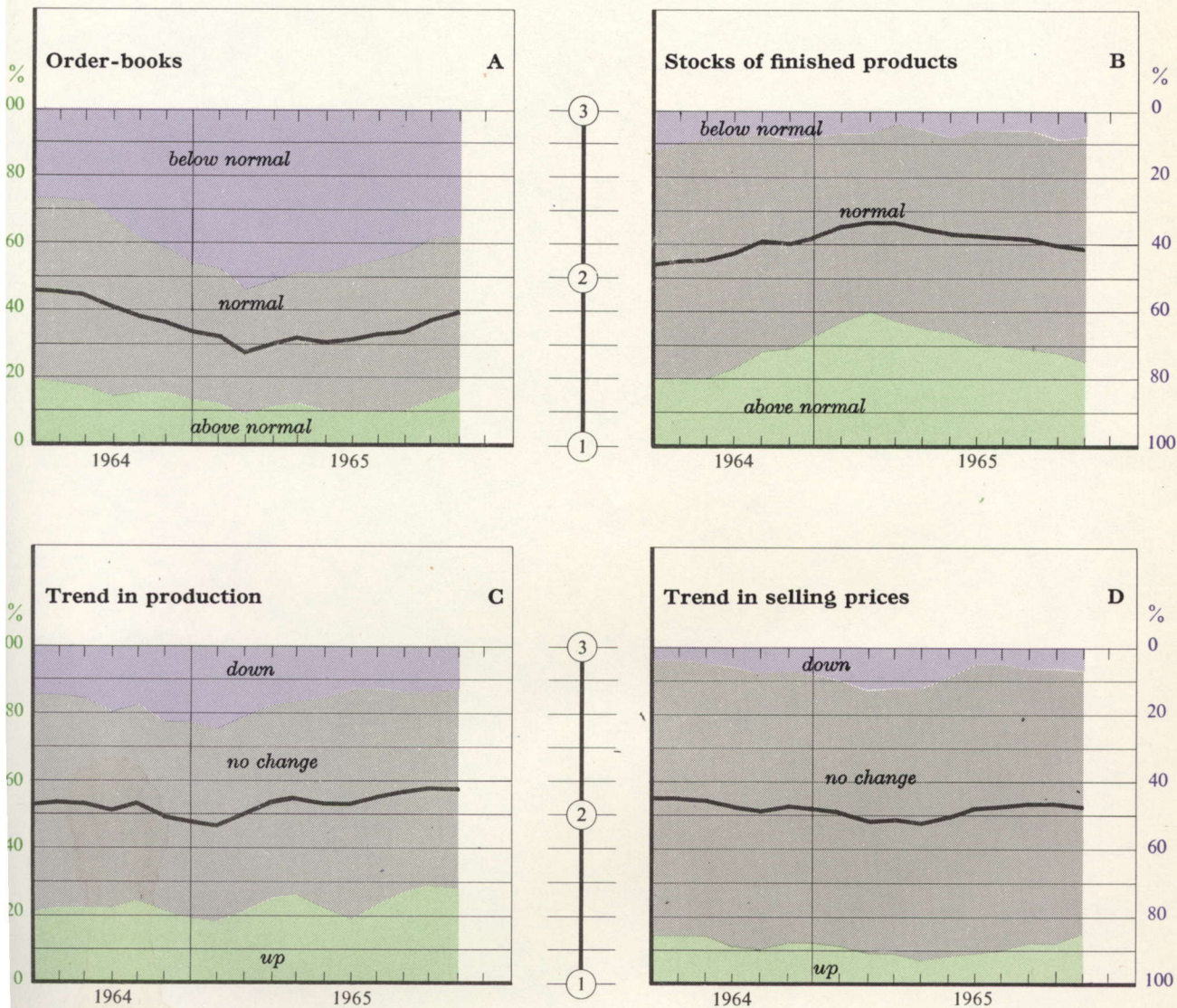
Gross fixed asset formation also appears to have provided some additional stimulus in the second half of 1965. At any rate, about the middle of the year public undertakings revised upwards their 1965 investment programmes, which had in any case provided for considerable increases in expenditure. The central government, too, stepped up not only its orders but apparently also its actual disbursements for building and equipment. Lastly, the propensity to invest of private firms, which in the industrial sector has been relatively weak for over two years, may already have been stimulated afresh—to some extent—by the gradual improvement in the general business climate and by the various official measures to facilitate financing. Expenditure on residential construction has continued to mount, albeit more slowly; in the first nine months of 1965 the number of housing starts was 5.5 % higher than in the same period of 1964 and the number of completions almost 20 % higher.

In spite of these generally more favourable trends, gross fixed asset formation as a whole probably rose appreciably less than for 1964, because of the slowdown in the course of 1964 and the relatively modest level that resulted from it at the beginning of 1965; at current prices the increase for 1965 may prove to be practically 9 % (as against 14.3 % in 1964), and at constant prices a good 5 % (as against 10.2 %).

The decisive factor affecting the development of the business situation in 1964 and 1965 was investment in stocks. The contraction of stocks, following a period during which they had been built up not altogether voluntarily, brought heavy pressure to bear on the level of production at the end of 1964 and the beginning of 1965; from the second quarter of 1965 onwards, there were signs that wholesale and retail trade in particular was beginning to replenish its stocks in view of the better sales prospects, and this proved a stimulus to production and employment. However, the results for 1965 as a whole, in terms of the national accounts, reveal only a slight increase as compared with 1964, whereas in 1964 stocks had risen so sharply as to account for a full 1.8 % of the growth of the gross national product.

The growth of public current expenditure on goods and services, which was still noticeably slacker at the beginning of 1965, probably advanced again more strongly in the following months—particularly where expenditure on materials is concerned. The main factors governing the trend of expenditure on wages and salaries were again the periodical rate increases of about 2 % on 1 April and 1 October. For the whole of 1965 public consumption probably attained about the same growth rate as for 1964, namely at least 7 % in value and about 3 % in volume.

BUSINESSMEN'S VIEWS ON THE INDUSTRIAL SITUATION



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

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

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

Much more striking—particularly in respect of its impact on the general business situation—was, however, the recovery in the growth of private consumers' expenditure during 1965. From the spring, and especially from the summer months onwards, there was a progressive revival of private demand on precisely those markets where sales had flagged in 1964 (clothing and cars); the retail trade again reported rising turnovers, and new registrations of private cars rose considerably, especially when the new models were launched. The figures for the full year should, nevertheless, still clearly reflect the earlier period of weakness; for private consumption as a whole, the increase will amount to no more than 6 % in value and about 3 % in volume—following increases of 7.9 % and 4.2 % respectively for 1964.

The progressive revival of private demand is mainly accounted for by the more favourable trend in incomes. From the spring onwards the total number of hours worked again rose somewhat, and there was no further slackening in the advance in hourly wage rates. At the same time transfer incomes went up more steeply as a result of increases in numerous welfare payments (e.g. family allowances and retirement pensions). In addition, the incomes of self-employed persons, particularly farmers, rose in the course of the year. Lastly, the trend in consumption was also affected by the fact that the burden of direct taxation and social insurance contributions on gross incomes was relatively lighter than in 1964 and by the fact that the savings ratio almost certainly did not rise any further.

Domestic production responded fairly promptly to the progressive recovery of overall demand.

The early spring saw the end of the modest recession in industrial production which had marked the winter months of 1964/65. From April onwards a pronounced upward trend was again apparent and until September the seasonally adjusted INSEE index (excluding construction) rose at a pace that would correspond to about 7 % over a twelve-month period. The recovery leaders were mainly the consumer goods industries (notably cars and textiles) and certain basic industries (chemicals, glass, building materials). Production in the capital goods industries, however, does not appear to have picked up during the same period to any appreciable extent, although here, too, orders were coming in slightly more quickly.

In spite of the recovery in expansion in the course of the year, the increase in industrial production for 1965 as defined for the INSEE index will be considerably less than for 1964 (2 % at most, as against 6.6 %), because the level of production at the beginning of 1965 was below the average for 1964. For construction, too, the growth rate for the year should prove somewhat less than for 1964—i.e. about 9 %, compared with almost 12 %, calculated from the net GNP contribution from the building industry at constant prices.

In spite of occasionally very unfavourable weather, agricultural production surpassed the exceptionally high level of the previous year. The grain harvests and wine production, in particular, turned out better than in 1964, and livestock production also made gains.

Including the contribution to GNP made by services, the volume increase in the gross national product is estimated at rather more than 2.5 % for 1965 (it was 5.5 % for 1964).

This overall economic growth is due solely to greater productivity (defined as the increase in gross national product per man/hour), for in 1965 the number of hours worked was, if anything, rather smaller than in 1964—largely as a result of shorter working hours in industry. A month-to-month analysis also shows that it was initially advances in productivity that fed the recovery in production until—after the second quarter—there was a fresh rise in the aggregate number of hours worked. The latter was, however, more the result of longer working hours per head than of an increase in the number of persons in employment. Conditions on the labour market continued to ease, as the young people born during the post-war years when the birth-rate was particularly high were reaching school-leaving age, and at the same time there was hardly any decline in the immigration of foreign workers. The number of persons seeking employment again rose steadily until the autumn; seasonally adjusted, the figure stood at 155 700 on 1 October, i.e. about 0.8 % of the labour force as against 0.6 % at the same time a year previously.

In 1965 imports took longer than domestic production to respond to the revival of overall demand. Only after the summer holidays did it become clear from the monthly figures for visible exports that industry's demand for raw materials is now mounting again and that sales of finished goods from abroad have become easier. The increase in the second half of 1965 was however offset by the decline in the first few months, so that for 1965 as a whole the volume of goods imported will not have gone up by more than 1 % compared with 1964, according to customs returns. (From 1963 to 1964 the increase was 13.3 %.)

Although at the same time imports of services went up by about as much as for 1964 and transfers of factor income to abroad (particularly wage and dividend payments) actually more than for 1964, total imports of goods and services in 1965 (as defined for the national accounts) should nevertheless hardly have risen by more than 2 % by volume or 3 % in value. (In 1964 the figures were 11.9 % and 14.6 % respectively.)

Elasticity of supply was relatively high, both from domestic production and from imports, and this helped the price climate to remain as calm as before although demand was once again expanding more rapidly. At any rate, in the case of finished manufactures, no intensification of the underlying upward trend in prices was apparent until the late autumn; in this connection it should, however, be pointed out that at the production

stage these goods were generally still governed by the stop on prices or at least by "stabilization agreements". In October 1965 the INSEE index of wholesale prices for processed industrial products was no higher than a year before; the INSEE retail price index for manufactured consumer goods was only 1.2 % up on the level of October 1964. The fact that supplies were generally adequate also checked the upward movement of food prices. On the other hand, the prices of services tended to go up noticeably more rapidly during 1965; the demand recovery, as well as administrative measures (rents, charges for public services) and structural factors (cost sensitiveness), probably had something to do with this.

In general, taking the average for the year, the general price level (all items) for 1965 will have risen by about 3 %, i.e. not much less than for 1964 (3.6 %). Retail prices continued to rise at an annual rate of something over 2.5 %.

With exports of goods and services forging ahead and imports stationary until well into 1965, the foreign trade balance improved quite considerably. Whereas in 1964 it had shown a deficit of some FF 400 million (goods and services as defined for the national accounts), in 1965 it probably closed with a surplus of at least FF 3 000 million. As the improvement occurred almost exclusively in trade with countries outside the franc area, there was a corresponding improvement in the balance of current transactions. Despite an appreciable falling off in net inflows of private capital and despite larger exports of public capital, which were due in the main to the advance repayment of a loan, the overall payments balance for 1965 should show a surplus at least as large as in the previous year (776 million u.a.). However, the official gold and foreign exchange reserves (gross) improved by only 344 million u.a. in the first ten months of 1965, compared with an increase of 542 million u.a. in the corresponding period of the previous year; but because of the assistance given to the United Kingdom to support the pound sterling France's claims on the International Monetary Fund increased much more than in 1964. The commercial banks' net foreign exchange position may also have improved somewhat in 1965.

The inflow of foreign exchange was, however, less important, in stepping up the expansion of internal liquidity during 1965, than the conduct of the public finances. From Spring on, the Treasury's cash transactions produced a heavier deficit, because expenditure rose more rapidly and the increase in revenue sometimes fell short of what had been estimated. From the end of March until the end of September the deficit (including debt redemption) amounted to over FF 3 100 million—compared with a deficit of only FF 1 500 million in the same six months of 1964. In contrast with the previous year, heavy calls were made once more on the banking system, mainly by the placing of short-term government securities.

Bank lending to trade and industry, which had hardly increased at all in the first quarter of 1965, also gathered a little momentum thereafter. At the same time business

picked up a little on the capital market; in the first ten months new bond issues totalled more than FF 7 300 million, whereas in the same period of the previous year they had only amounted to about FF 6 100 million (excluding government loans). Above all, enterprises in the public sector (including public savings institutes) stepped up their borrowing considerably—from FF 4 000 million to FF 4 900 million; but private industry, too, raised more money on the capital market than in the first ten months of 1964.

National product and expenditure

	1963 ⁽²⁾	1964 ⁽²⁾	1965 ⁽³⁾	1966 ⁽⁴⁾
	At current prices (in FF. '000 million)	% change by volume on preceding year		
Gross national product	395.6	+ 5.5	+ 2.5	+ 4.5
Imports ⁽¹⁾	55.0	+ 11.9	+ 2	+ 8
Private consumption	256.8	+ 4.2	+ 3	+ 4.5
Public current expenditure	53.7	+ 3.0	+ 3	+ 4.5
Gross fixed asset formation	79.1	+ 10.2	+ 5	+ 5
Exports ⁽¹⁾	56.7	+ 7.5	+ 8.5	+ 7.5

⁽¹⁾ Goods, services and factor income.

⁽²⁾ General Statistical Bulletin of the Statistical Office of the European Communities, No. 11/1965.

⁽³⁾ Commission estimates.

⁽⁴⁾ Commission forecasts.

Note :

a) The difference between the figures for product and those for expenditure is accounted for by movements in stocks.

b) The forecasts are approximations based on certain hypotheses, generally mentioned in the Quarterly Surveys. They are established and published on the sole responsibility of the Commission.

2. Outlook for 1966

Although there can hardly be any doubt that the French economy has entered upon a new period of expansion, it is still impossible to say with certainty to what extent the upswing will persist in 1966.

Demand from abroad can, it is true, be expected to continue to exert a very powerful influence. In general, it is probable that the French economy will capture an increasing share of export markets, owing to the improvement in its competitive position. Provided that there is no going back on the provisions to establish the Common Market, exports—notably to other Community countries—will remain quite dynamic; the growth of demand may well slacken in the Federal Republic of Germany, but this will certainly be largely offset by a firmer upward tendency in Belgium and, above all, Italy. Sales to the other industrialized countries of the West, especially the United States, will also generally continue to rise, in view of the economic prospects there. Finally, the recovery in exports to the overseas territories of the franc area is likely to be maintained, and here the agreements recently concluded with Algeria should be of considerable importance. Altogether, it is estimated that visible exports will increase by about 8.5 % in value in 1966.

However, the key to production and employment trends in 1966 will be domestic demand. At present it is hard to tell how great the expected increase will be, because the trend in gross fixed asset formation cannot yet be forecast precisely.

In this connection it is assumed that the total volume of gross fixed asset formation will rise by at least the same margin as for 1965. This presupposes, however, an appreciable improvement in the propensity to invest of private entrepreneurs, especially in industry, for, to judge by the draft budget, public investment should rise rather more slowly in 1966 than in 1965 (i.e. by about 9-10 % instead of almost 15 %). Furthermore, the trend in house-building permits issued in 1965 suggests that the growth rate in residential construction will lose momentum in 1966. Lastly, investment by publicly-owned enterprises may rise more slowly than in 1965, as less credit may be made available to them, especially to the atomic energy authorities.

Although there are some factors—chiefly improved sales expectations and easier access to funds from outside sources—which make it appear virtually certain that private industrial investment will begin to expand again, the increase is likely nevertheless to remain relatively limited, especially if allowance is made for any braking effect which the uncertainty that appeared in mid-1965 as to the EEC's future may have: industrialists may have postponed, or may yet postpone, the execution of investment projects which had largely been devised to meet the requirements of economic integration within the Common Market.

A serious problem would then persist in respect of the future prospects for the growth of the French economy, for it has already been apparent for nearly three years that there has hardly been any further increase in industrial investment, whereas in the other branches of the private sector, especially in trade and other services and also in agriculture, investment has nevertheless risen quite steeply.

One reason for these widely divergent trends may be the differences in profits, and these in turn are closely connected with official price policy. Almost the only measure in this field that in practice proved effective was the freezing of industrial producer prices; the result was that in industry profit margins were reduced more sharply and the scope for self-financing restricted more severely than in other sectors.

In 1966 investment in stocks should again do much to promote economic growth. Both manufacturers and dealers are likely to go on building up depleted stocks and adjusting them to rising turnovers.

As for the growth of public current expenditure on goods and services, wages and salaries can be expected to rise somewhat more rapidly as a result of the 1966 Finance Act. True, the rise in wage and salary rates is again put at only 4 % per year, but the number of persons in employment is to be increased sharply—especially in education. In spite of a slight slowdown in the growth of expenditure on materials, public current expenditure as a whole should therefore continue to rise perceptibly faster than even the gross national product at current prices.

Private consumption is another demand component which is very likely to expand more rapidly than in 1965. Private incomes will certainly go up more quickly; in the first place, the recovery in domestic production is leading to a further extension of the working week, and it is also fairly certain that there will be a slight increase in the number of persons in paid employment in trade and industry. Secondly, the improvement in the business climate should make it somewhat easier for wage claims to be pressed through—although here limits will be set by the arrival on the labour market of the many children born in the post-war years. As, moreover, a further vigorous advance in transfer incomes is to be expected and incomes from property and entrepreneurship should also improve as turnovers rise, the total gross incomes of private households in 1966 are likely to go up by about 8 % for 1966 as against an increase of 6-7 % for 1965. In addition, the incidence of direct taxation on these incomes will be noticeably less because of certain tax reliefs which have already been decided upon and because of certain technical repercussions of the slow pace at which incomes developed in 1965. For all these reasons, private consumers' expenditure is likely to rise more rapidly in 1966, especially as the savings ratio may well decline further—to the extent that those who in 1964/65 held back from buying consumer durables, particularly cars, make up for this in the coming year.

The elasticity of supply is likely to be relatively very high, and the supply trend should therefore adjust without difficulty to the more rapid expansion of demand which is expected. This applies—in view of the capacities available—mainly to industrial production. Here growth in the industries manufacturing consumer goods should be general and quite rapid. In the manufacture of capital goods, too, there may be some revival of expansion, as the emphasis in investment is beginning to shift from building to equipment. In the basic materials sector, on the other hand, the pattern will again

show fairly wide variations from industry to industry, because there is often a special situation on one market or another—as was the case with steel; the general trend will none the less be upward. Altogether industrial production may be expected to rise by about 6 % for 1966.

One cannot rule out the possibility of a decline in the rate of growth in building production—owing to the shifts in investment and a slower rate of increase in residential construction.

If a more rapid increase in the net contributions to GNP made by services is included, and the usual assumption as to normal weather for farm production is made, the growth rate of gross national product for 1966 may be estimated at a general figure of a good 4.5 %.

This growth will certainly be achieved mainly by advances in productivity, which are normally very pronounced in periods when business is picking up again. The increase in employment may, on the other hand, be smaller; in the early part of the year it will largely be due to longer working hours, and only later will the number of persons employed also begin to rise appreciably again. In view of current population trends, the situation of the labour market—at any rate on the labour market seen as a whole—will probably continue to be relatively easy in at least the early months of 1966.

In addition to domestic production, imports of goods and services will also rise more rapidly. However, as the supply situation of French firms mostly remains favourable, it is hardly likely that foreign suppliers will be able to capture a substantially larger share of the market; by and large the growth in imports should not exceed the growth of exports likely to be achieved.

The foreign trade surplus (“external contribution” as defined for the national accounts) is unlikely to decline very appreciably in 1966. The current account will probably yield a further surplus, and although net capital imports should continue to fall—not least because of official policy—it is nevertheless very probable that the overall payments balance will once again close with quite considerable surpluses.

The probable price trends can only be forecast with certain reservations. There is little to suggest that the fresh upsurge of business activity on the scale at present expected will release new forces that will cause prices to rise perceptibly more. Supply is too elastic for that, and in view of the high growth rates that productivity can be expected to achieve in the upward phase of the business cycle, it also appears that the trend of costs will not provoke any new upward movement in prices, provided that the results of wage negotiations between employers and workers reflect to some extent the easing of strain on the labour market and the requirements of economic policy. This applies mainly to industry. In the services sector, especially retail and wholesale trade, there is,

however, a greater possibility—mainly for structural reasons—that accelerated demand may strengthen the upward price trend. Added to this, there will in any case be some price increases which can be regarded as the delayed effect of previous inflation and of the accompanying cost increases, or which are of an “autonomous” nature: higher charges for various public services, increases in controlled rents and in certain agricultural prices, etc. Altogether it is hardly likely that there will be any further decline in the upward movement of consumer prices in 1966. Their rate of increase has already moderated considerably in relation with the previous trend, but at 2.5-3 % per year, the upward movement is certainly still too high, as the French authorities would agree.

These prospects show that the authorities responsible for economic policy must again concentrate at one and the same time on curbing the upward cost movement, on encouraging the propensity to invest of private industry (in view of growth prospects) and on efforts to stabilize prices and improve the price structure.

With regard to costs, it is important—not only in this context, but also for the implementation of the Fifth Plan—that efforts to achieve an incomes policy should be intensified. In this respect full use should be made of the opportunities at present afforded by the relatively relaxed situation on the labour market. For the same reason an even greater effort should be made to promote vocational training for those born soon after the war when the birth-rate was particularly high: this would obviate the danger of structural unemployment among the less qualified young people at the very time that a shortage of skilled workers would be hindering real economic growth and forcing costs up.

With regard to the propensity to invest, economic expansion will not be lasting, vigorous and balanced unless there is a sufficiently strong revival of private industrial investment. The Government itself has in its own hands the power to improve, to a great extent, the psychological factors and the patterns of business behaviour which have an important influence on the propensity to invest. In addition, however, the possibility of stimulating the propensity to invest by lifting the direct controls on industrial producer's prices that were introduced in September 1963 might perhaps be considered.

In September 1963 it seemed appropriate to introduce the stop on price in order to curb, in the first stage of the fight against inflation, the tendency to raise prices due to psychological factors. The pause was only intended to remain in force for a short time. The value of maintaining such controls over a long period must be regarded as doubtful; in the long run the disadvantages would probably outweigh the initial advantages. The economy is in fact being increasingly distorted, chiefly because the impact of price controls on the different sectors of the economy varies enormously; it is greatest in industry and least in the services sector. An arbitrary influence is being exerted, via prices, not only on the pattern of consumption and the distribution of incomes but also, to the detriment of industry, on the allocation of the factors of production, profit formation and the ability of industrial enterprises to invest, and thereby on the future prospects for expansion and

the competitive position of France vis-à-vis the outside world. Another point is that if price pauses are imposed in certain countries of the Community while others enjoy a substantial measure of price freedom, they are bound to have a prejudicial effect on the development of the Common Market.

The abolition of direct price controls could well, it is true, result in certain price adjustments; some prices would rise, but others—at least in the rather longer term—might perhaps fall. Moreover, only part of the effect of such a measure would be reflected in prices and profit margins; most of it would be psychological, but no less important for that. The present situation of the market is not one in which substantial price increases are feasible, and experience has shown that as the upsurge of economic activity becomes more pronounced the pressure exerted by costs declines. If the controls were not lifted, now that the period of sluggish demand is over and the business cycle is beginning to move up again, the question would then arise as to when it would ever be possible to take such a step again.

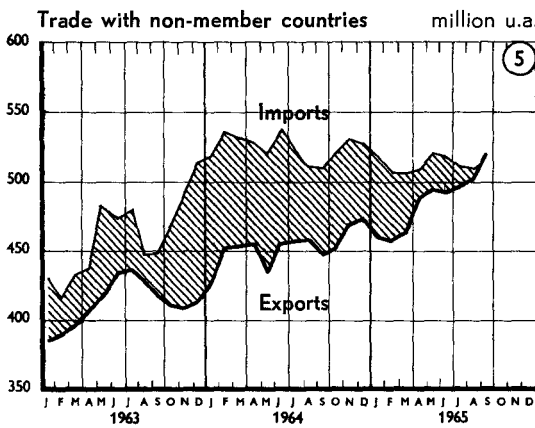
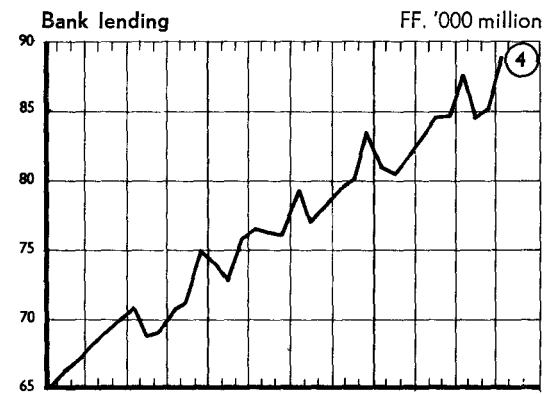
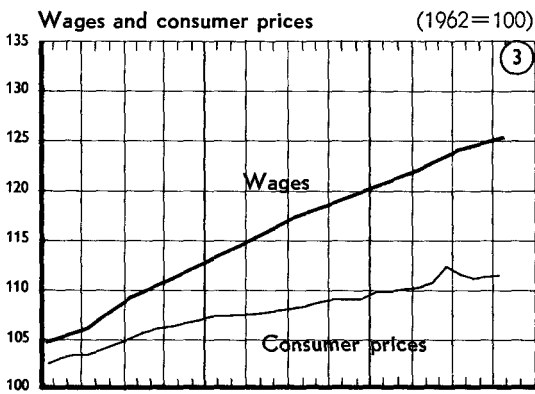
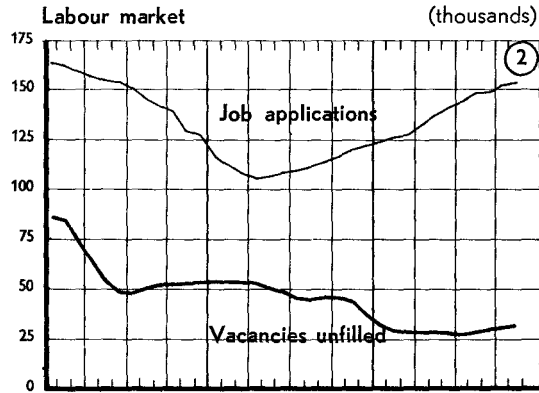
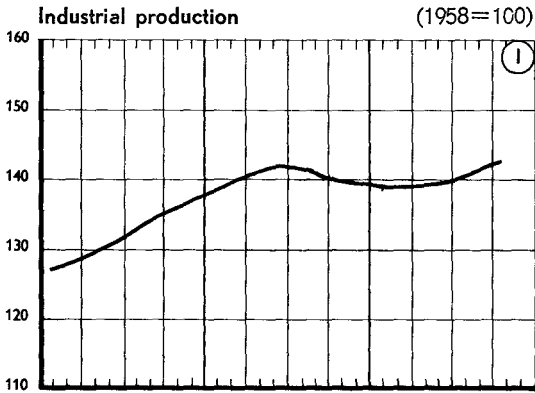
The problem of improving both the facilities for obtaining finance from outside sources and the machinery for financing seems, on the other hand, to be less urgent at present—as measures for its solution have already been taken, or are to be taken, by the authorities. The most important of these are the ones designed to promote the formation of savings capital (new schemes for saving through building societies and for savings accounts enjoying tax privileges, and tax reliefs for dividends from fixed-interest securities), whose beneficial effects are becoming increasingly apparent. The reform of the corporation tax should also be mentioned in this connection, as it should make it easier for joint-stock companies to build up capital from their own resources.

Appropriate measures to make prices even more stable would be those in the field of structural policy: improvement of market machinery, rationalization of distribution channels, promotion of competition, etc. The authorities have already been active in all these fields for some time now; if their efforts were intensified, more rapid results could be achieved. In this connection there also arises the question whether, by suspending certain duties and taking other measures to stimulate imports, the authorities could not achieve a considerable increase in competition which would completely check the tendencies towards rising prices—including any that might develop if the stop on industrial prices were lifted. What is certain is that France's current payments surpluses would at least not hinder such a policy.

Both in their overall effects and in the pattern of their expenditure, the form that the public authorities' budgets take is of great importance for the policy of stabilizing prices while promoting growth. The last Quarterly Survey pointed out that France's budget policy broadly fulfilled the requirements of the current economic situation—which certainly cannot be said of other Community countries. As 1965 went on, the State did indeed become rather more generous in its expenditure, but this was fully compatible with

the business situation; it did not in any way cast doubt upon the principles of a balanced budget, in spite of quite heavy pressure in this direction at one time. For 1966, too, the principles still hold good; the Finance Act envisages a balance between total expenditure and total revenue. It must, however, be realized that this balance will prove quite fragile if, in certain fields, the Government does not succeed in finding a permanent solution to the problem of the increasing calls being made on the national Treasury. In particular, if appropriate steps are not taken, the social insurance deficit may turn out to be larger than expected.

ECONOMIC INDICATORS



NOTES:

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

Graph 1. The trend curves represent estimates which have been established on the basis of indices (excluding construction, food, beverages and tobacco) adjusted by the SOEC for seasonal and fortuitous variations.

Graph 2. Series seasonally adjusted. Moving averages of 3 months.

Graph 3. Source: INSEE. National index of consumer prices (259 items). Index of hourly wage rate, all activities, all regions.

Graph 4. Source: Conseil national du Crédit. Short-term credits (up to 2 years) from monetary institutions to business and private customers — end-of-period figures.

Graphs 5 and 6. Series adjusted for seasonal and accidental variations (moving averages of 3 months). Exports fob, imports cif. Conversion at official exchange rates.

France

TABLE 1: Basic data (1964)

Total area ('000 sq. km.)	551.2
Total population ('000)	48 416
Density of population per sq. km.	88
Working population ('000)	19 251
Working population, breakdown by main sector (%)	
— Agriculture	19.0
— Industry	39.7
of which : Construction	10.7
— Services	41.3
Percentage share of gross domestic product	
— Agriculture	8
— Industry	48
of which: Construction	8
— Services	44
Gross product per capita (FF)	8 920

TABLE 2: Some elements of national product and expenditure
(annual rates of growth)

	% change by volume on preceding year						Volume indices (1958 = 100)	Contri- bution (in %) to 1964 GNP
	1959	1960	1961	1962	1963	1964		
Gross national product	+ 3.0	+ 7.8	+ 3.6	+ 7.0	+ 5.7	+ 5.4	137	—
Industrial production	+ 3.0	+ 7.3	+ 5.4	+ 6.4	+ 6.0	+ 6.5	140	—
Total imports	— 2.0	+17.3	+ 7.0	+ 8.1	+12.8	+12.0	168	15
Private consumers' expenditure	+ 2.0	+ 5.9	+ 5.6	+ 7.0	+ 6.6	+ 3.8	135	64
Public current expenditure on goods and services	+ 7.0	+ 1.9	+ 3.7	+ 4.4	+ 2.5	+ 3.3	125	13
Gross fixed asset formation	+ 2.0	+ 6.9	+11.0	+ 7.4	+ 6.9	+10.0	153	21
Total exports	+12.0	+17.0	+ 6.1	+ 2.9	+ 8.4	+ 7.7	167	14.5
Gross national product per capita	+ 2.0	+ 6.2	+ 3.2	+ 4.9	+ 3.0	+ 4.5	126.5	—
Gross national product per person gainfully employed	+ 3.5	+ 7.7	+ 2.7	+ 5.7	+ 3.7	+ 4.4	131	—

TABLE 3: Foreign trade (at current prices)

	% change on preceding year						Indices (1958 = 100)	Million u.a.	% of the total
	1959	1960	1961	1962	1963	1964	1964	1964	1964
Visible exports									
Total	+10.0	+21.8	+ 5.2	+ 2.1	+ 9.7	+11.4	176	8 990	100
Intra-EEC	+34.0	+34.3	+18.3	+12.2	+13.8	+12.9	307	3 487	38.8
To non-EEC countries	+ 3.0	+17.5	- 0.8	- 2.5	+ 6.8	+10.4	138	5 503	61.2
Exports of food, beverages and tobacco									
Total	- 1.0	+37.4	+16.9	- 2.5	+21.9	+14.3	216	1 436	16.0
Intra-EEC	+47.0	+55.1	+25.9	+ 1.4	+34.4	+16.9	457	557	6.2
To non-EEC countries	-11.0	-29.2	+13.9	- 5.3	+15.3	+13.3	162	879	9.8
Exports of raw materials and manufactures									
Total	+11.0	+19.8	+ 3.8	+ 2.9	+ 7.7	+11.1	170	7 554	84.0
Intra-EEC	+33.0	+30.8	+17.2	+14.2	+10.7	+12.0	289	2 930	32.6
To non-EEC countries	+ 5.0	+16.2	- 3.3	- 2.5	+ 6.1	+ 9.8	134	4 624	51.4
Visible imports									
Total	- 9.0	+23.1	+ 6.3	+12.6	+16.4	+15.4	180	10 067	100
Intra-EEC	+11.0	+36.0	+13.2	+20.5	+23.8	+20.4	307	3 762	37.4
From non-EEC countries	-15.0	+18.8	+ 3.0	+ 9.6	+12.3	+12.5	144	6 305	62.6
Imports of food, beverages and tobacco									
Total	-16.0	+ 6.0	- 2.2	+19.5	+ 5.8	+14.5	126	1 782	17.7
Intra-EEC	+54.0	+16.9	-12.2	+37.3	+37.8	+25.8	376	347	3.4
From non-EEC countries	-21.0	+ 5.1	- 1.2	+18.3	0	+12.4	109	1 435	14.3
Imports of raw materials and manufactures									
Total	- 7.0	+28.0	+ 9.2	+10.8	+18.8	+15.2	197	8 285	82.3
Intra-EEC	+ 7.0	+38.3	+16.2	+19.2	+22.4	+19.9	301	3 416	33.9
From non-EEC countries	-12.0	+23.9	+ 4.6	+ 6.1	+16.5	+12.8	159	4 869	48.4

TABLE 4: Basic monthly indicators

	Year	Jan.	Feb.	Mar.	Apr.	May	June	July	Aug.	Sept.	Oct.	Nov.	Dec.
Industrial production (1958 = 100)	1964	141	144	143	147	146	146	127	83	137	144	148	145
	1965	138	143	142	144	144	146	127	90	140	148		
Building : number of permits issued ('000)	1964	39.8	39.3	43.1	47.6	41.5	47.6	51.0	33.0	44.2	67.9	47.3	72.5
	1965	38.8	45.1	46.0	43.9	44.3	51.6	43.9	45.1				
Private consumers' expenditure : turnover of department stores (1958 = 100)	1964	189	178	197	199	209	203	206	183	225	249	218	330
	1965	211	181	197	228	219	223	232	167				
Total visible imports (million u.a.)	1964	861	846	883	930	841	896	814	630	783	840	827	917
	1965	816	799	934	900	872	866	827	679	814	889	926	
Total visible exports (million u.a.)	1964	781	751	768	771	705	797	754	554	697	834	806	823
	1965	688	732	896	839	853	823	877	651	826	937	903	
Balance of trade (million u.a.)	1964	- 130	- 95	- 114	- 159	- 136	- 99	- 60	- 76	- 86	- 6	- 21	- 94
	1965	- 128	- 17	- 38	- 61	- 19	- 43	+ 30	- 8	+ 12	+ 48	- 23	
Official gold and foreign exchanges reserves (gross, million u.a.)	1964	4 481	4 494	4 477	4 533	4 680	4 737	4 813	4 827	4 863	4 902	4 999	5 105
	1965	5 172	5 254	5 316	5 367	5 341	5 350	5 336	5 346	5 381	5 381	5 449	
Money supply (FF '000 million)	1964	147.7	146.6	148.5	148.6	149.0	152.1	156.3	154.8	155.2	155.8	154.5	162.0
	1965	159.4	158.3	159.9	161.9	162.6	166.3	170.1	169.2	170.0	171.2		

France

NOTES

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

Table 1

- Total population at mid-year.
- Working population in employment at mid-year.
- Breakdown of gross domestic product for 1962 at factor cost.
- GNP at market prices.

Table 2

- GNP at market prices.
- Industrial production : value added by industry.
- Total exports and imports : goods, services and factor income.
- The figures for GNP per head and per person in employment from 1958 to 1964 are Commission estimates based on the component series.

Table 3

- Exports fob, imports cif. Conversion at official exchange rates. The products have been regrouped on the basis of the Statistical and Tariff Classification for International Trade (CST) : food, beverages and tobacco (groups 0 and 1 CST), raw materials and manufactures (groups 2-9 CST).

Table 4

- Industrial production, excluding building. Source : Institut National de la Statistique et des Etudes Economiques.
- Construction. Building permits granted for housing. Source : Bulletin statistique du Ministère de la Construction.
- Private consumption. Index of value of total turnover of department stores and "single-price" stores.
- Exports fob, imports cif. Conversion at official exchange rates.
- Official gold and foreign exchange reserves. Gross reserves of gold and convertible currency held by the Banque de France and the Fonds de stabilisation des changes at end of month.
- Money supply. Source : Conseil national du Crédit. Fiduciary circulation (total of coins and notes in circulation, excluding coins and notes held by the Banque de France) plus sight deposits (deposits made with the Banque de France by private persons or enterprises, deposits with Post Office savings accounts or with Treasury agencies, plus the sight deposits relating to the activities pursued within France by the banks : registered banks, banques populaires, caisses de crédit agricole and the Banque Française du Commerce Extérieur, no matter whether these deposits are shown in French francs or some other currency or whether they belong to residents or non-residents). End-of-month figures.

C. Italy

The recovery of economic growth, of which there were signs at the end of 1964, continued in 1965, when the factors underlying the recovery gathered strength.

The expansion of overall demand in monetary terms was again due mainly to orders from abroad; in the first half of 1965 foreign demand grew even more rapidly than before. On the other hand the trend of domestic demand continued, despite the increased contribution made by the public authorities, to be sluggish, as expenditure on gross fixed asset formation continued its fall at any rate till mid-year. From 1964 to 1965 this component of demand may have been down, in real terms, by a further 10 %. By way of contrast, private consumers' expenditure was distinctly up both in comparison with the previous year and also in the course of 1965 itself.

On the supply side, agricultural production as a whole made further appreciable gains in 1965, and industrial output, which had fallen off for a while in 1964, rose steadily, though this did not apply to all sectors. Throughout the year building tended to ease. The contribution to the national product made by the services sector maintained its constant upward trend. In the aggregate there will probably have been a rise of 3 % in real gross national product.

Imports of goods and services certainly advanced during 1965, but as at the beginning of the year the seasonally adjusted figures for imports were low, the total of imports for the full year will probably have been a little higher than for 1964.

Despite the tendency for demand to rise again and despite a further if slower upward movement in unit costs, the rising trend of prices levelled off further. Only in foodstuffs were the price increases appreciable. In October the wholesale price index was 1.5 % higher than in October 1964. Between the same dates the consumer price index was still 3.6 % up.

The deficit on trade continued to fall steeply in 1965. A sharp recovery in the number of visitors from abroad was the major factor behind the appreciable growth in net receipts from the services sector. Although capital movements this year showed a deficit, the surplus on the overall balance of payments will probably be more than twice as high as in 1964, when it amounted to Lit. 474 000 million.

Although the net short-term foreign indebtedness of the commercial banks was further reduced—and in fact eliminated—official net gold and foreign exchange

reserves rose by Lit. 321 000 million in the first ten months of 1965, standing by the end of October at Lit. 2 669 000 million.

The business trends that can be discerned today and the economic policies being followed by the Italian authorities suggest that in 1966 economic expansion will continue and also, perhaps, be better balanced. The pace at which actual exports are expanding may slacken, and this development may be due in part to a more rapid growth of domestic demand: total expenditure on gross fixed asset formation is likely to develop more favourably than in 1965, even if the prospects for investment in construction contain special elements of uncertainty. Expenditure on consumption is likely to rise further, at least as fast as from 1964 to 1965.

In 1966, real gross national product is likely to increase by 4.5 % and industrial production alone may rise as much as 8 or 9 %. Although imports will probably have expanded sharply, the balance on current account may once again close with a very large surplus; it can however be expected that monthly surpluses will show a distinct decrease as the year advances.

Although supply will in general have no difficulty in keeping abreast of demand, rising costs are likely to cause a further, though decidedly smaller, rise in the level of prices.

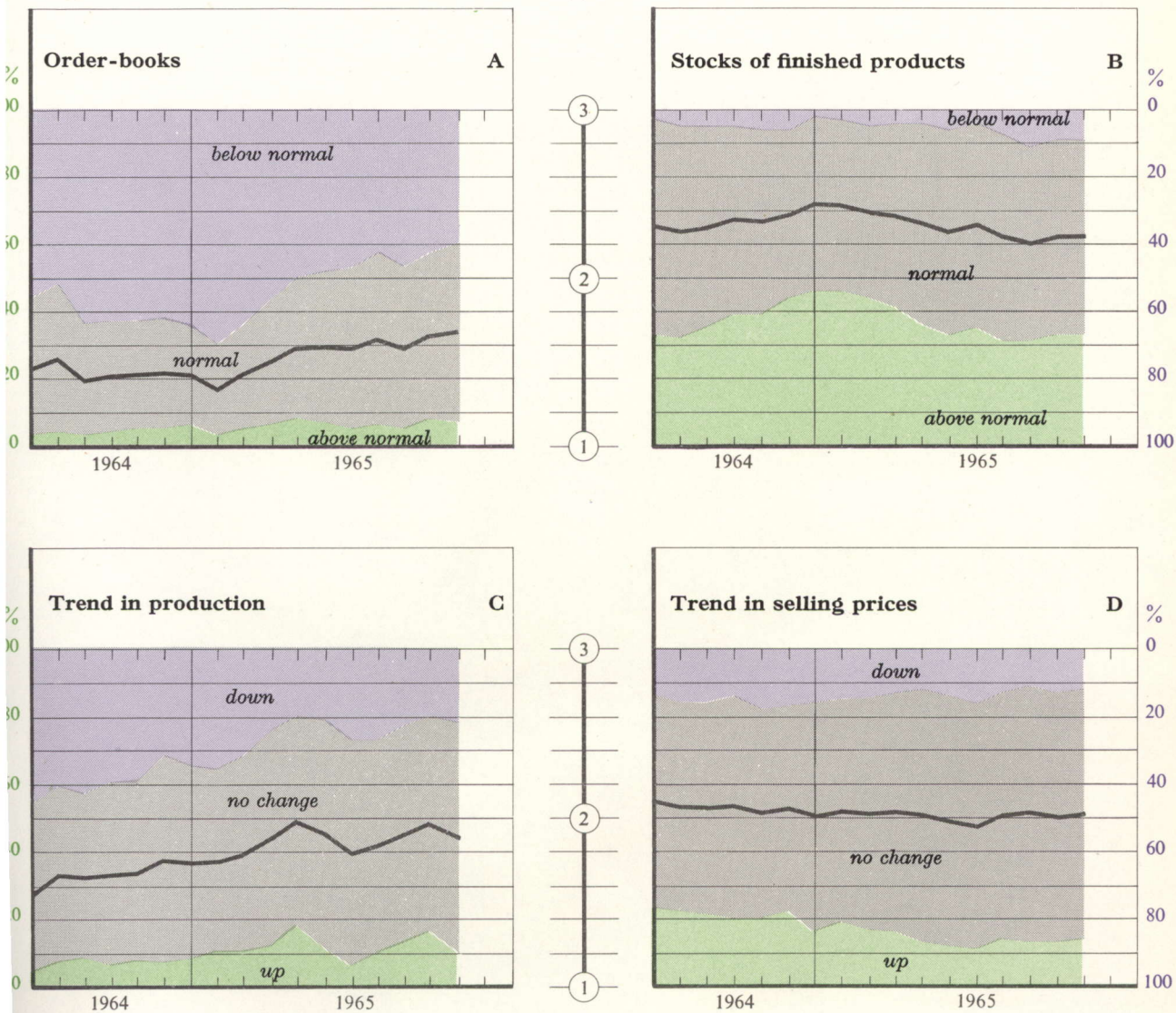
It will still have to be the aim of short-term policy to support economic growth while endeavouring to curb the rise in prices still more effectively than in the past. Less importance should now be attached to the expansion of government expenditure with its more or less direct effects on overall demand, and more to promoting—in addition to the measures taken to inject fresh life into construction—investment expenditure, and in particular incentives to private investment.

The forces that contribute to stability of costs and prices could be backed up by adopting the most "orthodox" methods possible for financing deficits in public budgets, by a policy of moderation over wages and, once economic growth is on a sufficiently sound footing, by increasing the competition offered by imports.

1. Balance-sheet for 1965

After the recessive trend of business activity in 1964 which followed a period of overheated growth, developments in 1965 were dominated by upward pressures. The fact that despite this change the year-to-year variations shown in the aggregates for 1965 differ for the most part but little from those for 1964 is mainly a matter of arithmetic.

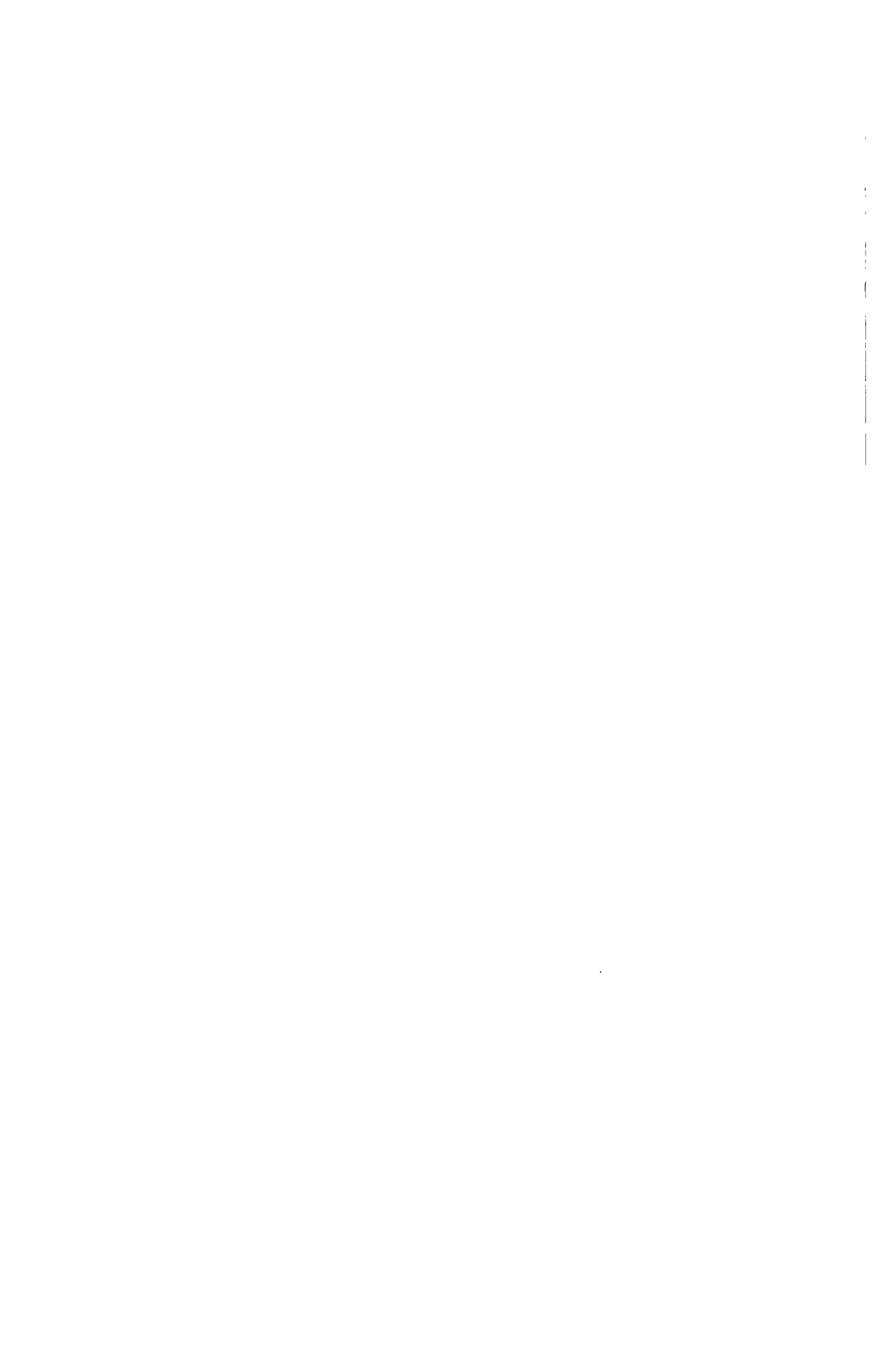
BUSINESSMEN'S VIEWS ON THE INDUSTRIAL SITUATION



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

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

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



Exports of goods and services were again far and away the chief factor in the expansion of demand in 1965. According to customs returns, visible exports are likely to have risen as much as 20 % in both monetary and real terms (compared with 18 % and 15.5 % in 1964). This rapid increase no doubt stemmed in part from the efforts made by businessmen to step up their sales abroad to compensate for the fairly slack development of domestic demand, which lasted at any rate into the summer months—especially in the capital goods sector. The rise in exports was also boosted by business trends in some of Italy's major foreign markets, and in particular by excess demand in Germany. The expansion of exports was helped when a new steel works in southern Italy began to sell its products abroad.

The highest growth rates were registered in exports of plant and equipment, iron and steel. Above average increases were also recorded in exports of foodstuffs and chemicals. Exports to member countries and other industrial nations were particularly buoyant.

In contrast to the previous year, there was also a sharp increase in exports of services. This was due mainly to a large influx of tourists and to remittances from Italians working abroad.

All in all, exports of goods and services in 1965 (including factor income from abroad, as defined for the national accounts) are likely to have increased 20 % in value and 18 % by volume.

The trend in domestic demand, on the other hand, was still subdued owing to the low level of investment activity. Expenditure on gross fixed asset formation probably dropped in the course of the year. According to production and foreign trade statistics, expenditure on plant and equipment pursued a downward trend at any rate till mid-year, though it might have recovered somewhat towards the end of the year. Expenditure on investment in construction—almost two thirds of the value of total fixed investment—seems to have fallen throughout the year. Although public works continued to show a distinct upward trend (in the first seven months they were 14 % in value up on January-July 1964), this was more than offset by an apparently steep decline in other forms of building—particularly housing; at any rate a general downward trend is indicated by the drop in the number of wage and salary earners throughout the sector. On the basis of the ISTAT quarterly sample surveys, it seems that their number fell by no less than 130 000, or 7 % (as against a 1964 increase of 3.7 %).

According to rough estimates, total expenditure on gross fixed asset formation in 1965 dropped at least 8.5 % in monetary terms and 10 % in real terms. The corresponding 1964 figures were 1.8 % and as much as 10.1 %.

Investment in stocks, on the other hand, is likely to have increased. This will doubtless be true of agricultural products and, judging by the quickened pace of production, there seems also to have been an accelerated build-up in stocks of raw materials and semi-manufactures. No doubt this will have much more than counterbalanced a simultaneous reduction in stocks of finished products.

Consumer expenditure probably rose at about the same pace as in 1964. The annual growth in public spending on goods and services is likely to be at least 13 % in value and 4 % by volume (the same as in 1964).

Private consumers' expenditure likewise showed a marked increase of some 7 %, with the volume of consumption rising about 2.5 % (the figures were 7.8 %, and 2.6 % in 1964). In the course of the year, however, the rise probably became steeper than it was in 1964.

This last assumption is supported by the upward trend in personal incomes. For the full year there was probably at least no further drop in the total number of hours worked, though the working week and numbers employed were cut in some industries—particularly building and textiles. Hourly wage rates again increased appreciably, though less steeply than in 1964. One of the reasons for the rise were further (six-point) increases in the cost-of-living allowances provided for in the sliding wage scales. The incomes of self-employed persons probably went up too, and especially in agriculture. In addition, retirement and old-age pensions were increased sharply.

Expenditure on consumer durables expanded with particular vigour, partly as a result of certain government measures. The number of new passenger cars registered, for instance, rose sharply at least until the summer; the monthly average in the second and third quarters was no less than 25 % higher than in the corresponding period of the previous year—when, it is true, business conditions were depressed.

On the supply side, agricultural production again rose appreciably, by 3 to 4 %, with sharp rises in output of wheat, vegetables and livestock products. On the other hand, the fruit harvests suffered from bad weather in the latter half of the year.

Industrial output too showed a steady, markedly upward trend following the recession which was apparent till August 1964; in 1965 the ISTAT index of industrial production probably increased by about 4 %, compared with a rise of only 0.3 % in 1964. The trend of output varied a great deal from one sector to another: while iron and steel, motor cars and chemicals registered appreciable gains, output declined in the cement and textile industries. It seems important to note that there were signs of some recovery in the metal-using industries in mid-1965 and, later in the year, in the textile industry also.

On the other hand, building production (value added at constant prices) may have fallen during the year by some 4 %, as against an increase of 4 % in 1964 (in view of the lack of adequate statistics, this estimate should be treated with caution). During the year the growth in the value added of the services sector can be estimated at a good 3 % (3.5 % in 1964).

All in all, the real increase in GNP is likely to have been about 3 %—virtually the same as in 1964, though business trends varied considerably between the two years.

The average number of wage and salary earners in 1965 was probably some 2.5 % down on 1964 (when it was already 0.6 % below the 1963 figure). Despite the revival in output the monthly employment figures are unlikely to have improved during most of 1965. This is probably due to the special difficulties faced by certain industries, like building and textiles, which employ a large percentage of the labour force, and also to the productivity reserves that have meanwhile been built up. Moreover, firms that stepped up production probably preferred to put workers on overtime rather than take on extra staff. Indeed, as a result of the steep rise in labour costs, even normal staff losses were often not fully compensated by fresh recruiting.

The number of unemployed showed a further increase; averaged over the year, according to ISTAT, it is likely to be up by a third on 1964, or some 170 000. On the other hand the average working week, and consequently the total number of hours worked, should prove to have developed far more favourably in 1965 than in 1964.

Imports likewise expanded appreciably during the year. This will not be immediately evident from the year-to-year figures, as imports eased during 1964 and at the beginning of 1965 the level was still low. However, apart from dips due to seasonal variations and random factors such as the extended strike of customs officials in the second quarter, there was a steady rise in visible imports from quarter to quarter. As defined for customs statistics, the total for the full year is likely to be, both in volume and in value, the same as in 1964—compared with a drop of 7 % by volume and 4.5 % in value from 1963 to 1964.

As a result of the weak demand for capital goods, imports of plant and equipment remained particularly sluggish till mid-1965; they began to move upwards, however, later in the year. Imports of raw materials and semi-manufactures, on the other hand, were pushed up throughout the year by the quickened pace of production. In the circumstances deliveries of goods from the developing countries showed a distinct tendency to rise, whereas imports from member countries and the other industrial countries remained on the whole sluggish.

In contrast to the trend in visible imports, imports of services are likely to have increased from 1964 to 1965. Total imports of goods and services (as defined for the national accounts) were up slightly in both real and monetary terms on 1964, compared with a drop of 5.7 % by volume and 2.7 % in value from 1963 to 1964.

The upward trend in prices slackened further in 1965. The pressure from costs eased, though it remained quite appreciable, and production was elastic enough for supply in general to keep abreast of the expansion in demand without difficulty.

Wholesale prices for manufactures even showed a slight downward trend, on the other hand, there was a distinct rise in food prices, since the supply of various crop products was affected by bad weather and was unable to keep pace at times with expanded demand. In the first ten months of the year, the average wholesale price index was only 1.6 % higher than in the corresponding period of 1964.

For consumers, too, food prices again showed an appreciable increase in 1965. The upward trend of other prices, however, flattened out considerably, so that consumer prices in general were no longer moving as rapidly as in 1964; compared with the corresponding periods of 1964 they were none the less a good 3.5 % up in October, or almost 5 % over the first ten months.

The steep rise in exports, coupled with the comparatively low level of imports at the beginning of the year, led to a distinct improvement in the balance of trade; the deficit (based on customs returns) fell from Lit. 800 000 million in 1964 to less than Lit. 100 000 million in 1965. In addition, there was a significant rise in net receipts from services. In the first nine months of the year the current account showed an overall surplus of Lit. 818 000 million. Although the figures from the exchange control office show that the capital account, which in 1964 had shown a large surplus, was tending to deteriorate, the surplus on the overall balance of payments in 1965 was probably more than double the previous year's already high figure of Lit. 474 000 million. The official net gold and foreign exchange reserves alone rose by Lit. 321 000 million in the first ten months of 1965, standing by the end of October at Lit. 2 669 000 million. The chief reason why this gain was considerably lower than the surplus on the balance of payments was that the commercial banks reduced—and in fact terminated—all their short-term foreign debts.

In 1965, as in the previous year, developments in the foreign exchange holdings of the monetary authorities had a strong expansionary effect on the domestic liquidity of the banks. Treasury transactions worked in the same direction; in the first nine months of the year (later information was not available at the time of writing) they contributed no less than Lit. 847 000 million to the liquidity of the banking system, as against Lit. 217 000 million in the corresponding period of the year before. The cash transactions connected with the national budget closed with a heavy deficit, which was only partly offset by funds coming in from other Treasury operations.

For want of other investment openings, the banks used most of the liquid resources left at their disposal after meeting their reserve commitments to reduce the quantity of ordinary trade bills rediscounted and advances against security arranged with the Central Bank, and also to purchase securities. The demand for bank advances was slow in reviving; over the first nine months, the average amount of outstanding loans was little more than 3 % higher than a year before. Expressed as a percentage of deposits, which increased at a much faster rate, loans sank to 70.7 % in September, compared with 78.1 % a year earlier.

National product and expenditure

	1963 ⁽²⁾	1964 ⁽²⁾	1965 ⁽³⁾	1966 ⁽⁴⁾
	At current prices (in Lit. '000 million)	% change by volume on preceding year		
Gross national product	28 329	+ 3.0	+ 3.0	+ 4.5
Imports ⁽¹⁾	5 461	— 5.7	+ 1.0	+ 13.0
Private consumption	17 543	+ 2.6	+ 2.5	+ 4.0
Public current expenditure	4 536	+ 3.8	+ 4.0	+ 5.0
Gross fixed asset formation	6 641	— 10.1	— 10.0	+ 5.0
Exports ⁽¹⁾	4 845	+ 10.7	+ 18.0	+ 9.0

⁽¹⁾ Goods, services and factor income.

⁽²⁾ General Statistical Bulletin 1965, No. 11, Statistical Office of the European Communities.

⁽³⁾ Commission estimates.

⁽⁴⁾ Commission forecasts.

Note :

a) The difference between the figures for product and those for expenditure is accounted for by changes in stocks.

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

Developments on the securities market were again varied in 1965, and were characteristic of the general economic climate. Whereas sales of new shares showed a downward trend, there was a constant and vigorous rise in purchases of fixed-interest securities. As

a result, the share of bonds in the total value of securities issued rose from 71 % in 1964 to about 87 % in 1965; about 56 % of this total was accounted for by bonds issued by the Government and by state-controlled undertakings (46 % in 1964). The value of new issues of this type of bond is likely to have doubled in 1965, whereas the value of private bonds and shares issued during the same period was some 25 % down. In the aggregate, however, the volume of securities issued in 1965 amounted to about Lit. 2 300 000 million—a rise of some 20 % over the previous year. As the demand for bonds rose more rapidly than supply, long-term interest rates tended to drop slightly.

2. Outlook for 1966

Economic growth is likely to continue in 1966—probably with more balanced results than in 1965.

Exports will no doubt continue to climb at a rapid pace, though probably more slowly than in 1965. Indeed the rise in visible exports showed a tendency to flatten out in the latter half of 1965. The 10 % reduction in intra-Community duties on 1 January 1966 is expected to stimulate Italian deliveries to the other member countries, and exports should receive an additional boost from government policy, but the prospects for economic expansion in some of Italy's main customers are not quite as good as they were a year ago. Furthermore, the expected sharp rise in domestic demand could reverse the trend which forced Italian supplies to seek export welfare in 1964 and 1965. However, providing the expansion in exports of services continues at a rapid tempo, total exports of goods and services should in 1966 rise by some 11 % in value and 9 % by volume.

Both the year-to-year comparison and the month-by-month figures for 1966 will probably show domestic demand growing faster than a year ago, though this forecast hinges on the assumption that there will be a distinct rise in gross fixed asset formation.

This assumption can be justified on a number of counts. The prospects for further expansion in foreign and consumer demand are solid; the growing pressure of competition from abroad, which will increase as a result of the cuts in intra-Community duties mentioned earlier, will probably promote investment in rationalization, especially as unit costs in Italy have been rising sharply for some years. The chief factor, however, is that

in 1966 investment is likely to be boosted by increased direct and indirect incentives from the public sector: the state-controlled concerns plan a 12 % increase in expenditure on plant and equipment (bringing it up to some Lit. 1 300 000 million), and the measures taken to speed up public works in the spring of 1965 should become fully effective in 1966. In addition, the interest rebates and other financial assistance given by the State to the textile industry and to promote investment in residential construction will no doubt bear more and more fruit as the year advances. Finally, a plentiful supply of credit, and the fact that interest rates have been falling for quite some time, mean that conditions are now propitious for a steep rise in investment activity.

Nevertheless there is no doubt that a rapid recovery of investment in construction will be held up by the length of the technical and administrative procedure and by certain politico-psychological inhibitions. And this, together with the very low level of the seasonally adjusted figures for investment in housing at the beginning of the year, will probably lead to an even further fall in this form of investment in 1966. As a result of the margin of capacity that in many cases continues to be idle and of the still slender margin of profits, private firms are reluctant to invest. Just in the utilization of capacity, however, a slight change for the better may be on the way, if it has not even started already.

At any rate, the EEC business surveys show that at least until the third quarter of 1965 the number of replies from manufacturers of capital goods who considered their backlog of domestic orders to be below normal was declining, though still relatively high.

In the aggregate, a certain increase in gross fixed asset formation in 1966 seems quite within the bounds of possibility, with the rate of expansion in plant and equipment considerably higher than in construction.

There will probably be an appreciable increase in investment in stocks, especially in stocks of raw materials and semi-manufactures.

From 1965 to 1966 there is likely to be a steeper rise in consumer expenditure—both public and private—than a year earlier. As far as private consumer expenditure is concerned, the growth in transfer incomes of households will probably be appreciably less than in 1965. On the other hand, the wage and salary bill is likely to rise at an accelerated rate. One reason for this is that the employment trend should be more favourable than in 1965. And—in contrast to 1965—new wage negotiations, which could lead to higher rates, are in the offing in several major industries, including engineering, foodstuffs and

construction. Finally, the recent easing of restrictions on consumer credit will stimulate purchases of durable goods.

All in all, as things stand at present, the likelihood is that private consumption will rise from 1965 to 1966 about 8 % in value and a good 4 % in real terms.

In view of the prospective trend of overall demand, the growth of industrial production should at least continue during 1966 at the same pace as during 1965, when the level was high; in other words, output should rise by 8 or 9 % from 1965 to 1966—about double the increases that occurred a year earlier.

On the other hand, building output in 1966 (value added at constant prices) will at best be slightly above the previous year's level. The real value added by the services sector is likely to increase at least 3 %. Provided there is normal growth in agricultural production, the overall rise in real GNP should thus be about 4.5 %.

The number of unemployed should move down in the course of 1966, but the year-to-year decline will probably be at best only slight.

Imports of goods and services are likely to increase far more vigorously than production: they may go up about 13 % by volume and some 14 % in monetary terms. And if the expected recovery of investment in plant and equipment takes place, there will be an especially steep increase in visible imports from the other member countries.

Although supply will generally have no difficulty in keeping abreast of demand, the possibility of a further distinct rise in prices cannot be excluded. For one thing, the rise in wages per person employed is again likely to outrun increases in productivity, though these will presumably be relatively large. And this, coupled with already narrower profit margins and growing demand, will probably accelerate the upward pressure on prices. It is also possible that manufacturers will attempt to pass on some of the previous sharp increases in unit costs by putting up prices. Moreover, certain controlled prices might be adjusted sharply upwards in 1966. Lastly, there is no doubt that structural factors, especially in the services sector, will continue to force prices up.

If exports and imports follow the trend outlined above, the deficit on trade should increase distinctly. However, the current account would none the less close once again with a very large surplus.

It is still uncertain what the scale and balance of economic growth in 1966 are likely to be. However, the outlook for prices is clearly not yet fully reconcilable with the aims of stabilization policy.

The main element of uncertainty concerns the rate at which investment will expand in 1966. The chief aim of short-term policy must be to stimulate investment activity while avoiding measures likely to send prices up still further. Direct action to curb cost and price increases should also be intensified.

In future the measures taken should perhaps aim less at directly reinforcing the expansion of overall domestic demand in money terms—an expansion brought about almost entirely by raising government expenditure and increasing the deficit if capital outlays by state-controlled concerns, which have in fact gone up significantly, are left out of account. It is primarily private consumers' expenditure which has so far benefited directly—and, it is true, indirectly as well—from these measures.

This policy was certainly justified inasmuch as it contributed to the expansion of domestic demand in such a way that—coupled with the effect of the rise in exports—it helped to improve the degree of utilization of productive capacity, rendering it less of an obstacle to a recovery in businessmen's propensity to invest than would otherwise have been the case. The same applies to the slackening of the restrictions on consumer credit, especially as this makes possible a more vigorous expansion of private consumers' expenditure without first increasing per capita wages and adversely affecting the budget.

In the near future, however, a considerably more cautious attitude should be adopted towards a policy that stimulates overall demand by increasing public expenditure. One major reason for this is that many of the items involved are comparatively inelastic.

Instead more importance should, wherever possible, be attached to measures that would improve the profit prospects of private firms in order to make it easier and more attractive for them to invest. If private firms cannot include a fair proportion of their own financial resources in the investments they are making, no amount of available credit will get investment expenditure moving up again. It would perhaps be more useful to grant tax concessions linked as directly as possible with productive investment activity, or subsidies, or further relief from social security contributions.

In this connection, of course, incomes policy too is of particular importance. In the interests of vigorous and solid economic growth—and in the interest of price stability—

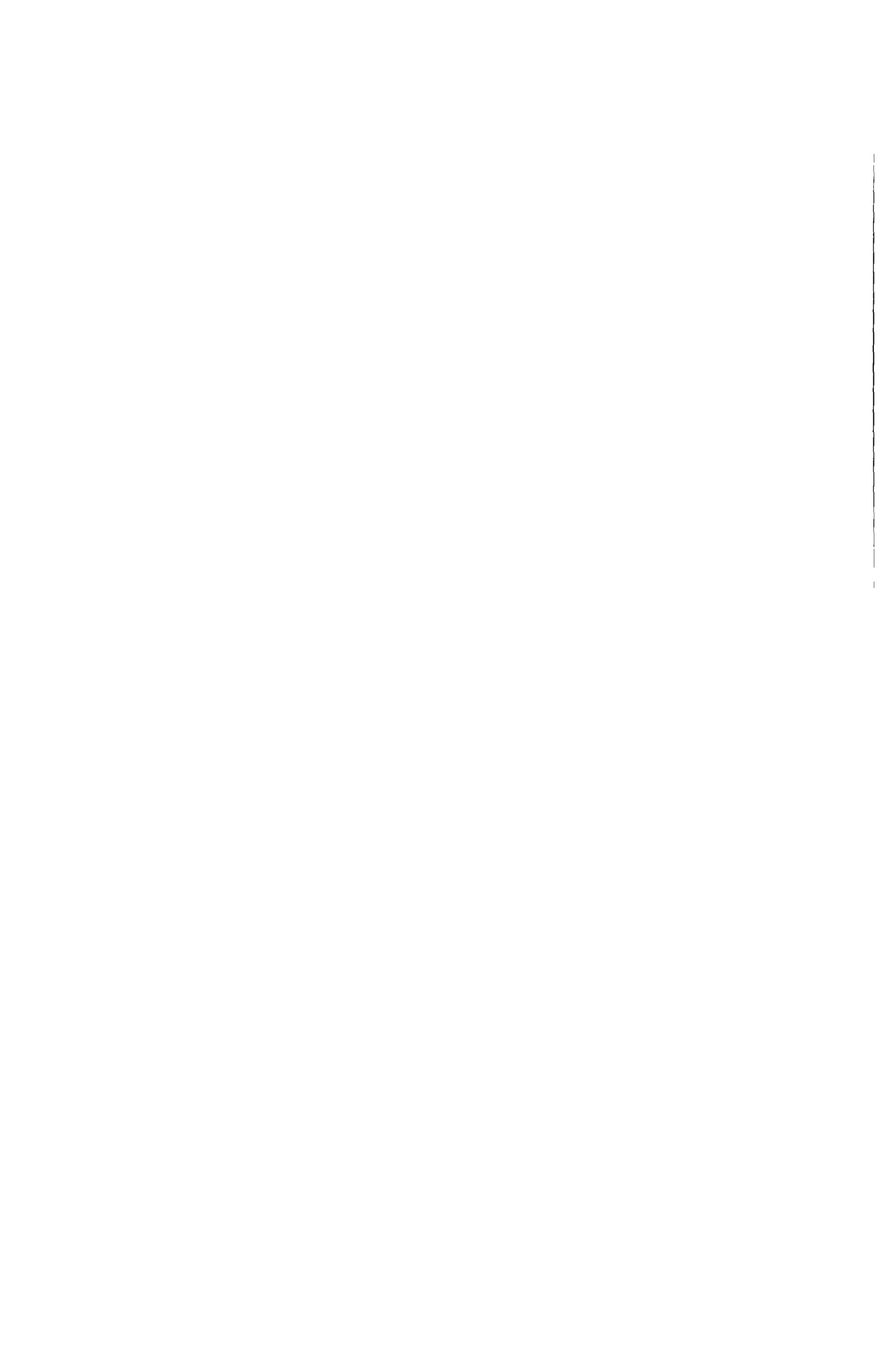
any further rise in unit costs must definitely be avoided. At the end of October 1965 the Government announced that it was setting up a committee of independent experts to mark out for each year the limits to which the various categories of income may rise without jeopardizing price stability or economic growth. Whether this step will bring about the requisite stabilization—at any rate quickly enough—remains to be seen. What is doubtless even more urgent is that the Government's wage policy, in those parts of industry under its control, should immediately be brought into line with short-term policy requirements. The existing system of sliding-scale agreements should be urgently reviewed to see whether certain of its aspects are not having a bad effect on investment, and consequently on economic growth—particularly at this stage in the economic trend—especially as the system is in addition proving to be a serious obstacle to solution of the crisis in the housing programme.

It is doubtful whether those responsible for fiscal policy, judged by the way it seems to be developing in the budget estimates for 1966, have taken all these requirements into account. This applies more to the structure and financing of the budget than it does to the overall rise in expenditure, which in the current economic situation can probably be taken once more in the country's stride without directly strengthening the upward price trend, particularly as the rise is less than in 1965.

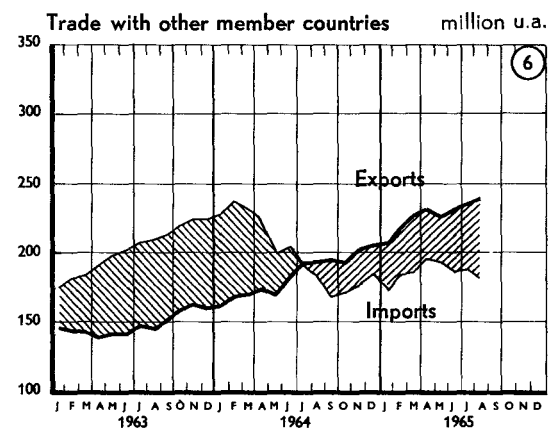
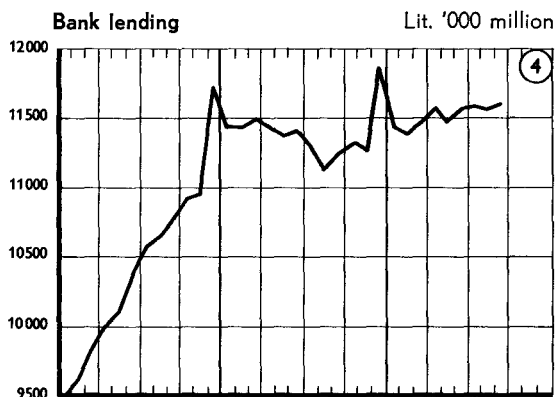
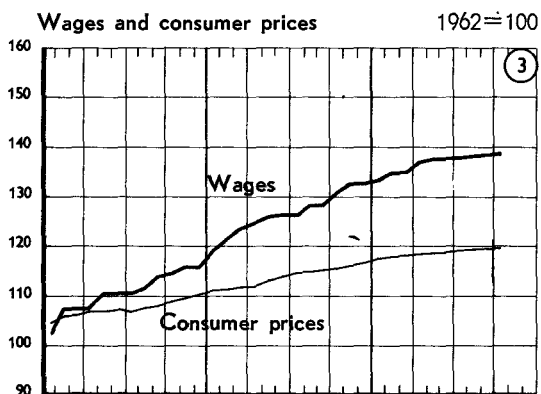
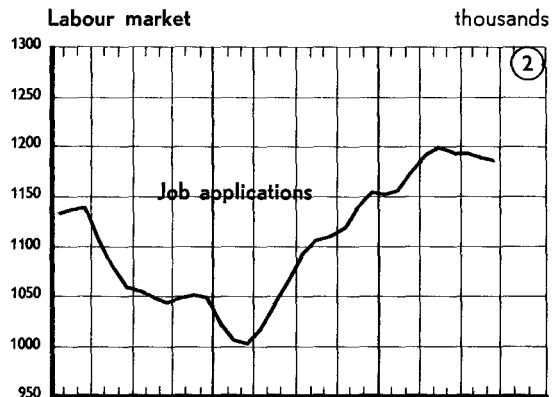
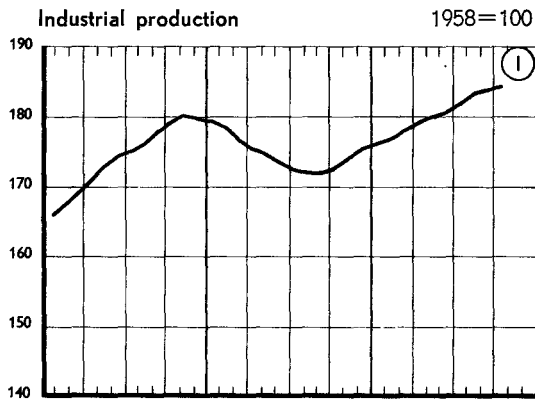
As far as the pattern of government spending is concerned, the budget estimates show that additional expenditure in 1966 will mainly be on items which directly or indirectly promote consumption—and, moreover, can hardly ever be adjusted so as to put a brake on the economy—whereas investment expenditure is scarcely to be increased at all. Although actual cash transactions in Italy, and consequently the pattern of expenditure, can differ widely from the budget appropriations, past budgets have none the less had a decisive influence on the longer-term trend of expenditure.

As regards the financing of the budget, the requirements of the State are going to rise—partly because the economy's loss of momentum in 1964 is likely to lead to an appreciable fall in receipts from direct taxation in 1966. In view of the need for judicious controls on domestic liquidity, which will be expanded further under the influence of the balance of payments, the authorities are strongly advised to make the fullest possible use of normal means in order to finance their 1966 requirements, i.e. from savings borrowed through the capital market. As a revival of private investment activity will mean a rise in business demand for long-term funds, it would appear that steps should be taken urgently to promote savings and the efficiency of the capital market—by removing tax obstacles, by approving investment funds, and so on. Given the Italian balance-of-payments position, there are no grounds whatsoever for importing greater quantities of capital from abroad.

In view of the present situation and the future trend of the current account, it should be worth considering whether the upward drift of prices might not be effectively dealt with by cutting duties in advance—this being a measure fully in accordance with the Rome Treaty and the Community's tariff policy. In any case, as soon as the economic upturn proves secure enough, such a policy would certainly merit consideration.



ECONOMIC INDICATORS



NOTES:

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

Graph 1. The trend curves represent estimates which have been established on the basis of indices (excluding construction, food, beverages and tobacco) adjusted by the SOEC for seasonal and fortuitous variations.

Graph 2. Number of registered unemployed, in thousands. Series seasonally adjusted. Moving average of 3 months.

Graph 3. Source: ISTAT. Agreed minimum wages in industry.

Graph 4. Short-term loans. Source: Banca d'Italia.

Graphs 5 and 6. Series adjusted for seasonal and accidental variations (moving averages of 3 months). Exports fob, imports cif. Conversion at official exchange rates.

Italy

TABLE 1: Basic data (1964)

Total area ('000 sq. km.)	301.2
Total population ('000)	50 730
Density of population per sq. km.	168
Working population ('000)	19 581
Working population, breakdown by main sector (%)	
— Agriculture	25.4
— Industry	40.8
of which : Construction	10.8
— Services	33.8
Percentage share of gross domestic product	
— Agriculture	14.4
of which: Construction	44.1
— Industry	8.5
— Services	41.5
Gross product per capita (Lit.)	605 800

TABLE 2: Some elements of national product and expenditure
(annual rates of growth)

	% change by volume on preceding year						Volume indices (1958 = 100)	Contri- bution (in %) to 1964 GNP
	1959	1960	1961	1962	1963	1964	1964	1964
Gross national product	7.3	6.8	8.3	6.4	5.2	3.0	143.0	—
Industrial production	10.7	11.8	10.1	9.3	8.4	1.8	166.4	—
Total imports	9.9	36.9	15.4	15.1	21.3	- 5.7	228.3	17
Private consumers' expenditure	5.2	6.4	7.8	7.4	9.9	2.6	146.0	61
Public current expenditure on goods and services	3.9	6.2	4.9	4.4	6.7	3.8	133.8	16.5
Gross fixed asset formation	10.0	15.1	12.3	8.7	7.3	-10.1	149.1	21
Total exports	16.4	19.1	16.2	10.7	6.2	10.7	209.7	18
Gross national product per capita	6.6	5.9	8.0	5.7	4.2	1.4	136.1	—
Gross national product per person gainfully employed	6.5	6.9	8.2	7.5	6.9	3.2	146.2	—

TABLE 3: Foreign trade (at current prices)

	% change on preceding year						Indices (1958 = 100)	Million u.a.	% of the total
	1959	1960	1961	1962	1963	1964	1964	1964	1964
Visible exports									
Total	14.1	26.1	14.7	11.4	8.2	18.0	234.9	5 956.3	100
Intra-EEC	30.7	36.0	21.8	23.7	10.3	26.4	373.6	2 265.9	38.0
To non-EEC countries	8.9	22.3	11.8	5.8	7.0	13.4	191.2	3 690.4	62.0
Exports of food, beverages and tobacco									
Total	4.4	5.6	10.6	14.5	- 3.4	2.4	138.2	705.1	11.8
Intra-EEC	18.1	12.5	14.7	23.4	- 8.7	8.8	187.0	354.3	5.9
To non-EEC countries	- 3.7	0.4	7.4	6.5	2.1	- 3.3	109.3	350.8	5.9
Exports of raw materials and manufactures									
Total	16.6	30.7	15.5	10.9	10.2	20.5	259.2	5 251.2	88.2
Intra-EEC	36.3	45.4	23.9	23.9	15.6	30.4	458.2	1 911.6	32.1
To non-EEC countries	11.5	26.0	13.7	4.5	7.7	15.5	207.6	3 339.6	56.1
Visible imports									
Total	6.2	41.0	10.6	15.9	24.5	- 4.1	229.3	7 231.3	100
Intra-EEC	31.5	45.7	17.2	22.9	31.1	- 4.5	345.9	2 364.6	32.7
From non-EEC countries	- 0.8	38.4	8.1	13.0	21.5	- 3.9	197.0	4 866.7	67.3
Imports of food, beverages and tobacco									
Total	2.0	33.5	5.3	7.3	57.5	2.4	248.1	1 355.1	18.7
Intra-EEC	15.3	42.6	- 1.3	10.0	73.1	15.7	357.5	278.1	3.8
From non-EEC countries	- 0.2	31.8	6.6	6.8	54.4	- 0.6	229.9	1 077.0	14.9
Imports of raw materials and manufactures									
Total	7.1	42.4	11.6	17.5	19.2	- 5.5	225.3	5 876.9	81.3
Intra-EEC	33.6	46.0	19.2	24.1	27.8	- 6.6	344.5	2 086.5	28.9
From non-EEC countries	- 0.9	41.0	8.4	14.4	14.8	- 4.8	189.3	3 789.7	52.4

TABLE 4: Basic monthly indicators

	Year	Jan.	Feb.	Mar.	Apr.	May	June	July	Aug.	Sept.	Oct.	Nov.	Dec.
Industrial production (1958 = 100)	1964	176.8	171.3	177.2	177.0	167.9	166.2	178.7	127.1	173.5	179.6	172.6	169.8
	1965	166.0	165.5	180.2	176.1	179.7	173.5	191.1	140.0	187.4			
Building: domestic turnover of building materials (1958 = 100)	1964	178.5	169.8	188.3	183.6	195.3	195.3	193.3	181.7	197.6	182.9	156.4	169.2
	1965	160.8	136.8	173.8	160.8	166.7	196.3	192.8	183.4	184.7			
Private consumers' expenditure: turnover of department stores (1958 = 100)	1964	254	210	255	246	277	300	280	232	290	355	289	513
	1965	270	215	249	303	284	318	296	241				
Total visible imports (million u.a.)	1964	715.3	696.0	667.7	650.1	633.4	635.6	548.5	448.4	539.0	590.9	510.4	597.6
	1965	545.6	591.9	630.3	595.3	615.2	573.9	629.5	561.9	614.9			
Total visible exports (million u.a.)	1964	419.4	449.7	452.7	489.7	458.7	505.8	575.4	436.8	530.6	567.4	504.7	540.0
	1965	460.7	559.9	643.4	588.8	571.4	611.4	627.4	552.6	616.0			
Balance of trade (million u.a.)	1964	-296.0	-243.7	-213.3	-156.8	-171.0	-126.1	+ 27.0	- 0.3	- 8.5	- 20.5	- 5.1	- 50.9
	1965	- 84.9	- 32.0	+ 13.1	- 6.5	- 43.8	+ 37.5	- 2.1	- 9.3	+ 1.1			
Official gold and foreign exchange reserves (net, million u.a.)	1965	3 154.1	2 958.7	2 748.3	2 728.9	2 761.2	2 826.2	2 898.2	3 071.0	3 257.1	3 432.1	3 615.2	3 756.3
	1965	3 797.8	3 873.9	3 755.8	3 811.5	3 895.5	4 032.3	4 250.4	4 390.7	4 323.0	4 270.2		
Money supply (Lit. '000 million)	1964	11 058	10 961	11 096	10 953	11 118	11 264	11 308	11 239	11 379	11 434	11 702	12 465
	1965	11 984	11 861	12 077	12 225	12 522	12 687	12 885	12 808	13 108			

Italy

NOTES

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

Table 1

- Present-in-area population (resident population less persons temporarily abroad). Average for year. Source : Istituto Centrale di Statistica.
- Working population in employment. Average for year. Source : Istituto Centrale di Statistica, "Rilevazione nazionale delle forze di lavoro—20 ottobre 1964".
- Breakdown of gross domestic product by factor cost.
- GNP at market prices.

Table 2

- GNP at market prices.
- Industrial production : value added by industry at factor cost.
- Total exports and imports : goods, services and factor income.
- GNP per head and per person in employment for 1959. Commission estimate.

Table 3

- Exports fob, imports cif. Conversion at official exchange rates. The products have been regrouped on the basis of the Statistical and Tariff Classification for International Trade (CST) : food, beverages and tobacco (groups 0 and 1 CST), raw materials and manufactures (groups 2-9 CST).

Table 4

- Industrial production. Source : Istituto Centrale di Statistica.
- Building. Internal trade in building materials, calculated from turnover taxes. Source : Istituto per lo Studio della Congiuntura.
- Private consumption. Retail sales of department stores, based on the turnover of 5 department stores and 2 "single-price" stores. Not very typical of the trend in private consumption as a whole.
- Exports fob, imports cif. Conversion at official exchange rates.
- Official gold and foreign exchange reserves. Source : Ufficio Italiano dei Cambi.
- Money supply. Notes and coin circulation, excluding cash holdings of the Treasury. Sight deposits of non-banks with registered credit institutions; bank drafts in circulation (whether vaglia or assegni) issued by the Central Bank and of other banks and credit institutions.

D. Netherlands

In 1965 the Dutch economy was again marked by considerable expansion. The rapid rise of overall demand in money terms and the persistent labour shortage continued, however, to produce distinct increase in costs and prices.

Partly as a result of certain special factors, the increase in total exports of goods and services declined; from 1964 to 1965 it was about 10 % in value—compared with 14.4 % from 1963 to 1964.

The main reason for the rise in expenditure on gross fixed asset formation, which at 10 % (after 23.6 % from 1963 to 1964) had slowed down considerably but was still fairly vigorous, was once more the powerful expansion of public investment and expenditure on housing. The growth rate of investment by enterprises, on the other hand, was significantly reduced. Stocks were even being run down in the first six months of the year, and though there was some recovery thereafter, the influence exerted by investment in stocks on the annual figures for imports and production was probably much less than in 1964.

The expansion of consumer expenditure continued at almost the same vigorous pace. While there was a certain slowdown in public current expenditure on goods and services, private consumers' expenditure again went up quite appreciably. This was helped by a rise in the disposable income of households that was almost double the real overall increase in production. Although the rise in consumption by households in money terms, at an estimated 12 %, was slightly less than from 1963 to 1964, it was somewhat faster in terms of volume because prices did not go up quite so steeply.

Supply from domestic production was distinctly up despite a fall in agricultural output due essentially to the weather. The expansion of industrial production, however, varied from industry to industry and lost momentum slightly in the course of the year. Nevertheless, the increase for the whole year might prove to be a good 6 %. The overall growth in real GNP from 1964 to 1965 will amount to fully 5 %—still below the 8.2 % gain from 1963 to 1964, a gain that stemmed in no small measure from certain special factors.

The decidedly weak upward trend registered by imports of goods and services in the first half of 1964 gathered strength during the second half of the year; the total in real terms, however, is hardly likely to have been more than about 6 % higher than in

1964. Since the foreign trade figures also benefited from an improvement in the terms of trade, the current account closed with a surplus (about Fl. 300 million) as against a sizeable deficit in 1964. The surplus on capital account, which in 1964 was very large, seems to have been much smaller. Gold and foreign exchange reserves in September 1965 were slightly (Fl. 13 million) lower than at the end of 1964.

The rise in costs and prices again slowed down a little, but it was still fairly vigorous—one reason being the persistent tightness of the labour markets. The increase in consumer prices is none the less likely to be 4.5 to 5 % (compared with 6.5 % a year earlier).

The prospect for 1966 is of further very rapid economic growth, with the pressure on costs and price continuing. Exports may well go up at the same rate as from 1964 to 1965, and domestic demand is likely to be a greater additional stimulus to economic activity than in the previous year. Here the relative importance of the different components of demand may alter.

Overall demand for capital goods should expand more vigorously than it did from 1964 to 1965. In the first place, public expenditure on investment is to be stepped up significantly. Secondly, expenditure on housing will continue to increase sharply. And certain special factors (such as purchases of aircraft and ships) may send up the amount firms spend on fixed assets more rapidly than in 1965.

The rate of expansion in consumer expenditure, unlike investments, may be reduced. This applies first of all to public spending on goods and services, particularly as wages and salaries in the public sector should no longer rise more rapidly than corresponding incomes in the private sector, but at much the same pace. This, together with the slower expansion of transfer incomes, will hold back the rise of household incomes, though wage and salary incomes in the private sector will be going up at an only slightly reduced pace. All in all, the expansion of private consumers' expenditure may be as much as 9 % (4.5 % by volume).

Strain on the labour market will persist, especially as the natural growth of the working population is likely to be slightly lower. Industrial production may nevertheless expand by about 7 %, total real GNP by about 5.5 %.

Imports of goods and services should go up more rapidly than before. While the current account in 1966 may still close with a surplus, this is likely to be at best very small.

The outlook for monetary demand, production, the labour markets, production costs and taxes affecting costs offers little prospect of the rise in consumer prices being much smaller than in 1965. Budget policy, which will involve a further sharp increase in spending, will, despite heavier taxation, again have a marked expansionary effect on the economy, though not, if the government keeps within the bounds set by the budget, so marked as in 1965.

Since wages policy is clearly no longer likely to achieve a rapid stabilization of costs at the moment, and since money and credit policy cannot be made restrictive enough without provoking an inflationary influx of capital, it is worth considering whether there should not after all be another definite reduction in the expansion of public cash disbursements or a sharper increase in the tax burden, so that the budgets would really serve as a brake on the rise of domestic monetary demand—and so on prices.

1. Balance-sheet for 1965

Exports, which from 1963 to 1964 registered an increase as sharp as any since the war, went up less vigorously from 1964 to 1965. On the basis of customs returns visible exports will probably have risen about 9.5 % in value and about 7.5 % by volume—over the 1964 figures, which were 17 % and 14 % higher than the year before. In the third quarter of 1965 the value of foreign sales was no more than 8.8 % higher than in July-September 1964.

The slower growth of exports is largely due to a loss of economic momentum in the Community, particularly in France and B.L.E.U. Exports to Germany also grew less rapidly, but this was in the main due to certain special factors. It was again special factors—but working in the opposite direction—that influenced the trend of exports to Italy.

This meant that for the first time since 1958 sales to member countries and to non-member countries increased by much the same amount during the year. Especially in the second and third quarters of 1965, exports to countries outside the Community expanded fairly dynamically, the strongest gains being in exports to the United States.

Keener competition on world markets had its impact on the trend of export prices for finished goods, which rose perceptibly less rapidly than in 1964. On the other hand, export prices for farm products made a recovery after giving way in 1964.

The increase in receipts from services and factor income also seems to have slowed down, though the trend of factor income from abroad was much more favourable than had been forecast. The total value of goods and services as defined for the national accounts is therefore likely to have increased by some 10 %, their volume 8.5 %; a year earlier the figures were 14.4 % and 11.9 %.

The growth of domestic demand in money terms was also smaller than it had been in 1964, the reduction being almost entirely in the capital goods sector.

Nevertheless, the increase for the year in expenditure on gross fixed asset formation was again quite considerable, and may have been as much as 10 %, with volume rising almost 6 %, after increases of 23.6 % and 16.5 % the year before.

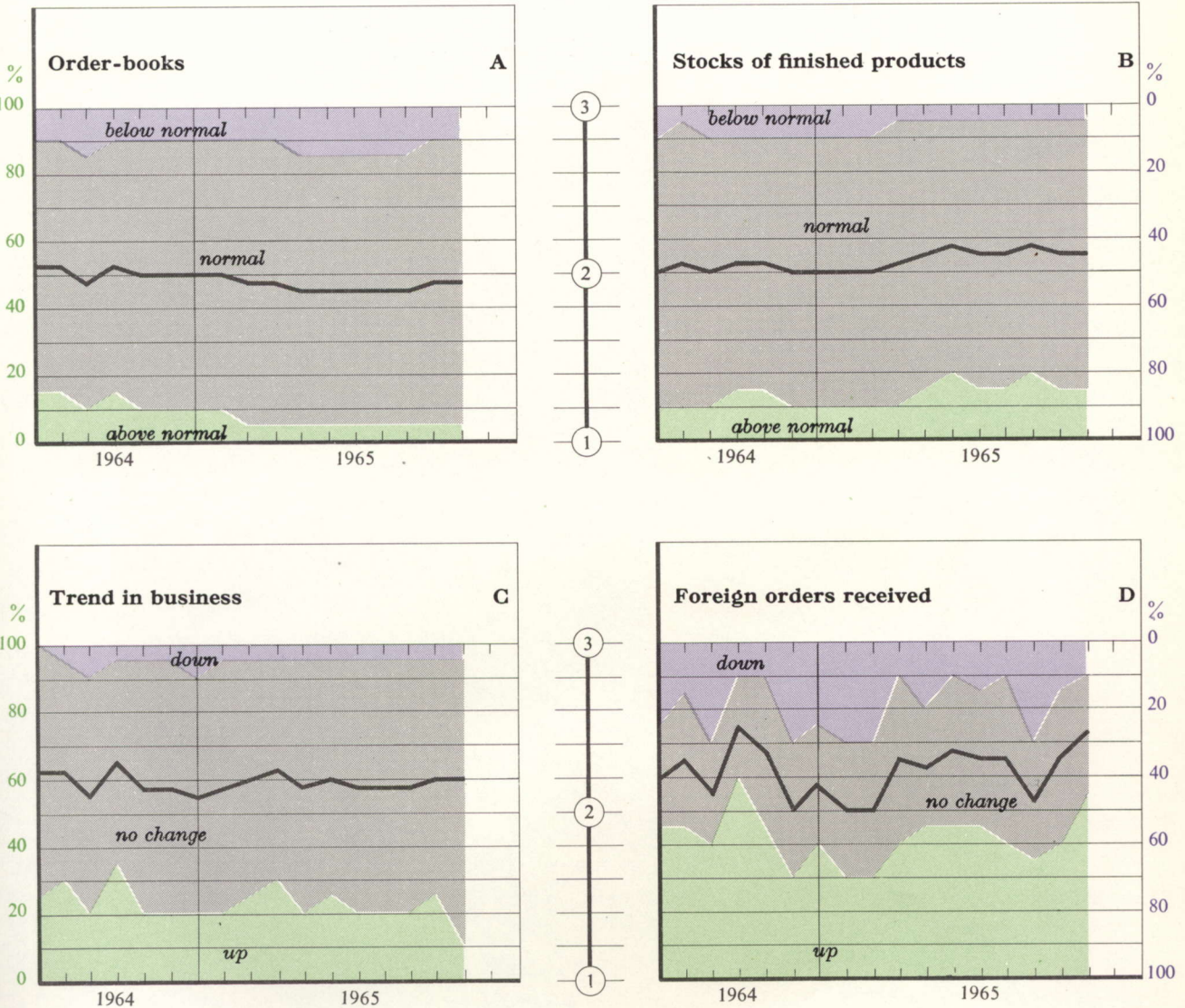
The rise in business gross fixed asset formation (excluding housing) was very much reduced. Between 1964 and 1965 it moved up 6.5 % in value and 3.5 % by volume—compared with a jump of 20.3 % in value and 1.4 % by volume from 1963 to 1964. Of course, this slowdown was in part a reflection of the special factors which had helped the 1964 results (particularly the weather).

The tax measures introduced since 1963 and the greater selectivity applied in granting building licences in 1965 seem none the less to have exerted some restraint on investment by enterprises. The principal factor, however, was that in several industries—and particularly small and medium-sized enterprises—direct government price policy and soaring unit costs were steadily paring profit margins. Another indication of this is that enterprises borrowed more from outside sources. On the other hand, the extent to which production capacity is being utilized, the mounting urge to rationalize and the new opportunities offered by the development of natural gas contributed to the expansion of investment expenditure by business as a whole.

Expenditure on investment in housing, on the other hand, seems to have continued its rapid rise. The number of completions reached an all-time record of about 115 000 (as against 101 000 in 1964 and 80 000 in 1963). There was also a sharp increase in the number of starts.

Lastly, public investment showed a vigorous growth of some 13 % in value and 7 % by volume. Expenditure by local authorities seems, as a result of the restrictions introduced in respect of financing, to have gone up less sharply than that of the central government.

BUSINESSMEN'S VIEWS ON THE INDUSTRIAL SITUATION



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

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

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

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

Investment in stocks from 1964 to 1965 rose considerably less than in the previous year. Because of the trend of world market prices and the shortage of liquid funds, stocks of raw materials and semi-manufactures were actually reduced in the first half of the year; in the next six months they again moved up. Stocks of consumer goods may well have decreased towards the end of the year as a result of the speed-up in private consumer demand.

From 1964 to 1965 consumer demand again expanded very dynamically, more vigorously than any other component of demand. Public expenditure on goods and services rose by about 13 %—chiefly as a result of the expansion of wage differentials in the public sector and of efforts to bring incomes in this sector into line with corresponding incomes in the private sector. The real increase of consumption from 1964 to 1965 will probably be 1.5 %.

The steady rise of disposable incomes again contributed to the expansion of private consumers' expenditure. This will have gone up about 12 %—as against 12.6 % a year earlier. In terms of volume, growth may well have been even faster (about 7 % instead of the 5.7 % from 1963 to 1964) since the increase in prices turned out to be rather slower.

The extraordinarily sharp increase in private consumers' expenditure—on the heels of the upswing caused in 1964 by soaring wages—seems to be chiefly due to the impact produced by a persistently overheated economy on the attitude of both sides of industry in wage negotiations. The total wage bill may have gone up another 14 % over the past year, and the previous year's increase was a good 18 %; wage costs per worker will probably have risen 12 %, as against some 16 % from 1963 to 1964.

In the business sector, where numbers employed went up at a slightly slower pace than in 1964, the wage increase per person employed probably exceeded 11 % (15 % from 1963 to 1964); about 3.5 % of this was due to rises in agreed wages and 2 % to special mid-year and end-year bonuses. Wage drift seems also to have become more pronounced in the course of 1965. Rates in the building industry again went up faster than in other industries. And again, as in previous years, the per capita increase in wages and salaries was distinctly bigger in the public sector (about 15 %) than in private business.

Disposable incomes of households were also sent up by a further marked improvement in transfer incomes and an increase in other non-wage incomes. Finally, the income-tax cut in the middle of the year gave a considerable impetus to the rise in disposable incomes. All in all, they are likely to have gone up 12 % over the year (as against about 14 % from 1963 to 1964).

The fresh pressures that affected consumer expenditure built up fairly steadily, the increase in the disposable incomes of households having been more evenly distributed

over the year than it had been in 1964. It should however be noted that the division of disposable incomes between spending and saving apparently shifted to the detriment of saving, with people making certain purchases in anticipation of higher prices which will result from the heavier indirect taxes to be levied from 1 January 1966.

As regards domestic supply, only agricultural production (value added at constant prices) will have fallen (about 4 % below the figure for 1964, when harvests were exceptionally good). Industrial production, on the other hand, again climbed fairly vigorously; the growth rate from 1964 to 1965 can be estimated at a good 6 %—after an 8.6 % increase from 1963 to 1964. According to the CBS index, industrial production in the third quarter was 6 % higher than a year earlier.

The slowdown apparent in these growth rates is mainly due to the influence of the special factors to which we have referred, as these boosted the 1964 figures. However, it is also a result of a slight flattening of the seasonally adjusted trend; in 1965 the growth of production showed greater differences from one branch to another than in 1964, with textiles even registering a decline of activity.

Once the considerable increase in the real contribution which the building industry will have made to GNP is taken into account (the upswing in production was again limited only by capacity), together with the expansion that is likely to occur in the services sector, it may be estimated that real GNP will have increased by a good 5 % in 1965 (compared with 8.2 % in 1964 and 3.1 % in 1963).

Despite the high degree of utilization of production factors, there was a considerable rise in productivity in 1965. In private industry, the increase was an estimated 4 % per person employed (as against 7.5 % from 1963 to 1964). However, this produced no real easing of strain on the labour market. Numbers in paid employment increased little less than in 1964 (2 % instead of 2.3 %), and building was the only industry in which the labour force increased less than before. Although the monthly average unemployment figure of 35 000 was rather higher than in 1964 (30 000), this hardly amounts to a general easing of the situation. Furthermore, most of the increase took place in 1964; the figure in the first quarter of 1965 was already higher than the 1964 average, and it did not rise further in subsequent quarters. Despite another rise in net arrivals of migrant workers, there was throughout the year a very appreciable shortage of labour, and this was reflected in the figures for unfilled vacancies. In November the unemployment rate (number of unemployed as a percentage of total number of employees, whether in employment or not) was as low as 0.8 %; in November 1964 it had been 0.7 %. With only 36 400 persons out of work, 121 800 registered vacancies were unfilled.

After a slight decline in the first quarter, imports during the rest of the year showed a steadily more marked upward trend; this was due to the tendency for stocks of raw materials and semi-manufactures to be replenished and to the growing demand for con-

sumer goods. Customs returns show that visible imports in the third quarter were about 6.5 % by volume and 7.6 % in value higher than a year before. For the full year 1965, however, the growth in the volume of visible imports will probably have been only about 5.5 %—compared with the 15 % of 1964.

As imports of services and factor payments to abroad, taken together, probably expanded as much as visible imports, total imports—as defined for the national accounts—seem to have gone up by almost 6 % by volume and about 6.5 % in value from 1964 to 1965.

Although in 1965 overall supply increased perceptibly in real terms, and government price controls were retained, there was still a pronounced tendency for prices to be pushed up, for since 1961 wages per person in paid employment in the Netherlands have been increasing more sharply than productivity, and since the end of 1962 import prices, which had for a long time been falling, have resumed their upward trend. These movements were not accentuated in 1965; if anything, they slackened off a little. None the less, higher costs continued to have their effect—particularly (and this is the deciding factor) as the expansion of monetary demand at least made it possible for prices to go up. It must be pointed out, however, that certain special factors—particularly the effect of bad weather on food prices—also contributed to the rise in consumer prices.

The increase in wholesale prices slowed down a little—especially because prices for finished products went up rather less.— A certain weakness in the prices paid for raw materials was much more than offset by the higher cost of farm products. Retail prices—seasonally adjusted—went up further, particularly during the first six months, with more than average increases for services. In October 1965 wholesale prices were 3.5 % and retail prices 4.3 % higher than a year before, when they had been 4.8 % and 6.4 % up on the prices of October 1963. The average increase from the first ten months of 1964 to the corresponding period of 1965 was 3.4 % in wholesale prices and 5 % in retail prices.

After the sharp deterioration of the current account in 1964, there was a considerable improvement in 1965. The surplus (as defined for the national accounts, but including unrequited payments) may be as much as Fl. 300 million, as against a deficit of Fl. 727 million in 1964. This improvement can be put down mainly to the reduction of the trade deficit from Fl. 4 200 million in 1964 to Fl. 3 400 million in 1965. After an exceptionally favourable result at the beginning of 1965, the balance of trade deteriorated steadily during the year under the twofold effect of a slowdown in the expansion of exports and a speed-up in the growth of imports.

With a reduction in the surplus on capital account, which is chiefly due to the repatriation of American capital and an increase in foreign issues on the Dutch market,

the surplus on the overall balance of payments in 1965 could turn out to be slight whereas in 1964 it closed with a surplus of some Fl. 200 million.

During the first nine months of the year, the net gold and foreign exchange reserves held by the banks (the Central Bank and others) fell by Fl. 13 million. The net reserves of the monetary authorities were Fl. 69 million down, the net position with the IMF will have improved by some Fl. 338 million, and the net foreign holdings of the commercial banks declined by Fl. 282 million.

National product and expenditure

	1963 ⁽²⁾	1964 ⁽²⁾	1965 ⁽³⁾	1966 ⁽⁴⁾
	At current prices (in Fl. '000 million)	% change by volume on preceding year		
Gross national product	52.34	+ 8.2	+ 5	+ 5.5
Imports ⁽¹⁾	26.09	+ 15	+ 6	+ 10
Private consumption	31.10	+ 5.7	+ 7	+ 4.5
Public current expenditure	7.90	+ 1.6	+ 1.5	+ 2.5
Gross fixed asset formation	12.37	+ 16.5	+ 6	+ 8.5
Exports ⁽¹⁾	26.36	+ 11.9	+ 8.5	+ 8.5

⁽¹⁾ Goods, services and factor income.

⁽²⁾ General Statistical Bulletin, 1965, No. 11, Statistical Office of the European Communities.

⁽³⁾ Commission estimates.

⁽⁴⁾ Commission forecasts.

Note :

a) The difference between the figures for supply and the figures for utilization is accounted for by movements in stocks.

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

The rapid expansion of monetary demand was not seriously hampered by the trend of domestic liquidity, which rose at much the same pace as net national product at market prices—at least until the autumn. In the banking sector this expansion of liquidity was reflected—in contrast to 1964—in the trend of sight deposits, while time

deposits and savings seem to have increased much less quickly. As transactions with abroad had only a slightly expansionary effect on internal liquidity, its upward movement must have been due mainly to the effects of the cash transactions of the Treasury, which financed an increased deficit until the summer by short-term borrowing. Transactions by local authorities, however, tended to reduce liquidity, since a considerable proportion of their short-term indebtedness was funded. Furthermore, the expansion of short-term bank advances to business and private customers slowed down perceptibly: from December 1964 to August 1965 they advanced 5.5 %, as against 8.8 % a year earlier. Penalty deposits, which, on the basis of bank advances at the end of May 1965, had gone up to a record Fl. 202 million, will have been down again— on the basis of advances at the end of September—to Fl. 98 million.

The rapid increase in demand for medium and long-term funds sent interest rates on the capital market up again in the course of the year. The tightness of the market was confirmed by the reticent reception given to a government loan floated in October, for which only Fl. 140 million was subscribed. Public issues in the first eleven months of 1965 totalled Fl. 1 068 million, as against Fl. 975 million in the corresponding months of 1964, while private issues totalled Fl. 814 million compared with a mere Fl. 405 million in 1964. It should also be noted that recourse by the private sector to other means of raising medium-term funds (bank credits and private loans made by private arrangement) increased markedly in 1965.

2. Outlook for 1966

Although domestic demand will doubtless expand briskly once more and the increase in costs and prices will continue at a rapid pace, exports may again be appreciably higher in 1966.

There is likely to be a further considerable increase in demand for visible exports by the other member countries — particularly if normal progress is made within the Common Market. It is quite possible that deliveries will speed up, except exports to Germany, which will be affected *inter alia* by certain special factors such as the termination of arms deliveries. Exports to non-member countries were already up significantly in 1965, but they too will probably continue their dynamic trend. The effects of increased Dutch aid to the developing countries may at least partially offset the reduction that could otherwise have been expected in the purchases made by these countries.

The essential point to be noted in connection with the prospects for Dutch exports is that the excess of demand at home is being concentrated on the building industry; in

view of the pattern of exports from the Netherlands, the supply available for sale abroad should not suffer much more from excess demand at home than it did in 1965. Moreover, the quantity of farm products available for export may increase in 1966, after being lower in 1965 than in 1964. Lastly, not only the Netherlands but a number of its customers also may expect costs to continue rising. It seems that the high proportion of imported goods contained in what the Netherlands offers for export has so far ensured that there is no serious threat to the country's ability to compete.

In view of the trend foreseen for exports of services and of a probable slowdown in receipts from factor income, the total value of exports (as defined for the national accounts) may in 1966 show an increase of about 9.5 %. Particularly because of the effects of keener international competition, the increase in value will no longer be as far ahead of the increase in volume as it was in 1965.

Within the expansion of domestic demand, the part played by each of its components may vary in 1966; a probable decline in the expansion of consumer demand will be accompanied by a more rapid growth of investment.

Gross fixed asset formation in particular should go up faster than in did in 1965. The added interest taken by the Government in certain objectives (building more schools and universities, intensifying public works, promotion of housing, etc.) should produce a more rapid increase in direct government expenditure on investment and in transfers of capital (for investment purposes) to other authorities. The growth of investment by local authorities in particular will speed up again after losing momentum last year.

Residential construction, chiefly because of the expansionary action of public authorities, will again provide a very appreciable stimulus to the upward movement of domestic demand in money terms. Outlay in this sector will probably be about 13 % up—but by volume the rise will be only about 8 %, because of higher costs.

The forecasts for the trend of investment by enterprises again contain several uncertain factors. Available information on plans in the transport sector (ships and aircraft) and in the energy sector indicates a very rapid increase in expenditure; and in other sectors the propensity to invest should after all remain quite strong in view of the way demand is likely to develop and of the urgent need to counteract the continuing rise of production costs. The extent to which the propensity to invest is translated into actual expenditure, however, seems to depend more than previously on financing possibilities. Although the effects of the prospective wage increases and of money and credit policy, tax policy and price policy are difficult to assess, it may be supposed that certain difficulties will result from the lack of own funds available to firms for investment and from the tightness of the capital markets. The expected increase of investment in stocks and the resultant calls on available funds might aggravate this still further.

These various factors suggest that the increase in investment by enterprises in the coming year can be estimated at 11 % in value and 8 % by volume. If the special factors already mentioned (purchases of ships and aircrafts) are excluded, this means that investment by firms should again expand much as it did during 1965.

A marked expansion of investment in stocks is to be expected in 1966, due chiefly to replenishment of stocks of raw materials and semi-manufactures.

The growth of public current expenditure on goods and services will probably be rather smaller than last year. However, this component of demand might expand at much the same rate as GNP in money terms; real growth should be rather greater than in 1965.

After the lively expansion recorded in 1965, private consumers' expenditure is expected to rise less vigorously in 1966. Although the general economic trend and in particular the continuing strain on the labour market may again promote sizeable wage increases, the total wage and salary bill is unlikely to go up as sharply as it did in 1965, particularly in the public sector, where the four year programme for the reorganization of government wage and salary scales and their alignment on incomes in the private sector came to a close at the end of 1965; the authorities intend to make greater efforts to keep actual expenditure within the limits contained in the budgets. However, public sector incomes will still go up at the same pace as those of workers in private industry—and, as is pointed out below, this will be quite rapid.

The assumption that the increase in per capita wages and salaries in the private sector will taper off somewhat is based exclusively on a lower estimate for certain special wage components (annual bonuses, compensation for higher social security contributions and higher rents); on the other hand, the upward movement of wage rates when collective agreements are renewed is likely to be very sharp once more. On the whole, it seems that the average per capita wage will be about 10 % up on 1965, with increases under collective agreements probably accounting for about half the rise.

A still very tentative estimate would put the increase in the total wage and salary bill at about 12 %, 2 % of which would be due to a rise in numbers employed. Transfer incomes and other non wage incomes too are likely to expand again, though probably not as much as in 1965. Lastly, direct taxes will not really put a brake on the growth of disposable income, because the progressivity of the tax system will be largely offset by the income-tax cut in mid-1965.

Consequently, an increase of about 9 % in value may be forecast for consumer expenditure by households—but here the assumption is that the proportion of incomes going to savings (quite apart from the taxpayers' compulsory savings certificates—an estimated total of about Fl. 425 million) remains virtually unchanged. After the pur-

chases made at the end of the year in anticipation of the pending increases in indirect taxation, the growth of consumer demand early in 1966 should for a time be relatively weak.

If the trend of the various components of demand develops as forecast, domestic production should mount rather more rapidly than it did in 1965, provided the wage negotiations for 1966 do not unduly curtail the working time per head.

Strain on the labour market will probably persist in 1966. The excess of unfilled vacancies over persons seeking work might drop slightly, as it did in 1965, but this is unlikely to have any significant effect on the labour market, especially as the natural growth of the labour force should be slightly slower than in 1965. In these circumstances the net inflow of migrant workers should continue relatively high.

Industrial production can be expected to expand some 7 % in 1966; this assumes a spurt in the production of natural gas and greater activity in the textile industry. Building output will probably expand only a little less rapidly than industrial production. Given normal weather, the contribution of agriculture to GNP might be considerably higher than last year; and provided the trend in services remains much the same as in 1965, a growth in real GNP of about 5.5 % may be forecast for the full year.

In view of the probable expansion of overall demand and its individual components—particularly investment in stocks—a more vigorous growth of imports can be expected. The increase in imports of goods could be almost twice as high as in 1965. The surplus on current account should tend to decline. Over the full year it might be lower than in 1965, especially if, contrary to present assumptions, import prices should go up.

In view of the probable trend of monetary demand and real supply—and even more of costs—there is little likelihood of price stabilization in 1966. The increase in productivity might conceivably be rather bigger than assumed in the forecasts, but so might the rise in costs; and it should be noted that employers' contributions to social security are to be increased sharply in 1966, and this time the percentage increases will be considerably heavier than the rise in wages and salaries. Moreover, the pressure to pass on the considerable earlier increases in costs—which have only partly been reflected in prices—is likely to continue, as the trend of costs is persistently upward.

Although an improvement in agricultural output could help wholesale prices to settle down, it will hardly suffice to counteract the upward movement in consumer prices caused by current developments, including higher costs, the adjustment of rents and public service tariffs, and the increase of indirect taxation. Consumer prices are therefore likely to be at least some 4 % higher in 1966 than they were in 1965; according to Dutch estimates, the effects of tax increases and higher rents account for about 1.75 percentage points.

It can certainly not be said that these prospects are fully in line with the objectives of stabilization policy. When allowance is made for the effect produced by the increase in indirect taxation, a further slowdown in the movement of prices can in fact be discerned, but it is doubtful whether the authorities should be satisfied with this, especially as it is by no means certain that the overall price increase can be kept within the intended limits.

The first point to be made in respect of short-term economic policy is that the current policy of the Dutch authorities does not take sufficiently into account the stabilization of prices and costs. Their policy consists at present in the retention of a relatively restrictive money and credit policy and of direct price controls, together with a still decidedly expansionary budget policy. International monetary considerations would seem to suggest that it might be better to weight in exactly the opposite way.

It may well be wondered whether this mix will be effective enough. For if, in order to stabilize prices and to restore to the current account a surplus consonant with the needs of the Netherlands, the authorities should try to make their money and credit policy as restrictive as it should be in view of the line followed by budget policy, there would without doubt be a greater influx of capital from abroad, and this in turn would do much to defeat the policy of restriction; even without this, there seems recently to have been a recovery in imports of capital, though credit policy is still following what is on the whole only a moderately restrictive line. The main factor is that strain on the money and even more the capital markets has also increased as a result of an upsurge of public and private demand for capital.

This means that budget policy should play a greater part in the task of stabilizing prices and costs; yet budget policy in 1966 will evidently have the reverse of an anti-cyclical impact. Mainly as a result of a sharp increase in direct expenditure on investment by the State and of its capital transfers to other authorities, budget expenditure will again increase vigorously. Although it is intended that the total expansion in government spending will be slower than the effective growth rate from 1964 to 1965, it would cause a dangerous increase in the deficit unless revenue went up also. Increased taxation amounting to Fl. 480 million is therefore envisaged.

The forecast deficit is to be kept down to Fl. 1 100 million as a result of this additional revenue—as against an estimated deficit for 1965 of Fl. 900 million and an actual deficit that will probably amount to Fl. 1 500 million.

The proposed increase—mainly in the form of indirect taxes—is to be offset, especially for wage and salary earners, by a cut in direct taxation—but in the form of savings certificates, which must be held by taxpayers for 5 years and which are non-transferable; the certificates are meant to bring in Fl. 425 million a year. But the possibi-

lity that higher indirect taxation may lead to a further increase in costs cannot, in view of the overall expansionary effect of the budget on the domestic economy, the speed-up in the growth of private investment and the persistent strain on the labour market, be ruled out with any certainty.

On the whole, if expenditure budgeted for in 1966 is compared with estimate of actual expenditure for 1965, an increase in total government outlays of about 11 % can be reckoned with—after a rise of 15.4 % from 1964 to 1965. If the additional increase in revenue accruing from changes in taxation is deducted—the increase of indirect taxation more than offsets the reduction in direct taxation—and if allowance is made for the increase in revenue that would result, under the existing system of progressive taxation, from a 5.5 % growth in GNP in money terms (i.e. without allowance for any inflationary effects), we are still left with an increase in government expenditure which goes beyond the 5 % norm laid down by the Council of the Community in April 1964. The Short-term Economic Policy Committee, in its formal opinion rendered on 8 July 1965, and the Commission both considered, however, that in 1966 this norm would have to be followed in the Netherlands, where it had not been observed in the two preceding years. The amount by which the Council's guide-line is overstepped in 1966 will at any rate be considerably less than in 1965—unless expenditure is after all higher than forecast in the budget, as it always has been in recent years.

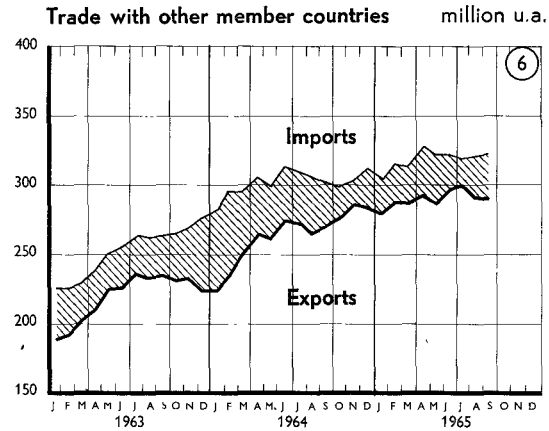
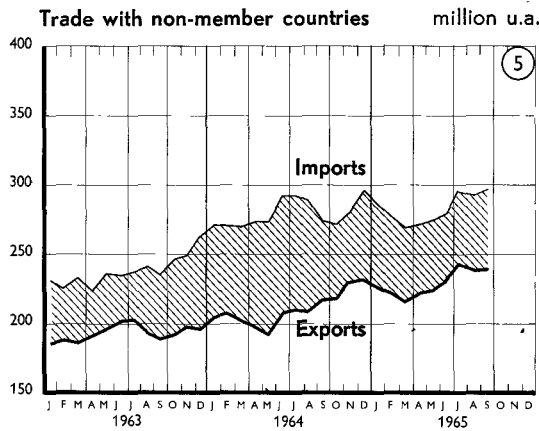
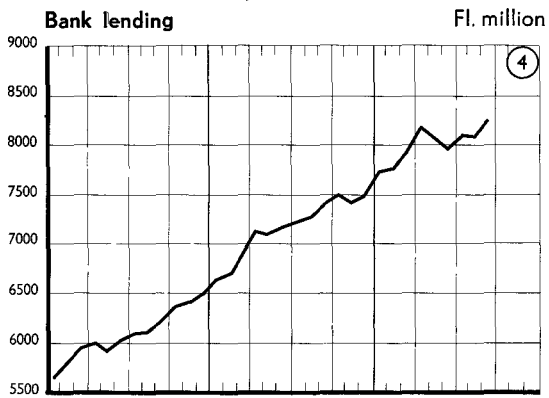
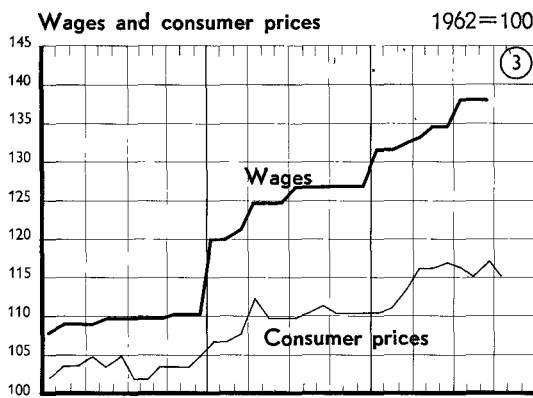
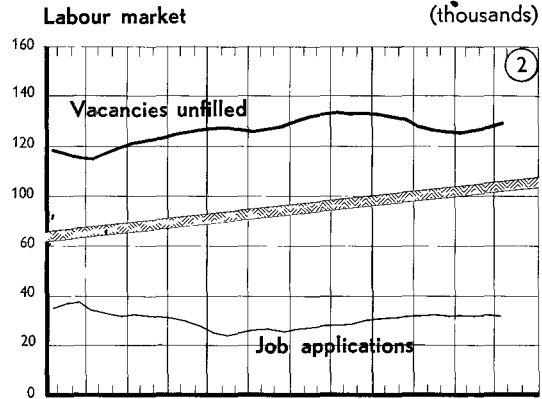
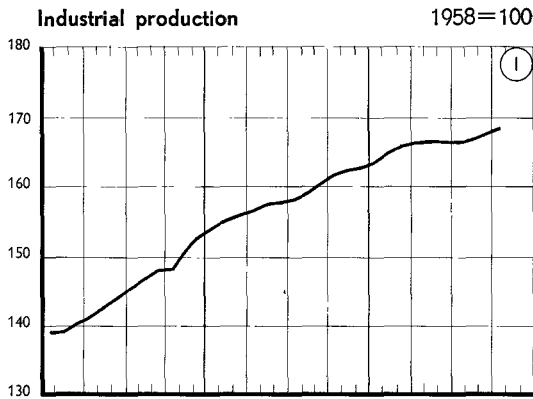
To judge by the forecasts, the outlook for a satisfactory and rapid drive to stabilize prices and costs is not too encouraging. The pressures on the labour market caused by the trend of demand in recent years have blunted this instrument of short-term policy in the Netherlands.

In these circumstances the authorities should perhaps try to contain the expansion of public expenditure more effectively or, if they do not accept this line, they should raise taxes more than is planned.

The risk deriving from years of inadequate attempts to combat inflation should not be underestimated. It is possible that certain favourable factors will arise after the end of 1966—including a reduction of the pressure exerted on building capacity by the demand for housing and the effects of natural gas production on the balance of current payments. On the other hand, very high annual increases in money income and sizeable price increases were coming to be regarded as normal, and this is coupled with growing inelasticity in the face of possible changes in the situation, as is shown by recent trends in some collective bargaining agreements (long-term agreements with rate increases clearly going beyond the possible rise in productivity in the economy as a whole, clauses requiring increases in consumer prices to be taken more fully into account). If in the longer term monetary claims and costs continue to grow as they have been doing for some years, the time will come when it will hardly be possible to balance the external trade account.

These considerations should perhaps to lead greater restraint in the short term. It must be conceded that it is very difficult for the Dutch authorities to impose this restraint when neighbouring countries and others which buy from the Netherlands are themselves suffering from inflationary tendencies. The advice given to the Netherlands should not be seen in isolation, however, but only in conjunction with corresponding advice given to the other member countries of the Community.

ECONOMIC INDICATORS



NOTES:

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

Graph 1. The trend curves represent estimates which have been established on the basis of indices (excluding construction, food, beverages and tobacco) adjusted by the SOEC for seasonal and fortuitous variations.

Graph 2. Source: CBS. Adjusted for seasonal variations. Three-months moving average.

Graph 3. Index of consumer prices — general index. Source: CBS. Wages — index of gross hourly earnings in industry (excluding mining, quarrying and construction). Index of negotiated wages.

Graph 4. Short-term loans made by monetary institutions.

Graphs 5 and 6. Series adjusted for seasonal and accidental variations (moving averages of 3 months). Exports fob, imports cif. Conversion at official exchange rates.

Netherlands

TABLE 1: Basic data (1964)

Total area ('000 sq. km.)	33.5
Total population ('000)	12 124
Density of population per sq. km.	362
Working population in 1961 ('000)	4 289
Working population, breakdown by main sector in 1961 (%):	
— Agriculture	10
— Industry	42
of which: Construction	10
— Services	48
Percentage share of gross domestic product:	
— Agriculture	9
— Industry	41
of which: Construction	7
— Services	50
Gross product per capita (Fl.)	5 014

TABLE 2: Some elements of national product and expenditure
(annual rates of growth)

	% change by volume on preceding year						Volume indices (1958 = 100)	Contri- bution (in %) to 1964 GNP
	1959	1960	1961	1962	1963	1964		
Gross national product	+ 5.0	+ 9.5	+ 3.5	+ 3.4	+ 3.3	+ 7.9	137	—
Industrial production	+ 9.0	+10.1	+ 4.2	+ 4.8	+ 4.6	+ 9.5	150	—
Total imports	+14.0	+16.7	+ 6.0	+ 7.8	+ 9.2	+14.5	190	51
Private consumers' expenditure	+ 5.0	+ 5.7	+ 6.3	+ 5.9	+ 7.2	+ 5.2	141	58
Public current expenditure on goods and services	- 1.0	+ 6.1	+ 4.8	+ 5.5	+ 4.3	+ 1.7	123	15
Gross fixed asset formation	+12.0	+11.6	+ 6.4	+ 4.5	+ 2.2	+16.9	166	25
Total exports	+12.0	+12.5	+ 3.2	+ 6.2	+ 5.8	+12.3	164	50
Gross national product per capita	+ 4.0	+ 7.7	+ 1.8	+ 2.6	+ 1.7	+ 6.7	127	—
Gross national product per person gainfully employed	+ 4.0	+ 6.7	+ 1.8	(+ 0.9)	(+ 1.8)	(+ 6.0)	(123)	—

() Provisional figures.

TABLE 3: Foreign trade (at current prices)

	% change on preceding year						Indices (1958 = 100)	Million u.a.	% of the total
	1959	1960	1961	1962	1963	1964			
Visible exports									
Total	+12.0	+11.6	+ 7.2	+ 6.7	+ 7.7	+17.5	181	5 808	100
Intra-EEC	+19.0	+16.0	+10.9	+10.5	+17.2	+22.2	242	3 233	55.7
To non-EEC countries	+ 7.0	+ 8.4	+ 3.4	+ 3.3	- 0.8	+11.4	137	2 575	44.3
Exports of food, beverages and tobacco									
Total	+14.0	+ 5.3	+ 0.8	+ 7.4	+ 9.2	+ 9.2	155	1 388	23.9
Intra-EEC	+27.0	+ 6.3	+ 3.0	+10.1	+11.8	+12.9	193	812	14.0
To non-EEC countries	+ 3.0	+ 4.9	- 1.9	+ 3.8	+ 5.5	+ 5.2	122	576	9.9
Exports of raw materials and manufactures									
Total	+11.0	+14.4	+ 9.4	+ 5.8	+ 8.2	+19.5	190	4 420	76.1
Intra-EEC	+16.0	+20.7	+14.3	+10.0	+19.3	+25.7	264	2 421	41.7
To non-EEC countries	+ 8.0	+ 9.3	+ 5.9	+ 3.2	- 3.1	+13.6	142	1 999	34.4
Visible imports									
Total	+ 9.0	+14.7	+12.8	+ 5.0	+11.5	+18.1	195	7 055	100
Intra-EEC	+15.0	+19.1	+21.2	+ 6.6	+14.7	+19.2	242	3 671	52.0
From non-EEC countries	+ 4.0	+12.5	+ 5.1	+ 2.4	+ 8.7	+17.5	161	3 384	48.0
Imports of food, beverages and tobacco									
Total	+ 9.0	+ 3.7	+ 6.2	+ 5.8	+15.7	+16.3	171	955	13.5
Intra-EEC	+10.0	+15.5	+41.7	- 6.7	+11.9	+21.8	229	182	2.6
From non-EEC countries	+ 9.0	+ 1.8	- 0.9	+10.0	+15.7	+15.0	161	773	10.9
Imports of raw materials and manufactures									
Total	+ 9.0	+16.5	+14.2	+ 4.1	+11.3	+13.5	199	6 100	86.5
Intra-EEC	+16.0	+18.1	+20.4	+ 7.3	+15.3	+19.1	243	3 489	49.4
From non-EEC countries	+ 2.0	+15.7	+ 7.6	+ 0.8	+ 6.3	+17.6	160	2 612	37.1

TABLE 4: Basic monthly indicators

	Year	Jan.	Feb.	Mar.	Apr.	May	June	July	Aug.	Sept.	Oct.	Nov.	Dec.
Industrial production (1958 = 100)	1964	152	157	159	159	163	157	141	145	157	166	169	168
	1965	165	167	167	170	172	170	149	151	166			
Investment (Fl. million)	1964			3 295			4 017			3 899			4 078
	1965			3 787			4 301						
Building (Fl. million)	1964			1 362			1 682			1 783			1 613
	1965			1 545			1 814			1 993			
Private consumers' expenditure (1958 = 100)	1964	157	146	159	157	172	159	180	160	165	181	172	192
	1965	175	156	173	183	186	179	204	173				
Total visible imports (million u.a.)	1964	589	569	549	640	562	628	636	499	559	628	567	630
	1965	554	564	631	614	577	617	665	537	620	677		
Total visible exports (million u.a.)	1964	452	446	440	479	455	491	484	405	561	552	505	538
	1965	477	489	532	506	501	554	543	438	596	594		
Balance of trade (million u.a.)	1964	- 137	- 123	- 109	- 161	- 107	- 137	- 152	+ 94	+ 2	- 76	- 62	- 92
	1965	- 77	- 75	- 99	- 108	- 76	- 63	- 121	- 98	- 24	- 83		
Official gold and foreign exchanges reserves (million u.a.)	1964	1 860	1 841	1 833	1 802	1 817	1 786	1 869	1 879	1 960	1 965	2 069	2 084
	1965	2 075	2 094	2 069	2 083	2 036	2 010	2 042	2 053	2 065	(2 077)		
Money supply (Fl. '000 million)	1964	14.31	14.31	14.29	14.51	14.99	15.08	15.10	15.01	15.13	15.01	15.27	15.45
	1965	15.53	15.56	15.67	16.05	16.62	16.82	16.99	17.01				

() Provisional figures.

Netherlands

NOTES

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

Table 1

- Total population at mid-year.
- Working population in employment, average for year.
- Breakdown of GNP by factor cost.
- GNP at market prices.

Table 2

- GNP at market prices.
- Industrial production : value added by industry.
- Total exports and imports : goods, services and factor income.
- Industrial production as % of GNP in 1961.

Table 3

- Exports fob, imports cif. Conversion at official exchange rates. The products have been regrouped on the basis of the Statistical and Tariff Classification for International Trade (CST) : food, beverages and tobacco (groups 0 and 1 CST), raw materials and manufactures (groups 2-9 CST).

Table 4

- Industrial production. Source : Centraal Bureau voor de Statistiek (CBS). General index.
- Investment. Source : CBS. Gross fixed investment. Total by value, quarterly figures.
- Construction. Source : CBS. Building production. Total by value, quarterly figures.
- Private consumption. Source : CBS. Index of value of private consumption.
- Exports fob, imports cif. Conversion at official exchange rates.
- Official gold and foreign exchange reserves. Gross reserves of gold and convertible currency held by the official monetary institutions.
- Money supply. Notes and coin circulation, excluding cash holdings of monetary institutions. Sight deposits with credit institutions.

E. B.L.E.U.

Belgium

The tendency for economic expansion to slow down, which began to become apparent in the second half of 1964, became more distinct in the first half of 1965; it was not until the autumn that the trend became a little firmer.

The growth of demand in 1965 was due largely to a further expansion of foreign demand, especially in the non-member countries; sharply increased sales of iron and steel products contributed for a time to this trend. Total exports of goods and services probably increased in value by some 10.5 % for 1965, as against 16.4 % for 1964.

On the other hand, the growth rate of the main components of domestic demand (apart from public current expenditure on goods and services, the rate of expansion of which has almost doubled) slowed down distinctly. This is true in particular of the underlying trend of gross fixed asset formation, which tended to stagnate for most of the year: the annual growth rate was probably a little more than 3 % in value, and by volume it may even have diminished by 1 %, while it was as high as 13.6 % in value and 7.6 % by volume in 1964. Only the fixed investment of enterprises tended to expand—though more slowly—to a still appreciable extent, mainly because of the execution of certain investments by foreign firms in industry. Public investment expenditure, on the other hand, contracted, while residential construction was hard hit by credit restrictions and higher costs.

Private consumers' expenditure went up by about 6.5 % in value and 3 % by volume, as opposed to 8.1 % and 4 % the year before. The main factor in this slight slowdown seems to have been a higher savings ratio while the increase in total disposable incomes of households was probably, on the whole, only slightly smaller than that for 1964.

Domestic supply expanded less than in 1964 because of the trend of final demand, greater caution in stock-building by enterprises, and the relatively bad weather. While agricultural output and construction made scarcely any progress, industrial production (value added at constant prices) may well have increased by some 2.5 % for 1965, as against 6 % for 1964. Consequently gross national product probably increased by some 3 % (5.2 % for 1964). The slower growth of overall demand also

affected the import trend of goods and services; the growth of 7.5 % in volume was distinctly slower than the 12.6 % recorded the previous year.

Although, generally speaking, the expansion of total monetary demand exerted no further pressure, prices continued to tend upwards in 1965. This does not apply so much to the prices of raw materials and semi-manufactures, which tended to become more stable because of the trend of import prices and reduced stock-building, as to finished products and services. Despite certain signs of relaxation, the labour market was still beset by strains which encouraged prices to continue rising. To this must be added the delayed effect on prices of certain increased costs and the influence of the bad weather. For 1965 as a whole the average increase in the retail price index was probably about 4 %.

The current account, which balanced out in 1964, may well have yielded a considerable surplus in 1965. The surplus, however, on the overall balance of payments is likely to be a little smaller than in 1964 because of the probable reduction in the net inflow of capital. Official gold and foreign currency reserves, including transactions with the IMF, increased by Bfrs. 3 400 million in the first nine months of 1965.

Economic expansion is likely to gather a little momentum in 1966. Foreign demand should increase at more or less the same pace as in 1965 on account of the more marked recovery of exports to Community countries and this would offset a possible slowdown in the pace at which exports to non-member countries were expanding. Domestic demand may expand a little faster than in 1965, especially where investment by enterprises is concerned, because of increased expenditure by foreign firms and the need to rationalize, and also because of the lively growth of investment in stocks. Public expenditure on investment may also show a distinct increase.

Private consumers' expenditure is also expected to expand a little faster thanks to a more dynamic trend in employment, to the upward movement of wages, which will be only slightly slower than hitherto, and to a probable slight decline in the savings ratio.

On the whole, it is estimated that the gross national product at constant prices will increase by some 3.5 % for 1966. A modest spurt in imports, which will be more marked as a trend than in the year-to-year figures, should not cause the current account surplus for 1966 as a whole to contract very appreciably.

According to the economic trends at present foreseeable, it seems hardly likely that the stabilization of prices, or in particular that of unit production costs, can be achieved in 1966, for the continuing high level of demand will not allow of a further easing of strains on the labour market. Total central government spending, furthermore, is tending to expand more rapidly and the budgetary deficit will become heavier despite appreciable increases in taxes, mainly indirect, and public service charges.

These increases may in their turn force costs up faster in view of the expected pick-up of overall demand and because of the sliding wage-scale machinery. In short, the upward movement of consumer prices is hardly likely to slow down very appreciably in 1966. This being so, the authorities are advised to continue and intensify their efforts to achieve stabilization, mainly by reducing the growth rate of public expenditure, which, in its turn, will reduce the public cash deficit.

1. Balance-sheet for 1965

With the growth of domestic demand slowing down distinctly, exports were the key to expansion throughout 1965. After slackening somewhat in the second quarter, they began to grow again at a much faster rate in the following months. In the third quarter visible exports, according to customs returns, were 16.7 % higher in value than a year previously. In 1965 as a whole visible exports (as defined for the national accounts) probably increased by 11 % in value and 13 % by volume, as against 16.6 % and 13 % in 1964. The dip in export prices, which affected the 1965 growth rates, reflects not only the severer conditions of competition that were gradually felt on the world markets in 1965 but also a fortuitous factor, the lower export price for steel.

A year-to-year comparison shows that visible exports to the other member countries rose faster than visible exports to countries outside the Community, although sales to the United States—particularly of iron and steel products—rose sharply. Within the Community, exports to Germany and the Netherlands were the growth leaders. Apart from seasonal variations, however, the expansion of exports to the United States and Germany slowed down in the second half of the year.

A breakdown by product reveals, in particular, a strong increase in exports of farm and food products, non-ferrous metals, transport equipment and chemical products, while exports of machinery and appliances and textiles increased more slowly.

On a year-to-year basis, it is probable that the growth of visible exports and, even more so, that of receipts from services and factor incomes, became slower. The increase in total exports (goods, services and factor incomes, as defined for the national accounts) for 1965 was probably 10.5 % in value and about 11.5 % by volume, against 16.4 % and 12.8 % in 1964.

The expansion of domestic demand slowed down. This slower growth affected mainly expenditure on gross fixed asset formation, which from 1964 to 1965 probably increased by only just over 3 % in value, while by volume a slight decline of some 1 % seems likely. In 1964 the corresponding growth rates were 13.6 and 7.6 %.

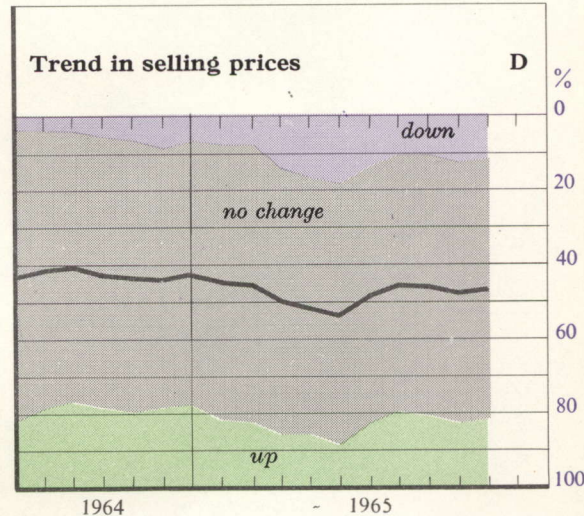
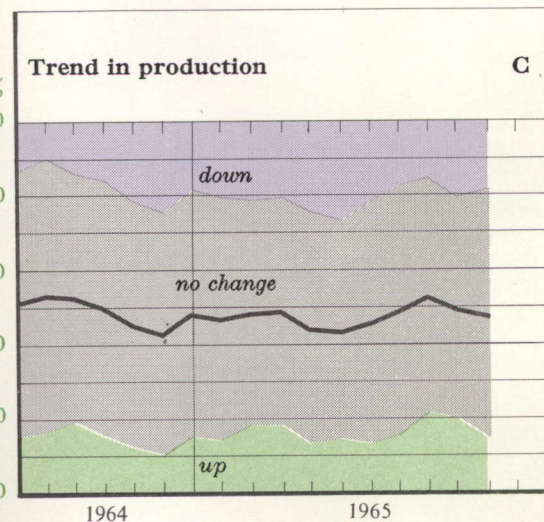
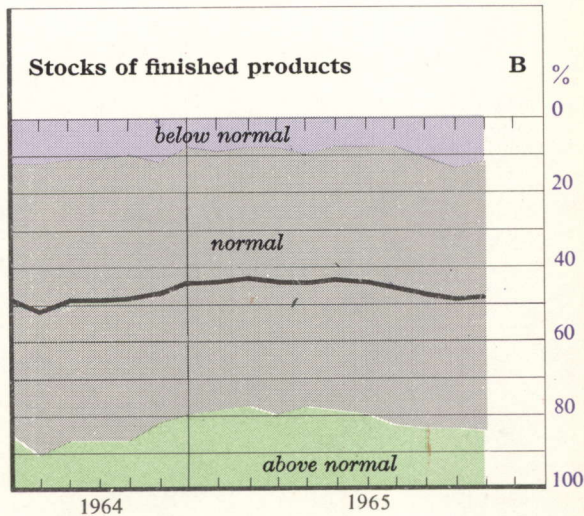
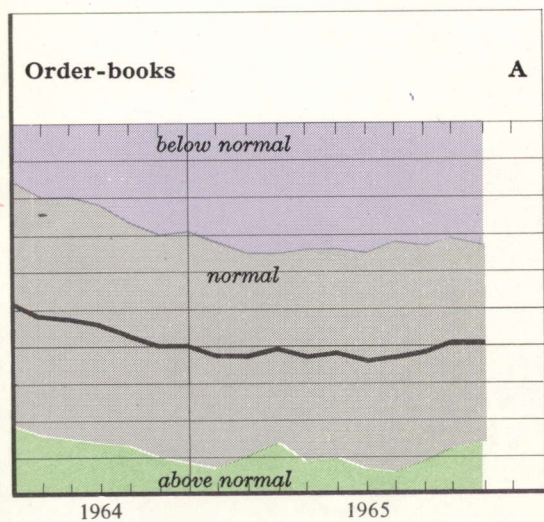
The fixed investment of enterprises, nevertheless, again increased slightly in 1965, though more sharply in value than by volume. It had tended to slow down during the first six months but picked up again slightly after the summer. This spurt seems to have been provoked mainly by big investment projects carried out by foreign firms and by the trend of investment, especially in construction, in the services sector. In the other branches of the enterprises sector the tendency for investment activity to level out persisted, owing in part to the restrictive credit policy applied until the summer, but above all to the increase in unit production costs, which could hardly be passed on in the shape of higher prices, least of all for exports. Consequently pressure on profit margins seems to have increased.

After exceptionally lively expansion in 1964, residential construction declined steadily throughout the year. For 1965 as a whole the increase in terms of value was probably very limited, while it is likely that the volume figures were actually some 2 % down. Policy on loans for residential construction, which was tightened up from time to time, the higher interest rates and the exceptionally rapid increase over the last few years in the price of land and the cost of building were the main factors in this trend.

Public expenditure on investment may have actually contracted by some 2 % in value and by 7 % in volume. This is probably due to the decision to limit public investment taken early in 1964 under the stabilization policy; the effects of this measure were felt only progressively during 1964 and in the first half of 1965, although in late 1964 and early 1965 steps had already been taken to increase such expenditure, which in fact seems to have picked up quite appreciably in the second half of 1965 and even more so in the final months of the year. Expenditure by the local authorities climbed steeply before the local government elections of 1964. Disbursements then declined for a time to a corresponding extent and showed little change in 1965.

To all intents and purposes 1965 saw no increase in stocks over 1964. The main factors here were probably the process of adjusting the level of stocks to the slower ex-

BUSINESSMEN'S VIEWS ON THE INDUSTRIAL SITUATION



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

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

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

pansion of demand and production, the restrictions on credit for financing stocks and the reduction in the prices of certain raw materials.

Unlike all other components of demand, public current expenditure on goods and services expanded particularly rapidly: for 1965 it may well have increased by 15 % in value as against 6.8 % for 1964. Because of the rise in the cost-of-living index, wages and salaries were raised by 2.5 % on two occasions, in January and August. There were also other substantial increases, mainly as a result of a general review of wages and salaries in the public sector.

The expansion of private consumers' expenditure slowed down until about the middle of 1965. The explanation is to be sought not so much in the growth of disposable household incomes, which it is true was a little slower, as in an increase in the savings ratio; this, in its turn, was due to a change in the economic climate.

The exceptional upsurge of earnings in 1964 seems to have lost a little momentum in 1965. Total wages and salaries paid in industry, however, were 11 % higher in the first half on 1965 than they were a year before; this advance was due mainly to the increase in hourly earnings, about half of which was the result of the action of the sliding wage-scale, while the level of employment scarcely changed and there was even a tendency for the number of persons employed in some branches of industry to decline for a time.

The expansion of private consumers' expenditure seems to have given signs of picking up after the summer holidays, especially when higher indirect taxes for 1966 were announced. On a year-to-year basis private consumers' expenditure probably went up by 6.5 % in value and 3 % by volume in 1965, as against 8.1 % and 4 % in 1964.

In view of the trend of overall demand outlined above, supply expanded at no more than a modest pace. This was certainly true of domestic supply, and particularly of industrial production, the curve for which, after flattening somewhat in the fourth quarter of 1964, remained fairly flat until the autumn of 1965. The INS index (1958 = 100) was even 0.5 % lower in the third quarter than in the same quarter of the year before, but in this connection the effects of the longer paid holidays must be borne in mind.

Among the branches of industry hardest hit by the slacker demand were textiles for a time, and iron and steel towards the end of the year. The structural difficulties in coal-mining, furthermore, were aggravated by the normal consequences of slacker business activity.

Generally speaking, it is unlikely that value added in industry increased for 1965 by more than 2.5 % in terms of volume, as compared with 6.0 % for 1964.

In building and construction, activity declined somewhat in the first six months of the year, the decline was probably due mainly to the slowdown in the execution of public works. Net contribution to GNP at constant prices may well have been down slightly in 1965 on the 1964 figure.

In agricultural production, the net contribution to GNP does not seem to have increased; rain in the spring and summer had a great deal to do with this.

In the services sector the slowdown in expansion was less appreciable and the growth rate was probably higher than that of the gross national product.

A general estimate based on currently available information is that in 1965 the gross national product increased by almost 3 % in volume and by 8 % in value against 5.2 % and 10.1 % in 1964.

The rather sluggish growth of production with productivity (i.e. value added per person in paid employment) improving at the same rate as hitherto helped to prolong, at least until early autumn, the modest trend towards easier conditions on the labour market, of which these were already signs in 1964. There was a slight tendency for the number of unemployed to increase, but only in certain trades and areas. As a whole, however, employment was at a level which may be considered as full employment. At the end of October the unemployment rate (the ratio of the total number of able-bodied fully unemployed to the number of employees registered for unemployment insurance) was only 0.8 %. Furthermore, the average number of registered fully unemployed increased only from 26 000 to 32 000 from 1964 to 1965. Lastly, according to the latest available figures, it seems that the decline in the number of unfilled vacancies which was discerned in late 1963 has now ceased.

The growth of imports, which had tended somewhat to slow down in the second half of 1964, gathered a little momentum again in 1965, without, however, reaching a particularly high rate. For all items (goods, services and factor incomes, as defined for the national accounts) the advance is estimated at 6.5 % in value for 1965 against 14.4 % for 1964. As import prices eased down slightly, the expansion by volume would be some 7.5 %, against 12.6 % for 1964.

Visible imports, according to customs returns, may well have expanded by 6 % in value for 1965. Imports of goods from the other member countries seem to have expanded more dynamically than those from non-member countries. This trend is due to the tendency for purchases of raw materials and semi-manufactures to level off while imports of finished products continued to increase. The growth of visible imports from

other member countries may be estimated at 7 % and from non-member countries at 4 % (value).

The gradual improvement of the relationship between overall monetary demand and supply has not yet been reflected in the trend of prices. For one thing, the persistent rise in unit production costs was an important inflationary factor; secondly, certain special factors, such as the repercussions of the bad weather on a number of farm products, contributed to the higher cost of living. Retail prices rose almost as rapidly as in 1964; in the third quarter and in October-November they were 3.8 % up on prices in the corresponding period of 1964. For 1965 as a whole the average increase in consumer prices is estimated at 4 %. Wholesale prices, on the other hand, according to the official index, did not go up more than 1 %, against 4.6 % for 1964. From the first quarter of 1965 onwards they even fell slightly, mainly because of the drop in the prices of raw materials, while the prices of semi-manufactures remained stable and those of finished products continued to rise.

While the trend of prices was far from satisfactory, external equilibrium was none the less re-established. The trade balance, (national accounts definitions) probably yielded a surplus of Bfrs. 10 000 millions in 1965, against a deficit of Bfrs. 2 000 million in 1964. Although the surplus on the balance of payments will probably be small, the current account, which balanced out in 1964, will have yielded a considerable surplus for 1965. The capital transactions of the public authorities probably showed a deficit, while net capital receipts in the private sector may well have been less than in 1964. Consequently, the surplus on the overall balance of payments may be slightly less than in 1964, when it was Bfrs. 10 400 million.

The net gold and foreign currency reserves of the banks and non-money-creating institutions increased by Bfrs. 4 700 million in the first nine months of 1965. While, apart from their net position vis-à-vis the IMF (which improved by Bfrs. 5 400 million), the Central Bank's net balance showed scarcely any change, the commercial banks' net currency position deteriorated by Bfrs. 1 900 million. The foreign currency holdings of non-money-creating institutions improved by Bfrs. 1 300 million.

Because of the contribution made by transactions with abroad, domestic liquidity increased much more sharply in the first nine months of 1965 than in the corresponding period of 1964. Financing of public expenditure by recourse to the money market was, at least until September, appreciably less than in 1964 : despite the heavier deficit, the Treasury kept its calls on money and credit institutions within bounds. Again, mainly as a consequence of the quantitative restrictive measures applied until July, short-term loans by the commercial banks to enterprises and individuals increased less than in 1964. From the end of 1964 to the end of September 1965 such loans increased by only 7.2 %, as

against 8.7 % in the first nine months of 1964. From October onwards, however, there were signs that the expansion of credit was beginning to gather momentum once again.

National product and expenditure

	1963 ⁽²⁾	1964 ⁽²⁾	1965 ⁽³⁾	1966 ⁽⁴⁾
	At current prices (in Bfrs. '000 million)	% change by volume on preceding year		
Gross national product	697.9	+ 5.2	+ 3.0	+ 3.5
Imports ⁽¹⁾	259.3	+ 12.6	+ 7.5	+ 9.5
Private consumption	474.2	+ 4.0	+ 3.0	+ 3.0
Public current expenditure	91.2	+ 2.9	+ 2.5	+ 2.0
Gross fixed asset formation	135.6	+ 7.6	— 1.0	+ 2.0
Exports ⁽¹⁾	254.9	+ 12.8	+ 11.5	+ 9.5

⁽¹⁾ Goods, services and factor income.

⁽²⁾ General Statistical Bulletin 1965, No. 7-8, Statistical Office of the European Communities.

⁽³⁾ Commission estimates.

⁽⁴⁾ Commission forecasts.

Note :

a) The difference between the figures for supply and the figures for utilization is accounted for by changes in stocks.

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

Despite this trend of credit and despite an appreciable increase in deposits, interest rates on the money markets failed to decline to any appreciable extent. In fact, in the course of the year, there were fairly clear signs from time to time that the situation was becoming more difficult; this may have been partly due to the effects of the official drive in the United States to restore the balance-of-payments situation.

There was a sharp increase in calls made by the public sector on the capital market, and new issues amounted to Bfrs. 29 700 million from January to August 1965, against

Bfrs. 25 600 million in the corresponding period of 1964. Private issues of both bonds and shares, on the other hand, decreased distinctly. Interest rates on the capital market in 1965 did not differ considerably from those obtaining at the end of 1964.

2. Outlook for 1966

Economic growth can be expected to gather a little momentum again in 1966. This forecast is, however, based on the assumption that domestic demand will expand slightly more rapidly, a development which should be mainly the outcome of a rather more lively advance in investment expenditure.

In view of the outlook for economic development in the main customer countries and of the relative variations in prices and costs, foreign demand should not expand more rapidly in 1966 than in 1965. Visible imports will make their greatest gains in trade with the other member countries, for it is expected that the tendency for sales to Italy and France to gather momentum will become more marked. Exports to the Netherlands, furthermore, may well make more appreciable progress than in 1965. Even though a slowdown in the growth of sales to the Federal Republic of Germany is probable, this should not unduly curtail the progress of total sales to the Community.

It seems likely, too, that the trend of sales to non-member countries will be less dynamic in 1966. Despite the tendency for economic expansion to persist in the United States, exports to that country will certainly not increase as much as in 1965, now that the exceptional circumstances affecting the American iron and steel industry until the autumn of 1965 no longer obtain. Deliveries to the other industrial countries, on the other hand, and those to developing countries may advance less briskly than in 1965.

Given a growth rate of invisible exports and of factor incomes corresponding to that for 1965, total exports (as defined for the national accounts) will probably increase by some 10 % in value and about 9.5 % by volume. The slight increase in prices implied in these estimates is based on the assumption that the price index for services and factor incomes will rise slightly and that after falling in 1965 visible export prices will remain stable.

The latest developments in the Belgian business situation already point to the possibility of a modest spurt in the expansion of domestic demand due to a revival in the growth of investment spending.

Expenditure on gross fixed asset formation should increase a little more sharply in 1966. This applies in particular to the fixed investment of enterprises, where firmer

growth is expected, especially in the manufacturing industries. The continuing implementation of a number of large industrial schemes by foreign enterprises should make a further vigorous contribution. In the other industries the sharp increase in costs over the last few years has made rationalization a matter of increasing urgency and the relaxation of the policy of restraint means that there is now greater scope for such rationalization projects. Lastly, orders placed by enterprises with the building industry increased appreciably in 1965; this reflects not only the more lively expansion of industrial investment in construction, but should also lead to more investment in plant and machinery.

Public expenditure on investment, furthermore, should forge ahead in 1966. While the increase in investment by the local authorities will certainly be less pronounced than that in investment by the central government, it is nevertheless expected that public investment as a whole will increase for 1966 by more than 10 % in value and some 5 % by volume.

On the other hand, no significant change is expected in residential construction in 1966. As the principle of moderation in granting loans will have been maintained until the end of 1965 at least, and as the volume of work in progress diminished sharply in 1965, an appreciable expansion of expenditure—as an average for the year—in this sector is hardly to be expected in 1966. The proposed tax increases, furthermore, seem likely to aggravate the problem of rising construction costs. Nevertheless, a slight increase of some 2 % in value in expenditure on residential construction for 1966 may be predicted. After stocks had remained unchanged in 1965, investment should increase quite appreciably in 1966, since it is probable that world prices of raw materials and semi-finished products will mark time and stock levels cannot be allowed to lag too far behind expanding production.

Public expenditure on goods and services will probably increase only a little more slowly than for 1965. It must be remembered that a number of expenditure items authorized in late 1965 under the budget for that year will partly affect 1966, and must therefore be added to commitments already authorized under the 1966 budget. It is also safe to assume that the continued rise in prices in 1966 will set in motion the machinery of the sliding scale, which would influence both the trend of pay in the public sector and the purchase price of goods. Consequently, the growth in 1966 of public expenditure on goods and services will probably be over 10 %. The expansion in volume may be less sharp than in the preceding year because of efforts to limit increases in personnel.

Private consumers' expenditure will probably show a more distinct tendency to expand in 1966. In the first few months of 1966, however, purchases are likely to decline to offset the wave of buying provoked in the autumn of 1965 by the announcement of higher indirect taxes from 1 January 1966 onwards; it is not possible at present, however, to assess the scale of this buying.

The disposable income of households and in particular, the total wage and salary bill, should expand to much the same extent as in 1965 : as a result of the expected revival in economic activity (growth in the total number of hours worked), it looks as if the total wage and salary bill, despite a probable slight slow-down in the growth of wage rates, will increase only a little more slowly than it did for 1965. The growth of transfer incomes, however, is expected to recover vigorously. Furthermore it seems probable that the propensity to save of households, which had increased in 1965, will fall back again in 1966 : in the first place, the economic climate will be more favourable, and secondly, the further and relatively sharp increase in prices will certainly not encourage saving.

Generally speaking, private consumers' expenditure should increase by nearly 8 % in 1966; because of the higher prices, the expansion in volume will certainly be distinctly less.

The prospects outlined above indicate that the expansion of supply should accelerate somewhat. In particular, industrial production, which, for 1966, probably increased by from 3 to 3.5 % (real contribution to GNP, national accounts definitions) should grow faster. In building and construction growth should be in the region of 1-2 % and services should expand at least at the same rate as for 1965. Given the possibility of a modest increase in agricultural production, the increase in the gross national product at constant prices should be some 3.5 %.

Mainly because of the expected build-up of stocks of raw materials and semi-finished products, the propensity to import of Belgian industry and commerce should increase slightly in 1966. The year-to-year growth rate of total imports of goods and services (as defined for the national accounts, i.e. including factor incomes transferred to abroad) is estimated at 9.5 % by volume and 10 % in value for 1966. In view of the prospects for total exports, the surplus on current account for 1966 should remain much as it was for 1965; during the course of 1966, however, it is expected that the surplus will tend to contract.

On the labour market no further relaxation is expected, but strain should not increase to any appreciable extent either: the expansion of production will probably depend on improvements in productivity, which will probably be greater than at the time when growth was losing momentum. The longer paid holidays, furthermore, which depressed the figures for 1965 compared with 1964, will no longer represent a factor restricting *per capita* productivity. However, the agreed working week is to be shortened in a number of important industries.

The strains on the labour market remain sufficient nevertheless to provide support for the persistent upward movement of unit costs, the basic trend of which will probably be slower than in 1965, but which is strengthening itself by the effects of a vicious circle

formed by costs, prices and the sliding wage-scale, with its repercussions on costs. Another factor affecting prices is the planned increase in indirect taxes, the effects of which, though they will not be reflected fully in prices at once could, because of the sliding-scale, assume some importance. If the higher prices in certain public services are also taken into account, it appears scarcely likely that the increase in consumer prices will be less in 1966 than in 1965.

In short, the objective of stable prices and costs, which the Belgian authorities responsible for economic policy set themselves for 1964 and 1965—in line with efforts made in all the member countries and with the Council's recommendations of April 1964 and 1965—is still far from being achieved. The main reason for this situation is that while monetary and credit policy was fashioned with a view to stabilization, budget policy was not properly adjusted to meet the requirements of the short-term economic policy; contrary to the EEC Council's recommendations, it was too expansive. Government spending itself must have increased by 12 % from 1964 to 1965; as a result actual disbursements went well beyond the budget estimates for 1965.

It seems doubtful whether official budgetary policy will, in 1966 at least, play the role which the objective of stabilization requires of it. Including commitments carried over from previous years, the Commission forecasts for 1966 that the central government's effective expenditure will be distinctly higher than in 1965, even if there is no further budgetary overspending of any importance. In 1965 the growth of ordinary receipts had already lagged behind that of expenditure. Taxes, in particular indirect taxes, are therefore to be raised, and this should bring in a further Bfrs. 13 700 million a year. Even if these additional revenues are deducted from the foreseeable increase in total central government expenditure, the increase will still be much more even than the growth of GNP in monetary terms.

A still more important point is that even the additional receipts—the rate of the turnover tax is to be increased from 6 to 7 %—will not suffice to balance the ordinary budget for 1966. Consequently the Treasury's cash deficit to be financed will probably be appreciably higher in 1966 than in 1965. At the same time the demand for capital will increase as the expansion of the other elements of domestic demand, in particular investment by enterprises, gathers momentum. In these circumstances, heavy official recourse to the capital market is liable to drain off funds that would otherwise be available for the private sector. This could mean a partial financing of the deficit by recourse to the money market or to heavier imports of capital—both devices which would be entirely in conflict with the requirements of stabilization.

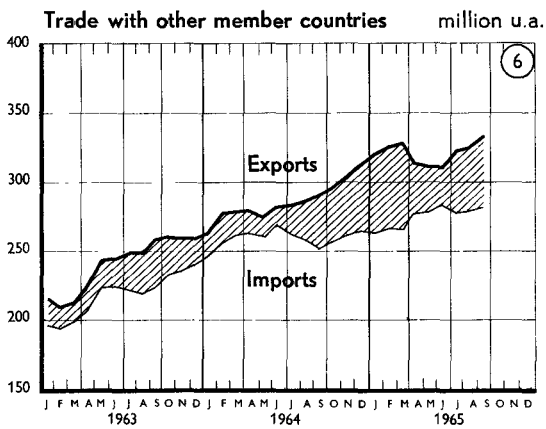
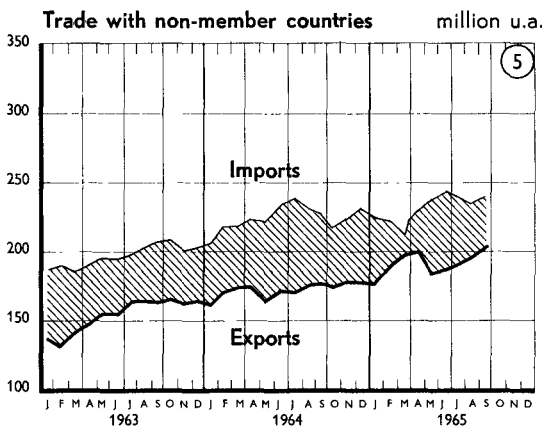
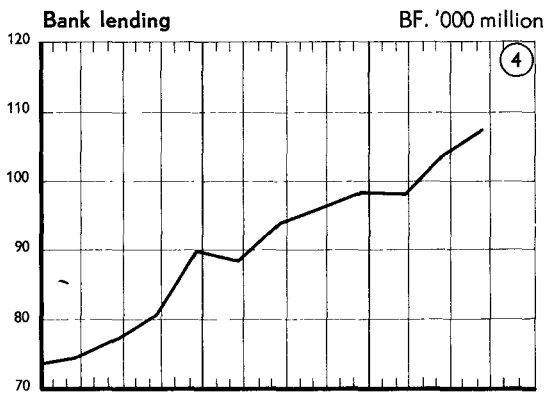
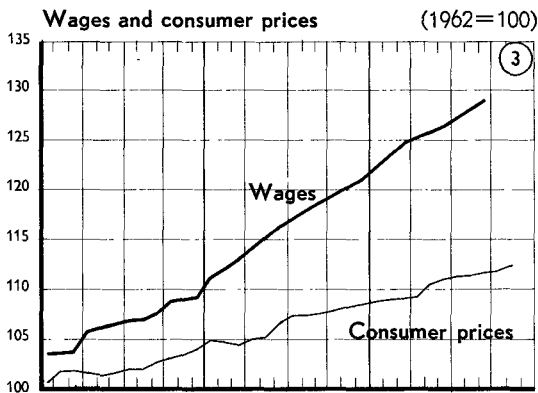
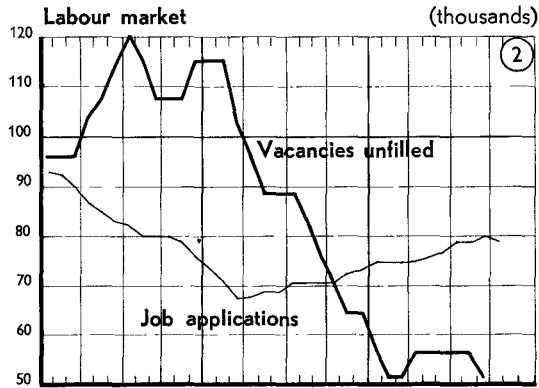
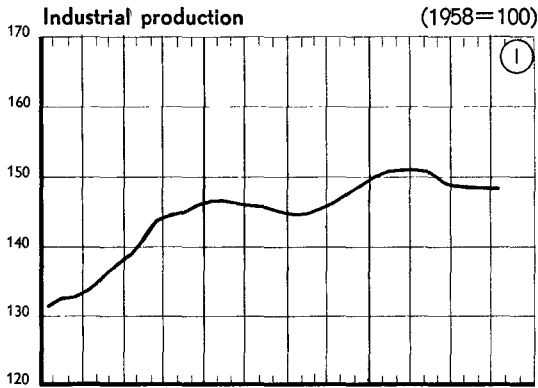
It must therefore be recommended that the growth of cash expenditure by the public authorities—central and local, and the semi-public corporations—be limited more strictly than it appears it will be according to the preliminary budget estimates published.

Another relevant point here is that monetary and credit policy must, as far as possible, continue to be one of restraint, especially as liquidity has already reached a very high level. This does not mean that productive investment by enterprises should be curtailed. The present selective credit policy seems to be fully justified. Given probable future retail price trends, the relaxation of restrictions on consumer credit might create various problems.

The campaign against the persistent rise in prices and costs should also, however, be pursued in a more direct manner, firstly by measures to encourage competition, and secondly by measures to increase the supply of manpower and promote vocational training, and lastly, by greater selectivity of state intervention under the 1959 law on the revival of the economy.

While in the present circumstances it is difficult to apply the necessary moderating criteria in the framework of the incomes policy, the authorities should nevertheless further intensify their efforts along these lines.

ECONOMIC INDICATORS



NOTES:

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

Graph 1. The trend curves represent estimates which have been established on the basis of indices (excluding construction, food, beverages and tobacco) adjusted by the SOEC for seasonal and fortuitous variations.

Graph 2. Adjusted for seasonal variations. Three-months moving average. 1962 = 100.

Graph 3. General index of retail prices. Source: Ministère des Affaires Economiques. Agreed wages for operatives, all branches; source: Ministère du Travail et de l'Emploi.

Graph 4. Short-term loans made by monetary institutions.

Graphs 5 and 6. Series adjusted for seasonal and accidental variations (moving averages of 3 months). Exports fob, imports cif. Conversion at official exchange rates.

Belgium

TABLE 1: Basic data (1964)

Total area ('000 sq. km.)	30.5
Total population ('000)	9 378
Density of population per sq. km.	307
Working population ('000)	3 726
Working population, breakdown by main sector (%)	
— Agriculture	6
— Industry	45
of which : Construction	8
— Services	49
Percentage share of gross domestic product :	
— Agriculture	7
— Industry	42
of which : Construction	8
— Services	51
Gross product per capita (Bfrs.)	81 900

**TABLE 2: Some elements of national product and expenditure
(annual rates of growth)**

	% change by volume on preceding year						Volume indices (1958 = 100)	Contri- bution (in %) to 1964 GNP
	1959	1960	1961	1962	1963	1964		
Gross national product	+ 3.0	+ 4.9	+ 4.6	+ 5.3	+ 5.0	+ 4.8	131	—
Industrial production	+ 4.0	+ 8.7	+ 4.4	+ 7.6	+ 6.3	+ 6.7	144	—
Total imports	+12.0	+12.5	+ 7.1	+ 8.1	+ 8.9	+12.6	179	39
Private consumers' expenditure	+ 2.0	+ 5.9	+ 1.9	+ 4.5	+ 6.1	+ 4.1	127	67
Public current expenditure on goods and services	+ 5.0	+ 5.7	+ 1.8	+ 8.8	+12.2	+ 2.9	142	13
Gross fixed asset formation	+ 9.0	+11.9	+11.5	+ 2.9	+ 1.4	+ 7.7	153	20
Total exports	+ 7.0	+ 9.3	+ 8.5	+ 9.4	+ 7.1	+12.8	168	39
Gross national product per capita	+ 2.0	+ 4.9	+ 4.7	+ 4.5	+ 3.4	+ 4.1	126	—
Gross national product per person gainfully employed	+ 3.0	+ 5.8	+ 3.7	+ 2.7	+ 4.3	+ 4.1	126	—

TABLE 3: Foreign trade (at current prices)

	% change on preceding year						Indices (1958 = 100)	Million u.a.	% of the total
	1959	1960	1961	1962	1963	1964			
Visible exports									
Total	+ 8.0	+14.8	+ 4.0	+10.0	+12.0	+15.1	133	5 580	100
Intra-EEC	+11.0	+24.3	+10.1	+17.8	+19.6	+18.7	254	3 494	62.6
To non-EEC countries	+ 8.0	- 4.7	- 1.8	+ 1.8	+ 1.8	+10.6	125	2 086	37.4
Exports of food, beverages and tobacco									
Total	0	+ 7.0	+15.0	+30.0	+29.4	+ 3.4	214	327	5.9
Intra-EEC	+15.0	+11.3	+18.8	+31.6	+30.5	+ 5.4	275	241	4.3
To non-EEC countries	-19.0	- 3.7	+ 7.7	+26.2	+26.4	- 1.5	132	86	1.6
Exports of raw materials and manufactures									
Total	+ 8.0	+15.7	+ 3.2	+ 9.3	+10.6	+16.0	181	5 253	94.1
Intra-EEC	+10.0	+26.4	+ 9.4	+16.4	+18.6	+20.0	252	3 253	58.2
To non-EEC countries	+ 7.0	+ 5.6	- 2.7	+ 1.8	0	+10.7	124	2 000	35.9
Visible imports									
Total	+10.0	+14.5	+ 7.1	+ 7.4	+12.4	+15.3	188	5 901	100
Intra-EEC	+11.0	+17.1	+12.3	+ 8.9	+15.7	+16.8	215	3 146	53.3
From non-EEC countries	+ 9.0	+12.8	+ 1.6	-6.4	+ 9.0	-13.8	165	2 755	46.7
Imports of food, beverages and tobacco									
Total	+ 7.0	+ 0.9	+ 0.9	+10.1	+ 9.2	+16.8	153	716	12.2
Intra-EEC	+13.0	+ 4.4	+ 7.6	+ 3.1	+16.8	+16.3	178	277	4.7
From non-EEC countries	+ 3.0	+ 1.0	- 4.8	+16.2	+ 4.3	+17.5	141	439	7.4
Imports of raw materials and manufactures									
Total	+10.0	+17.3	+ 7.8	+ 7.9	+12.7	+14.8	194	5 185	87.9
Intra-EEC	+11.0	+18.0	+13.0	+ 9.5	+15.4	+17.6	220	2 869	48.6
From non-EEC countries	+10.0	+16.4	+ 1.6	+ 5.4	+10.2	+12.6	170	2 315	39.2

TABLE 4: Basic monthly indicators

	Year	Jan.	Feb.	Mar.	Apr.	May	June	July	Aug.	Sept.	Oct.	Nov.	Dec.
Industrial production (1958 = 100)	1964	141	138	144	151	137	148	128	136	152	162	149	150
	1965	140	141	157	151	144	150	119	138	157	158		
Investment (1961 = 100)	1964	116.3	134.1	138.9	147.9	153.0	152.3	126.2	134.1	147.3	144.8	152.9	149.7
	1965	119.1	125.6	140.7	161.9	159.9	163.2						
Building (1962 = 100)	1964	92.8	108.2	109.5	124.5	112.6	126.0	99.0	111.0	125.2	125.9	116.2	103.9
	1965	86.3	82.1	107.0	117.5	111.4	121.4	79.9	116.7				
Private consumers' expenditure (1961 = 100)	1964	115.8	116.3	119.1	122.4	120.7	124.8	125.0	122.1	122.6	124.9	120.4	128.4
	1965	123.3	125.2	128.6	134.0	131.4	136.4	135.5					
Total visible imports (million u.a.)	1964	492	475	481	515	479	513	486	419	480	503	486	529
	1965	451	474	539	552	506	514	506	452	541	554		
Total visible exports (million u.a.)	1964	451	449	468	490	426	484	453	377	477	522	485	500
	1965	501	520	571	507	478	548	509	428	580	546		
Balance of trade (million u.a.)	1964	- 41	- 26	- 13	- 23	- 53	- 23	- 33	- 42	- 3	- 19	- 1	- 29
	1965	+ 50	+ 46	+ 32	- 45	- 28	+ 34	+ 3	- 24	+ 38	- 8		
Official gold and foreign exchanges reserves (million u.a.)	1964	1 796	1 794	1 795	1 789	1 812	1 788	1 796	1 816	1 834	1 870	1 954	1 992
	1965	2 000	2 006	2 002	2 026	2 010	2 000	2 010	2 028	2 018	2 010		
Money supply	1964	271.2	270.1	274.3	276.1	282.0	287.1	282.7	282.2	285.1	286.4	285.2	298.7
	1965	291.1	292.3	294.1	299.7	304.2	311.8	307.2	304.3	307.4			

Belgium

NOTES

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

Table 1

- Total population at mid-year.
- Working population in employment, average for year.
- Breakdown of gross domestic product by factor cost.
- GNP at market prices.

Table 2

- GNP at market prices.
- Industrial production : value added by industry.
- Total exports and imports : goods, services and factor income.

Table 3

- Exports fob, imports cif. Conversion at official exchange rates. The products have been regrouped on the basis of the Statistical and Tariff Classification for International Trade (CST) : food, beverages and tobacco (groups 0 and 1 CST), raw materials and manufactures (groups 2-9 CST).

Table 4

- Industrial production. Source : Institut National de Statistique (INS). General index.
- Investment. Source : Département de l'économie appliquée de l'Université libre de Bruxelles (DULBEA).
- Construction. Source : INS. Index based on number of man-hours worked.
- Private consumption. Source : DULBEA. Current prices.
- Exports fob, imports cif. Conversion at official exchange rates.
- Official gold and foreign exchange reserves. Gross reserves of gold and convertible currency of the official monetary institutions.
- Money supply. Notes and coin circulation, excluding cash holdings of the Treasury, the Central Bank and other banking institutions other than the Postal Cheque Office. Residents' sight deposits (up to one month) with banking institutions. Holdings of the special agencies of the Treasury and non-residents' holdings on postal cheque accounts.

Grand Duchy of Luxembourg

In 1965 the expansion of foreign demand for iron and steel weakened perceptibly and domestic demand also faltered, with the result that economic expansion lost much of its momentum.

It is estimated that the total volume of goods and services exported (as defined for the national accounts) rose by only 4 % for 1965. Since export prices of iron and steel fell, the growth of exports in terms of value was even less rapid than in terms of volume.

Owing to a heavy decline in business investment, gross fixed asset formation declined appreciably.

Public current expenditure on goods and services was probably stepped up even more rapidly than in 1964. On the other hand, the growth in the disposable income of households was—partly because of the weaker development of the other demand components—slower than in 1964, and the increase in private consumer's expenditure was therefore relatively small.

As a result of this trend, domestic production grew very moderately in 1965, and the average growth of industrial production will not be more than about 1 %. Including the more dynamic development of agricultural production and particularly the increase in the contribution made by the services sector, a first very tentative estimate is that the real gross national product grew by 1.5 % in 1965, compared with a growth rate of 6.5 % for 1964.

The slackening in the expansion of imported goods and services was approximately the same as in that of domestic supply; its growth rate in terms of volume was probably about 2 %. Import prices went on rising and this probably contributed to the swing in the terms of trade against Luxembourg.

Mainly because of higher import prices and the withdrawal of farm subsidies, the price level rose further. The recent upward movement in costs, due to continuing strain on the labour markets, also helped to force prices up. The cost-of-living index rose at about the same rate as in 1964; in October-November it was 3.4 % higher than a year earlier.

As in the past, the outlook for economic development in 1966 is largely dependent on the prospects for steel exports, which this year are not particularly favourable.

None the less, if the growing quantities exported by the new industries are taken into account, the growth of total exports should be greater than in 1965.

Public investment expenditure, particularly central government expenditure, will again make a contribution to economic activity. The outlook for consumer demand is still one of expansion, although it is hardly likely that the pace will increase.

A tentative working hypothesis is that for 1966 the growth in real gross national product will be 2.5 %.

The main economic policy problem in 1966 will, however, have less to do with growth than with the upward movement of costs and prices, the underlying trend of which is still rising too fast. It seems that the government budget will at any rate do nothing to counter this trend; in addition, in view of the situation on the capital market, a heavier deficit may run into financing difficulties. It is therefore important that measures should be taken to improve the prospects of the public finances.

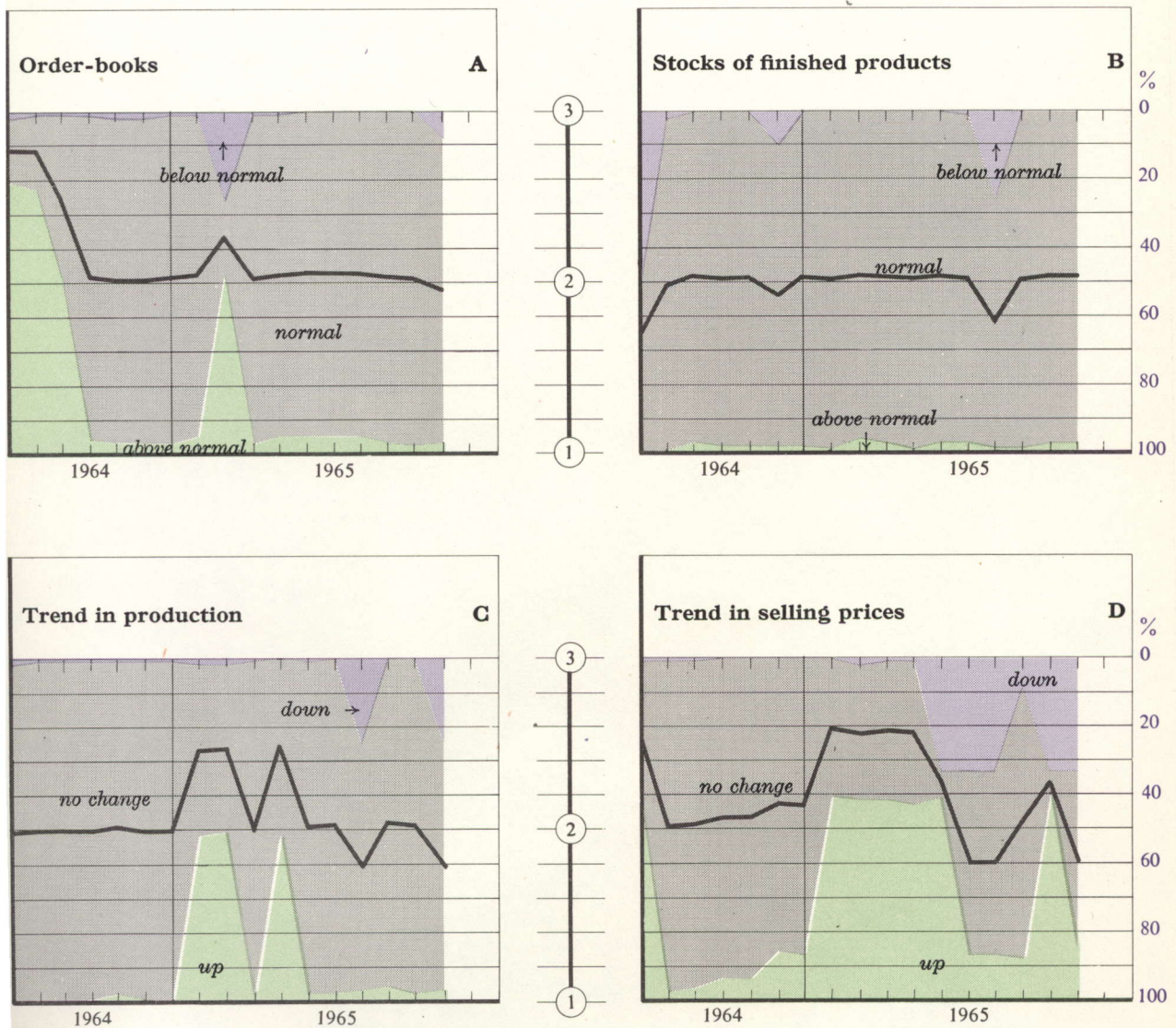
1. Balance-sheet for 1965

The expansion of foreign demand, as reflected in actual exports, was substantially smaller in 1965 than in 1964. For one thing, international demand for iron and steel—which reached the peak of its recovery in the spring of 1964—has been slipping back appreciably since the first quarter of 1965; the consequent downward trend of orders meant that exports of iron and steel failed to reach the total of the previous year. In addition, the quantity of goods exported by a number of new industries that began production in or after the spring was not enough to swell the external trade figures to any appreciable extent.

The growth of overall exports of goods and services (as defined for the national accounts) may none the less have been, in terms of volume, around 4 %, against the corresponding 1964 figure of 13-14 %. In view of the fact that average export prices were probably lower than in the previous year, it is likely that growth in terms of value was smaller than in terms of volume.

After an upswing in 1963, gross fixed asset formation made only a weak contribution to economic activity in 1964, and in 1965 its lack of buoyancy even served as a brake

BUSINESSMEN'S VIEWS ON THE INDUSTRIAL SITUATION



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

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

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

on activity. The decline of fixed investment—by about 13 % in 1965—was mainly accounted for by a decline in purchases of plant and equipment by industry: most of the investment programmes of new firms and of public utility enterprises had run out in the course of 1964. At the same time investment in the iron and steel industry was cut back: in order to reverse the shrinkage in profit margins, which were endangered by the different trends followed by costs and prices on world markets, managements concentrated their efforts on further rationalization and the modernization of existing equipment.

It is estimated that expenditure on residential construction grew moderately in 1965. Although the upward movement of prices has slowed down in this sector, it is by no means impossible that in terms of volume investment under this heading will be practically the same as in 1964. In this connection, it should be noted that in early spring the State Savings Bank tightened up on loans for residential construction.

Total outlay on public investment may prove to have been lower than in the previous year, since an increase in investment by local authorities failed to offset a fairly substantial decline of direct investment by the central government.

Private consumers' expenditure had increased more steeply in 1964, but this trend gave way to a rather slower upward movement in 1965, when the disposable incomes of households probably expanded less vigorously than in the previous year. The growth of the total wage and salary bill in the public sector was less rapid, and this means that conditions were returning to normal after the sharp rises conceded since the end of 1963. The same applies to transfer incomes, which had swelled rapidly in 1964 because of the improved old age pensions. In the private sector, the rise in the total number of hours worked was almost certainly less steep than in the previous year, while the upward movement of wages for unskilled workers was limited by the improved supply of labour (especially from abroad). On the other hand, the new collective agreements (notably in building and in iron and steel) and the rates paid in the new industries show that the marked upward trend of wages for skilled workers has persisted, and the sliding wage scale, brought into operation twice in 1964 by rising prices, was invoked again in July and December.

The trend in the disposable incomes of households suggests that private consumption in 1965 grew by nearly 7 % in terms of value and by 3 % in terms of volume, compared with figures of 9.5 % and 5.5 % for 1964.

Contrary to expectations, the increased numbers employed in the public sector probably offset the effect which reductions in the working week had on public current expenditure in terms of volume. In terms of value, it could well be that the growth of this demand component was actually higher than it had been in 1964 (6 %).

Strains on the labour market were not dispelled, and while it became a little less difficult, notably in the building industry, to recruit unskilled manpower, labour shortages in other industries probably grew more severe. At all events the number of unfilled vacancies, which (seasonally adjusted) had steadily declined from the summer of 1963 to the end of 1964, rose again from the beginning of 1965 onwards. This trend is almost certainly connected with the demand for manpower by the new industries: incomplete statistics indicate that while for the first ten months of the year the year-to-year growth in the number of persons in paid employment was 3.5 % (for foreign workers only, about 16.5 %) the figure for industries other than mining and iron and steel was over the same period almost 7 %.

Domestic supply grew very moderately in 1965. According to the national index, industrial production for the first ten months of 1965 was 0.8 % higher than in the same period of 1964. The growth in output of the iron and steel industry was of the same magnitude. In the period from July to October, industrial production was even 2 % lower than in the corresponding period of 1964; but the index would seem to exaggerate the degree of decline, since the new industries—in which production is now slowly getting under way—are not yet included.

In construction, the growth of output was probably also fairly small. On the other hand the volume of agricultural production showed an appreciable improvement.

When a further expansion of the contribution to GNP made by services is taken into account, the growth of real gross national product in 1965 will have been some 1.5 %, compared with 6.5 % for 1964.

With domestic final demand growing relatively slowly, the main factor affecting imports was the quantity of raw materials and semi-manufactures purchased by the new industries starting up in 1965. In view of the way other components of the import account have developed, overall imports of goods and services (as defined for the national accounts), probably rose in 1965 no more than about 2 %, compared with 9.5 % in the previous year. In contrast with export prices, average import prices seem to have continued rising, and if this was so the terms of trade must have swung against the Grand Duchy.

Prices again moved up. The trend reflects not only the hardening in prices of imported goods, but also the wage trend, which—particularly in the services sector—rose faster than productivity. In addition, certain autonomous factors were of great importance: the progressive withdrawal of farm subsidies, in particular, contributed to the upward movement of consumer prices.

In the course of 1965 the cost-of-living index rose on average at much the same pace as in 1964; in the third quarter it was 3.3 % and in October-November 3.4 % higher than a year earlier.

Because of the heavy demand for funds stemming in particular from the private sector, including a number of new foreign firms, the money and capital markets came under sharply increasing pressure in 1965. Interest rates rose appreciably. The State Savings Bank therefore introduced certain measures in the spring to raise rates of interest on deposits and advances. The situation of the capital market is also reflected in the somewhat cool reception that was accorded a government loan of Lfrs. 300 million in April 1965 : at 4.5 % the effective rate of interest offered was too low in view of the changes which had supervened on the capital market.

National product and expenditure

	1963 ⁽²⁾	1964 ⁽³⁾	1963 ⁽³⁾	1966 ⁽⁴⁾
	At current prices (in Lfrs '000 million)	% change by volume on preceding year		
Gross national product	27 496	+ 6.5	+ 1.5	+ 2.5
Imports ⁽¹⁾	23 413	+ 9.5	+ 2	+ 3
Private consumption	16 641	+ 5.5	+ 3	+ 3
Public current expenditure	3 484	+ 2.5	+ 0.5	+ 3
Gross fixed asset formation	8 826	0	— 14	— 6.5
Exports ⁽¹⁾	21 858	+ 13	+ 4	+ 5.5

⁽¹⁾ Goods, services and factor income.

⁽²⁾ General Statistical Bulletin, No. 11, Statistical Office of the European Communities.

⁽³⁾ Commission estimates based on calculations made by STATEC in connection with the economic budget.

⁽⁴⁾ Commission forecasts.

Note :

a) The difference between the figures for supply and the figures for utilization is accounted for by changes in stocks.

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

2. Outlook for 1966

The outlook for the economic development of Luxembourg in 1966 points to a moderate increase in the pace of expansion.

Any further growth of exports will depend on the situation on world steel markets. Even if 1966 should see a gradual recovery from the weakness of world demand, which became steadily more obvious in 1965, it is unlikely that there would be any substantial growth in the volume of iron and steel products delivered. Economic expansion in the Community should be more vigorous, but the production prospects of Community iron and steel users do not on the whole offer any hope of an expansion in sales of Luxembourg iron and steel products, and the abnormally high stocks of steel accumulated by users in certain member countries in the autumn of 1965 have certainly not yet returned to normal. As for the probable expansion of sales of iron and steel products to non-member countries, the growth rate to be expected is unlikely to exceed the average long-term advance.

Luxembourg industry, however, now has a wider range of products to offer abroad, and as exports of services are likely to make further gains, the growth in overall exports of goods and services (volume) for 1966 should none the less be about 5.5 %.

The factors mentioned when the development of business investment in 1965 was discussed should entail a further—though slower—decline in gross fixed asset formation. The weakening of expenditure on plant and equipment in 1966 might well prove a little less pronounced than in 1965. Given the continuing tightness of the labour market and the difficulties besetting small- and medium-sized industrial enterprises, it is not impossible that the authorities, in order to obtain a bigger improvement in productivity and competitiveness in traditional Luxembourg industries, will do more to encourage these industries to press ahead with their rationalization and modernization schemes. But in macro-economic terms, these measures are unlikely to have any great effect as early as 1966.

Gross fixed asset formation in housing is not expected to show much advance on the 1965 figure, but various factors, including the higher provision being made in the national budget for the relevant items, suggest that in 1966 there will be a revival of public fixed investment.

The development of exports and investment is unlikely to make any contribution that would promote an advance in private consumers' expenditure significantly more rapid than that recorded in 1965. There will be a further growth in the total number of hours worked, and mass private incomes will therefore grow once again. In addition, most industries must expect further wage adjustments, one reason being that the wages

they pay are tied by indexation clauses to the cost of living. In general, wages per person gainfully employed will probably grow by much the same margin as in 1965, although bonuses in the iron and steel industry, which were up in 1965, are likely to be smaller. Wages and salaries in the public sector could rise a little more than in 1965.

Although the labour market will still be tight, the expansion of domestic production could pick up a little. Expansion in the output of the new industries will be an important component in an estimated increase of 2.5 to 3 % in the contribution which industry will make to real GNP. If the probable development of activity in the other sectors of the economy is also taken into account, it can now be estimated that real gross national product will expand in 1966 by 2 to 3 %.

Overall imports will certainly grow faster than in 1965, notably because the development expected in exports should entail an expansion of the stocks of raw materials and semi-manufactures held by the new industrial enterprises.

The upward movement of prices is likely to continue. The impact of structural economic factors and of others stemming from current developments is likely to be strengthened by the further scaling down of farm subsidies. In particular, the price of butter must be expected to rise.

It is also perfectly possible that, in order to fall into line with budget policy decisions taken by Belgium, Luxembourg's partner in B.L.E.U., certain measures entailing higher indirect taxes may be adopted. Such measures would be likely—or at least liable—to strengthen the upward price movement.

Any price increases that may result from the raising of indirect taxes, or for that matter any price increases due to the scaling down of farm subsidies, need not be regarded as directly inflationary; but if, through the working of the sliding wage scale, they are immediately reflected in wage rates, the measures could engender upward price movements or lead to a corresponding narrowing of the funds available for investment. The question therefore arises whether agreements could not be reached to limit the extent to which this could happen.

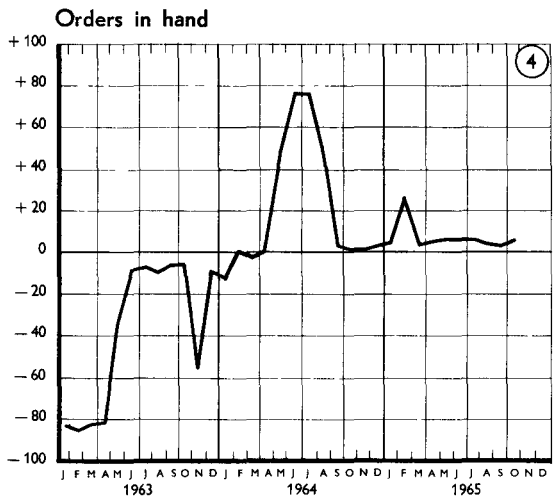
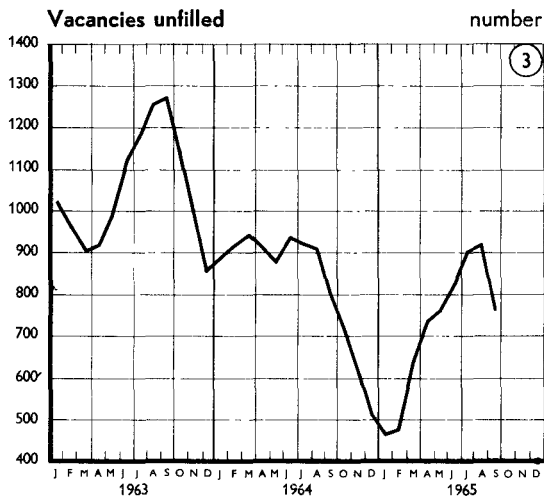
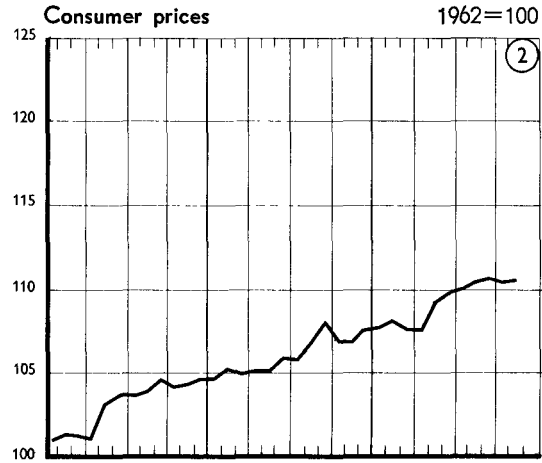
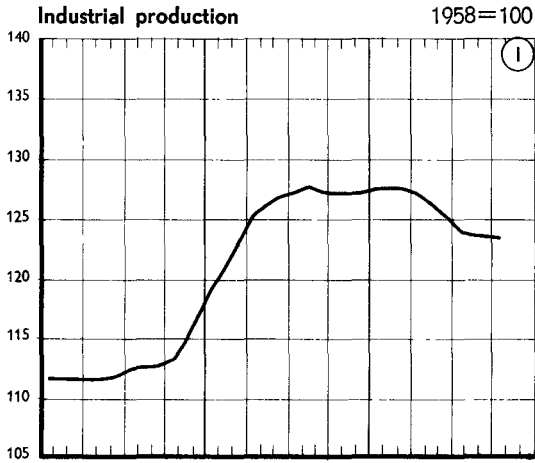
From the point of view of fiscal policy and its impact on the business situation, additional central government revenue would certainly be desirable, unless it proves possible after all to curtail the expansion of expenditure more sharply. The "explosion" of central government expenditure in 1964 was followed by an increase in actual disbursements for 1965 which is estimated at 9 %, although direct government investment expenditure actually contracted. This trend was definitely not quite in line with the recommendations of the EEC Council—and the 1965 budget, after all, had even provided for a slight reduction in expenditure. For 1966 the budget already shows expenditure that is 9 % heavier than in the 1965 budget; and spending may in fact exceed estimates again

this year, though to a lesser extent than last year. The central government's revenue is far from keeping up with this trend in expenditure. The result will be a considerable deficit in the 1966 budget—and perhaps an even heavier deficit on cash transactions. To cover the gap by borrowing on the domestic capital market may well raise considerable problems.

In the circumstances it would be useful, from the point of view of economic policy, if additional revenue were obtained; of course it would be still better if the expansion of expenditure were further curtailed. This applies to consumption expenditure and to transfers increasing private consumption—but not to investment, which as mentioned above, was already down in 1965. Consumer and transfer expenditure has risen so sharply in recent years that by now a more moderate trend in this field should be possible.

What must at all costs be avoided is that parts of the cash deficits of the public authorities should be financed by short-term borrowing, or by the floating of a loan abroad, a measure which would have the same disadvantages.

ECONOMIC INDICATORS



NOTES:

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

Graph 1. The trend curves represent estimates which have been established on the basis of indices (excluding construction, food, beverages and tobacco) adjusted by the SOEC for seasonal and fortuitous variations.

Graph 2. Source: STATEC. General cost-of-living index.

Graph 3. Index adjusted for seasonal variations. Moving averages of 3 months.

Graph 4. Source: EEC business survey.

Grand Duchy of Luxembourg

TABLE 1: Basic data (1964)

Total area ('000 sq. km.)	2.6
Total population ('000)	328
Density of population per sq. km.	126
Working population ('000)	138
Working population, breakdown by main sector (%):	
— Agriculture	15
— Industry	45
— Services	40
Percentage share of gross domestic product in 1963	
— Agriculture	7.0
— Industry	53.0
— Services	40.0

TABLE 2: Basic monthly indicators

	Year	Jan.	Feb.	Mar.	Apr.	May	June	July	Aug.	Sept.	Oct.	Nov.	Dec.
Industrial production (1958 = 100)	1964	115	117	125	129	131	130	123	122	126	127	125	124
	1965	125	129	121	130	132	129	124	116	125	125		
Crude steel production ('000 m.t.)	1964	356	357	375	402	372	389	396	365	391	412	361	383
	1965	383	379	388	392	391	377	397	353	385	392	377	
Building (1958 = 100)	1964	48	57	83	103	106	109	110	96	98	95	73	63
	1965	48	55	82	103	110	102	105	100	96	93		
Workers employed in the iron and steel producing industry and in mining ('000)	1964	23.5	23.6	23.7	23.9	24.0	24.0	24.1	24.1	24.2	24.2	24.3	24.3
	1965	24.2	24.1	24.0	24.0	24.0	24.0	24.0	24.0	24.1	24.1		
Retail prices (1958 = 100)	1964	106.8	107.6	107.2	107.4	107.5	108.3	108.3	109.2	110.3	109.3	109.3	109.9
	1965	110.2	110.5	110.3	110.3	111.6	112.3	112.6	113.0	113.2	112.9	113.1	114.7

Grand Duchy of Luxembourg

NOTES

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

Table 1

- Total population at mid-year.
- Breakdown of gross domestic product by factor cost.

Table 2

- Industrial production. Source : Service central de la Statistique et des Etudes économiques.
- Steel production. Source : STATEC.
- Construction. Index based on number of man-hours worked. Source : STATEC.
- Workers employed in the iron and steel industry and in mining. Source : STATEC.
- Consumer prices. General cost-of-living index. Source : STATEC.

