

EUROPEAN
ECONOMIC
COMMUNITY

COMMISSION



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

3

SEPTEMBER

QUARTERLY SURVEY

1965

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

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Note :

This Survey was completed around mid-September 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 9-1965 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 in the Community continued in the second quarter and also in the summer months, as far as can be judged from the incomplete statistics at present available.

Though the stimulus provided by external demand was rather less than at the beginning of the year, the value of goods exported to non-member countries (as shown in foreign trade statistics) was 11 % higher than a year earlier. Sales to the United States increased particularly fast.

In contrast to external demand, demand from within the Community will probably have risen a little more rapidly than before.

Expenditure on gross fixed asset formation continued to increase at about the same rate as in the first quarter. In the Community as a whole expenditure on construction continued to rise steadily, although building activity was hampered by bad weather and in Italy there was some decline in housing owing to the weakness of demand. Investment in plant and equipment also continued to show a marked upward tendency, expanding with particular vigour in the Federal Republic of

Germany. Although in Italy and—to a lesser extent—in France businessmen still hesitated to invest, there was a substantial increase in investment by enterprises in the public sector. Stock-building did not on the whole contribute greatly to economic activity.

The growth of expenditure on consumption quickened perceptibly, especially expenditure on private consumption, which was particularly dynamic in the Federal Republic of Germany and the Netherlands and showed a marked recovery in Italy and France.

Internal supply again increased at much the same moderate pace as before. According to the seasonally adjusted index of the Statistical Office of the European Communities (excluding construction and food, beverages and tobacco), industrial production went up almost 1 % between the first and second quarters. Agricultural output, on the other hand, was hampered by bad weather in several member countries, and supplies of potatoes, vegetables and fruit were particularly affected.

Tightness on the member countries' labour markets persisted, except in Italy, where unemployment continued to rise owing to the decline in activity in the housing sector, and in France, where there was some further relaxation, although this was less marked than before. The slight signs of easier conditions observed in Belgium were confirmed, but in the Federal Republic of Germany the labour shortage became even more acute.

Imports to the Community picked up again, after having dropped—largely owing to exceptional factors such as the dock strikes—between the fourth quarter of 1964 and the first quarter of 1965. Customs returns show that the value of goods imported from non-member countries was 3 % higher in the second quarter than a year earlier.

This essential improvement in imports, coupled with the slower expansion of exports, led to a deterioration in the Community's visible balance of trade; in the second quarter the deficit reached 487 million u.a. ⁽¹⁾. The current account is likely to show a similar trend. As net capital inflows were apparently less strong than in the early months of the year, there appears to have been a drop in the Community's overall balance-of-payments surplus. The Member States's official gross reserves of gold and foreign exchange fell by \$390 million.

⁽¹⁾ The value of the unit of account is that of 0.888671 gram of fine gold, which is also, at official exchange rates, the value of US \$1.

Prices continued to rise, although the faster pace of growth in intra-Community trade did much to achieve a better balance between supply and demand; the value of intra-Community trade in the second quarter, as shown by customs returns for imports, was 11 % up on a year ago. Consumer prices rose more rapidly, but this was largely due to exceptional factors such as the increase in food prices occasioned by the bad weather; apart from this there was again little upward movement of prices except in the Federal Republic of Germany and the Netherlands.

The economic outlook in the Community for the remaining months of 1965 suggests that the pace of growth may perhaps be even slightly faster than before.

External demand should again expand perceptibly, although it is possible that there may be some slight slackening in the growth of exports to non-member countries. Gross fixed asset formation can be expected to continue its advance at about the same pace as before, while expenditure on consumption may rise more rapidly. Private consumers' spending will in fact receive an additional boost, particularly from the faster increase in mass incomes which is likely in Italy and France, and it will again rise rapidly in the Federal Republic of Germany and the Netherlands.

In view of these prospects for the development of the various components of demand, internal supply will continue to expand. The upward trend in the Community's industrial production may even gather momentum between now and the end of 1965, mainly owing to more substantial progress in France and Italy.

In addition, the Community's imports from non-member countries can be expected to rise more rapidly than hitherto, owing to the economic recovery in France and Italy, the probable continuance of the situation of excess demand in the Federal Republic of Germany and the Netherlands, and the slight recovery in imports of raw materials. The best that can be expected is that after seasonal adjustment the Community's balance of trade will in the coming months perhaps show no change—but it may even show a slight tendency to deteriorate.

Prices may continue to move upwards, and essentially the same trends may be apparent as in the last few months, although there may be marked differences from one member country to another. Only in the Netherlands and the Federal Republic of Germany need there be any fear that the upward thrust of prices will continue to be brisk.

In view of the way the business situation has been developing since the beginning of the year, and the prospects for the rest of 1965, the forecasts published for

this year in the last Quarterly Survey, No. 2/1965, are still valid: real gross Community product should increase by almost 4 % over 1964, and industrial production (as defined in the index of the Statistical Office of the European Communities) by about 4.5 %.

An appreciable level of economic growth can again be expected in 1966. Although the present prospects for the world economic situation suggest that exports from the Community to non-member countries may increase somewhat less rapidly, internal demand should expand more vigorously than in 1965, a slight slackening in the pace of growth in the Federal Republic of Germany being more than offset by more pronounced increases in Italy and France.

Where production is concerned, too, certain restraining factors—mostly of a physical nature—may make themselves felt in the Federal Republic of Germany and also, to a lesser extent, in the Netherlands. Nevertheless, as production should rise noticeably faster in Italy and France, the gross Community product in real terms may increase by 4.5-5 % between 1965 and 1966.

This forecast, however, is based on the assumption that investment expenditure by private enterprises will recover in Italy, and that it will rise more rapidly in France; but the trend in such expenditure has for some time been rather slack, owing to the general business situation which has been affected by the relatively rapid inflation previously experienced and the energetic stabilization measures needed to deal with it. Whether or not real and lasting recovery will be possible must depend not only on short-term economic policy but also, of course, on the chances for further development of the Common Market.

The Community's external equilibrium in 1966 should be satisfactory on the whole, although it is not inconceivable that there may be some deterioration in the balance of current payments. At present it is impossible to make any forecasts as to the balance of capital transactions.

The Community's internal equilibrium is not yet assured. In particular, the cyclical tendencies that cause prices to rise may still be very pronounced in the Federal Republic of Germany and the Netherlands. Furthermore, in the member countries generally—and even in those like France and Italy, where the tendency for prices to level off should persist—certain factors, due to previous cost movements or structural causes or of an autonomous nature, will continue to exert an upward pressure on prices.

Short-term economic policy will have to be so framed as to deal with this situation by checking the growth of domestic demand in the Federal Republic of Germany and the Netherlands, and by cautiously promoting economic recovery, especially by stimulating investment, in most of the other member countries. In the Federal Republic of Germany and the Netherlands the decidedly expansionary tendencies that can be seen in public budget policy ought to be further modified, if only because of the risk that excessive imports into these two countries might lead other countries to follow suit as soon as they had regained a markedly higher level of activity.

A. Recent developments

1. Demand

Overall demand again increased appreciably between the first and second quarters and probably also in the summer months. The trend in internal demand should even have begun to quicken slightly.

On the other hand, the growth of external demand (i.e. actual Community exports of goods and services to non-member countries), although still very vigorous, appears to have slackened somewhat. Customs returns show the value of the Community's exports of goods in the second quarter to have been 11 % higher than at the same time last year.

In contrast to the generally rather more moderate development of exports both to industrial and to developing countries, sales to the United States have risen more rapidly. In the second quarter they were 19.5 % up on the corresponding period of last year. This considerable growth was partly due to the making good of earlier delays : in the first quarter, sales to the United States were adversely affected by exceptional factors (dock strikes). But the vigour with which the expansion of demand in the United States has continued was unquestionably a further factor in this development.

The United States' real gross national product did indeed—as forecast—increase less in the second quarter of 1965 than in the first, when demand for cars and steel had been exceptionally high; nevertheless the increase over the first quarter was, after seasonal adjustment, some 0.7 %—considerably more than had been expected.

Private consumers' expenditure again acted as a particularly powerful stimulus, being itself influenced by a further substantial rise in disposable incomes and the expansion of consumer credit, which was again considerable. Expenditure by enterprises on fixed assets continued to show a very appreciable upward tendency, the extent of the increase corresponding roughly to the replies previously received in response to business survey questionnaires. On the other hand, there was a marked slowdown in stock-building—certainly not unconnected with the better prospects for an agreement between employers and workers in the steel industry. In view of this trend in domestic demand, not only did industrial production show fresh advances from month to month, but imports also rose considerably faster.

As far as it is at present possible to judge, the advance of business activity in the United States appears to have continued with considerable vigour in the third quarter. In this respect, important contributory factors were the fresh reduction in indirect taxation

(by \$1 750 million per annum), retrospective social insurance payments (totalling \$2 000 million), and the increasing impact which the Vietnam conflict is having on many aspects of demand in the United States.

The Community's sales to the United Kingdom, which had declined in the first quarter, began to recover again in May; in the second quarter they regained the high level of a year earlier. Most of this recovery was, however, due to the reduction in the import surcharge which took place at the end of April, just as most of the previous decline had occurred in anticipation of the reduction.

Apart from making up for arrears in this way, exports to the United Kingdom appear to have shown little if any further tendency to increase. In this country there was a marked slackening of business in the second quarter: exports (seasonally adjusted) fell, and so did the rate of expansion of private consumers' expenditure—particularly by volume, owing to substantial price increases; the effects of this trend on production were not offset by the further vigorous rise in public expenditure and a further, albeit moderate, increase in investment expenditure by enterprises; in addition, imports recovered perceptibly. Seasonally adjusted, the gross national product in real terms declined by about 0.5 % in the second quarter compared with the first; it was only some 2.5 % higher than in the second quarter of 1964.

There are signs that—in conjunction with this trend in production—the tightness of the labour market began to ease somewhat at the middle of the year, but these signs are still not very pronounced.

At the beginning of the summer there appears to have been a slight rise in economic activity, as exports were again rather better; in view of the increasing impact of various restrictive measures it is, however, doubtful whether the rise continued throughout the third quarter.

In the period covered by this Survey, the stimulus to the Community's exports provided by other industrial countries was less strong than before. The growth of exports to the continental EFTA countries, particularly Switzerland and Denmark, slackened appreciably; in those two countries, the measures taken by the Governments to damp down business activity have clearly helped to curb imports. As was expected, purchases by the developing countries as a whole also increased more slowly. At the same time demand from the associated overseas countries and territories remained below average.

Where domestic demand within the Community is concerned, the expansion of gross fixed asset formation continued at about the same rate as in the first quarter, although expenditure on construction as a whole was somewhat affected by the relatively bad weather. In France and the Netherlands expenditure on construction, partic-

ularly housing, continued to show a vigorous upward tendency when compared with the preceding months; this was also the case in the Federal Republic of Germany, although to a lesser extent. In Belgium, on the other hand, the expansion of expenditure on building and construction was noticeably more hesitant than before, owing particularly to a decline in public investment and to the tendency for housing to level off. In Italy, where the housing market is rather depressed, actual expenditure on housing dropped again, and the slight recovery of industrial and commercial building observed in the first quarter was not maintained; the only sector to show a very vigorous increase in expenditure was public works.

Visible exports to non-member countries ⁽¹⁾

(% change in values on preceding year)

	1964	1964				1965	
		1st quarter	2nd quarter	3rd quarter	4th quarter	1st quarter	2nd quarter
United States	+ 11	+ 17.5	+ 8	+ 9	+ 11	+ 11.5	+ 19.5
EFTA	+ 11	+ 14	+ 10	+ 10.5	+ 10.5	+ 9.5	+ 6.5
of which :							
United Kingdom	+ 15	+ 25	+ 12.5	+ 14	+ 9.5	- 5	+ 0
Developing countries	+ 8.5	+ 12	+ 4.5	+ 4.5	+ 12	+ 10	+ 8.5
of which :							
Associated overseas countries and territories	+ 7	+ 9	+ 1.5	+ 2	+ 14	+ 1	+ 4
Total non-member countries	+ 11.5	+ 15	+ 9	+ 9.5	+ 13.5	+ 12	+ 11

(¹) In comparing the year-to-year growth rates for the first and second quarters of 1964, the reader should bear in mind that the rates for the first quarter reflect the low level of exports in the first quarter of 1963, which was in part a consequence of the exceptionally cold weather.

In the Community as a whole investment in plant and equipment also continued to rise, although the pace varied from country to country. In the Federal Republic of Germany the already very rapid rate of increase was maintained. In the Netherlands,

the slackening of expansion expected in various quarters would hardly seem to have materialized yet. In Italy, on the other hand, and in some branches of industry in France, private industrial investment continued sluggish, but in both countries this was offset by a vigorous increase in public investment. In Belgium, the less expansionary trend in demand and the reduction of profit margins appear to have had some influence on enterprises' propensity to invest, but the level of investment in plant and equipment was maintained owing to the execution of a few major investment projects that had already been begun by foreign firms.

Investment in stocks did not on the whole exert any very strong influence on overall demand. Except in Italy, purchases of raw materials and semi-finished goods either remained at a relatively low level or else, as in the Federal Republic of Germany, declined perceptibly. Producers of hard coal continued their involuntary build-up of stocks. In the processing industries movements in the stocks of finished goods were on the whole normal; in Italy and France even this meant a change, in that the decisions taken by managements with regard to stocks began to be less negative, and sometimes even made a positive contribution once again to production. The tendency for dealers in France and Italy to run down their stocks of finished goods may even have been reversed.

In the Community as a whole expenditure on consumption quickened perceptibly. The acceleration is not very marked in public current expenditure, where the trend in wages and salaries was temporarily rather less expansionary in the second quarter; but both in the second quarter and in the following months private consumers' expenditure went up more rapidly than before, being particularly dynamic in the Federal Republic of Germany and the Netherlands; in France and Italy, too, the comparatively slow increase in expenditure on consumption has picked up considerably. Only in Belgium and the Grand Duchy of Luxembourg was expansion inclined to slow down in the second quarter.

The differences in the pace at which private consumers' expenditure was growing stemmed of course in part from differences in the development of disposable household incomes. Another contributory factor, particularly in the Netherlands and perhaps also in Italy and France, may have been a temporary increase in the propensity to consume, corresponding to a reduction in the savings ratio.

The total wages bill went up more rapidly, owing no doubt partly to even greater strains experienced on the labour market. The rise was particularly marked in Germany; in France hourly wage rates went up again and the rise, although moderate, was none the less slightly faster than before; in addition, there were the effects of an increase in minimum wages and a fresh rise in the total number of hours worked; in Italy, too, the trend in employment was no longer as unfavourable as before and, in addition, family allowances and cost-of-living bonuses were raised; in the Benelux countries the pace at which wages went up was evidently less rapid in the second quarter, but in the Netherlands generally an additional payment of 1 % of the annual wage was made in the third quarter,

and in Belgium wages again rose rather more rapidly as price increases brought the sliding wage scale into operation.

In addition, social transfer incomes rose again to a greater or lesser extent in all member countries. Lastly, the trend in private consumers' expenditure, particularly in the Federal Republic of Germany and the Netherlands, was affected by considerable reductions in direct taxation—in Germany as a result of reductions already made, while the Dutch were discounting a reduction that took effect at the middle of the year.

According to the latest EEC business survey, demand for consumer durables in general did not slacken despite relatively high expenditure on foodstuffs, the prices of which rose sharply owing to the bad weather. Above all, sales of new passenger cars showed considerable dynamism; in Italy, France and the Federal Republic of Germany, the growth of internal demand for passenger cars even showed a marked intensification or recovery.

2. Production

In the second quarter and the summer months internal supply in the Community continued to increase at much the same, comparatively modest, rate as before.

In several member countries agricultural production was hampered by the cold, wet weather. Most vegetable products were affected, particularly potatoes, vegetables and some kinds of fruit. The incomplete figures at present available suggest that conditions improved somewhat during the summer months. However, the grain harvest in the Community as a whole has been lagged a little behind the 1964 figures although in France and Italy it was in fact considerably better than last year. Supplies of livestock products also increased again but here, too, the bad weather acted as a brake.

The advance in the Community's industrial production was in the second quarter almost the same as in the first : the seasonally adjusted index of the Statistical Office of the European Communities (excluding construction and food, beverages and tobacco) rose by a little under 1 %. For the quarter the gross index was 4 % higher than a year earlier.

The trend in industrial production showed rather less difference from one country to another than previously; in the Federal Republic of Germany the pressure on the factors of production, particularly labour, led to a slower pace of growth. At the beginning of the summer a similar tendency was apparent in the Netherlands, where it had so far been possible to expand production slightly more rapidly than before. In Italy the signs

of recovery which had been apparent for some time became much more pronounced. This also applies—although to a slightly lesser extent—to France, where growth has since the early spring been proceeding faster. In Belgium and the Grand Duchy of Luxembourg industrial production showed practically no change.

Where development by sector is concerned, there was only a relatively modest increase in the output of the basic industries; this was partly due to a decline in coal-mining and a levelling off in the iron and steel industry, although the Italian steel industry even expanded very vigorously. In most of the member countries the chemical industry was more or less able to maintain its lively rate of production.

In the various member countries the production of capital goods continued to expand, although on the whole at very different rates and levels. In mechanical engineering the advance in production was rather less substantial than before, while production in the electrical equipment industry benefited increasingly from the great efforts being made to achieve rationalization. Production of commercial vehicles, however, which had improved in early spring, again showed an appreciable decline.

In the industries producing consumer goods, including consumer durables, production rose more rapidly. In the second quarter the output of passenger and estate cars was 7 % above the level of the same time last year; even allowing for the fact that production at that time was showing signs of slackening, growth appears to have been slightly faster. In the textile industry as a whole, on the other hand, production was still inclined to be hesitant everywhere except in the Federal Republic of Germany.

Once allowance is made for the effects of the bad weather, building and construction registered a further considerable advance, especially in the production of housing, which benefited everywhere except in Italy, the only country to show some decline.

In the services sector, the transport of goods tended to expand rather more slowly as sales slackened in a few basic industries. In commerce, on the other hand, the recovery observed in Italy and France in the first few months of the year was maintained. Services connected with the tourist trade probably even showed quite a strong tendency to expand.

The second quarter brought no real change in the situation on the labour markets. In the Federal Republic of Germany the strains on the labour market intensified further, to a degree unprecedented since the end of the war—although the number of persons employed went up again as foreign workers continued to arrive. The general shortage of labour also persisted in the Netherlands and the Belgo-Luxembourg Economic Union, but there were increasing signs of a limited improvement in Belgium. In France the situation continued to ease, although less appreciably than before, and in Italy there may well have been a further rise in unemployment owing to the low level of activity in

construction and in textiles. The recovery of economic expansion in these two countries was largely reflected in longer working hours and in increased production per man-hour; be that as it may, there was no further decrease in the numbers employed in France.

3. The balance of the markets

There was a definite recovery in imports of goods and services from non-member countries, for which the seasonally adjusted figures had, largely owing to exceptional factors, declined between the fourth quarter of 1964 and the first quarter of 1965. The value of goods imported into the Community in the second quarter was, on the basis of customs returns, again 3 % higher than a year earlier.

Purchases by the Federal Republic of Germany, which are still very high, have been rising slightly more slowly. Imports into Italy, on the other hand, continued to recover steadily (although they were temporarily hampered by a strike of customs officials); in France and the Benelux countries, where there had even been a marked decline in imports in the first quarter, purchases from non-member countries went up again in the second quarter.

The Community's imports from the United States expanded vigorously, after having decreased in the early months of the year mainly owing to dock strikes. Exports from the EFTA countries to the Community, on the other hand, fell appreciably between the first and second quarters, not least because of a decline in exports from the United Kingdom. Owing to the generally more cautious buying of raw materials by member countries, the Community's imports from the developing countries hardly increased at all.

The expansion of trade between member countries continued at a slightly faster pace in the second quarter. Customs returns for imports show that the seasonally adjusted increase in the value of visible trade between the first and second quarters was 4.5 %; it was 11 % higher than for the second quarter of 1964.

As also in the early months of the year, the vigour of demand from the Federal Republic of Germany was a major factor in intra-Community trade. The expansion of West German purchases was, it is true, somewhat slower in the second quarter than in the first, but they were nevertheless about 35 % up on the level of the corresponding period of last year. Purchases by the Benelux countries and France, which had remained stationary between the fourth quarter of 1964 and the first quarter of 1965, again showed a more or less distinct increase. Italy's imports continued to rise slowly but were still appreciably lower than at the same time last year.

Owing to the lively demand from a few member countries and the existence of unused productive capacity, Italy and France were again able to increase their exports to other Community countries considerably. Italy's sales in particular were considerably higher than in the second quarter of last year (about 27 %). On the other hand, the growth of exports from the Belgo-Luxembourg Economic Union and the Netherlands slowed down. In the Federal Republic of Germany, where exports were affected not only by the still relatively slack business situation in Italy and France but also by excess demand at home and declining production elasticity, there was even a marked slow-down in sales to other Community countries.

Visible imports from non-member countries ⁽¹⁾

(% change in values on preceding year)

Exports to	1964	1964				1965	
		1st quarter	2nd quarter	3rd quarter	4th quarter	1st quarter	2nd quarter
United States	+ 7.5	+ 14	+ 4.5	+ 5.5	+ 8	- 8	+ 8
EFTA	+ 7	+ 14	+ 8	+ 1	+ 5	+ 4	+ 1
of which :							
United Kingdom	+ 5.5	+ 14	+ 9	- 2	+ 2	- 1.5	- 5.5
Developing countries	+ 11.5	+ 16	+ 16	+ 5.5	+ 9	+ 3.5	+ 1
of which :							
Associated overseas countries and territories	+ 8	+ 6	+ 18	+ 5	+ 3	- 4	- 3.5
Total non-member countries	+ 8.5	+ 16	+ 10	+ 4	+ 7	+ 0.5	+ 3

⁽¹⁾ In comparing the year-to-year growth rates for the first and second quarters of 1964, the reader should note that the very high growth rates for the first quarter reflect the low level of imports in the early months of 1963, which was in part a consequence of the exceptionally cold weather.

The main result of these trends in intra-Community trade was a further, quite substantial deterioration in the Federal German trade balance; in the second quarter of 1965 the deficit was already 133 million u.a. In addition, there was a distinct decrease

in the Belgo-Luxembourg Economic Union's surplus on trade. In contrast to this, the trade balances of Italy and France improved considerably, while the Netherlands' balance showed no very significant change.

The forces exerting an upward pressure on prices in the Community have weakened somewhat, except in the Federal Republic of Germany and the Netherlands. Nevertheless prices—especially consumer prices—went up more rapidly in most member countries in the second quarter. The decisive factor here was above all the increase in food prices, largely due to the bad weather, which had quite a substantial influence on the cost-of-living indices in all member countries but France.

The trend in food prices was marked by a continuing increase in the price of meat partly due to special, longer-term factors of disequilibrium. In addition, there was a particularly striking increase in prices for fruit and vegetables, especially potatoes. Only in August did this movement appear to have abated somewhat.

Producer prices for industrial goods in the member countries generally showed little upward movement; the exceptions were in the Federal Republic of Germany and the Netherlands, where in some sectors the upward movement was if anything rather more rapid. Consumer prices on the other hand still showed a certain tendency to rise, owing to the incidence of the increasingly high cost of services; this tendency was least pronounced in France and Italy, where the increase in demand was comparatively moderate.

Prices for services continued to go up in all member countries—whether because of fresh increases in costs, particularly in the Federal Republic of Germany, or as a result of previous increases in costs, which were ultimately passed on in the form of higher prices. Adjustments made some time ago in rents, for instance, and in the charges for certain public services had some effect in the period covered by this Survey, especially in the Netherlands and France.

In June consumer prices—on the basis of the national cost-of-living or retail price indices—were in the Netherlands about 7 %, in Italy 4.4 %, in Belgium 4.1 %, in the Federal Republic of Germany 4 %, and in Luxembourg 3.7 % higher than a year earlier. In France the rate of growth was 4.3 %, but here there was an exceptional and temporary factor (higher prices for medical services following the difficulties encountered in concluding new contracts between the doctors and the health insurance funds).

Up to August the year-to-year rise in the indices was again somewhat more moderate in most member countries because the effect of higher food prices decreased and in France the exceptional factor mentioned above ceased to operate; it amounted to about 4.5 %

in the Netherlands, about 4 % in Italy, 3.9 % in the Federal Republic of Germany, 3.7 % in Belgium, 3.4 % in Luxembourg and 2.5 % in France.

In the early months of the year, the Community's balance of visible trade still showed a distinct tendency to improve, but under the influence of the trend in exports and imports described above it tended to level off—or perhaps even to deteriorate again. Customs returns show that the deficit reached 487 million u.a. in the second quarter—nearly half as much again as in the first three months of the year. After adjustment for seasonal factors, this deficit is still heavier than in the first quarter. However, it must be borne in mind that the exceptional factors in the first quarter (dock strikes), which have already been referred to several times, probably slowed imports more than exports, so that the deterioration in the trade balance in the second quarter may have been partly due to the results of making this good.

It is scarcely to be expected that the Community's balance of current payments in the second quarter will again have closed with a surplus. As net capital inflows also appear to have been down on the first few months of the year, the surplus on the overall balance of payments is likely to have fallen appreciably.

The gross gold and foreign exchange reserves of the monetary authorities in the member countries fell by about 390 million u.a. in the second quarter. On the other hand, the Community countries' net IMF holdings rose by 621 million u.a., mainly owing to United Kingdom drawings. There should on the whole have been some improvement in the commercial banks' net foreign exchange position.

In the second quarter the balances of payments have had distinctly different effects on internal liquidities in the various member countries—but these have generally been beneficial from the point of view of short-term economic policy. Thus in the Federal Republic of Germany and the Netherlands, where the growth of demand is certainly excessive, the overall deficits have helped to reduce internal liquidities, while in the other member countries payments transactions with foreign countries had the effect of increasing liquidity—sharply in France and Belgium, and very noticeably in Italy where the increase in liquidity occasioned by the balance of payments was more than twice that of the first quarter.

However, the other factors that influence the supply of money—particularly the cash transactions of the public authorities and changes in the volume of bank advances—did not always work in the same direction. In the Federal Republic of Germany and the Netherlands the amount of money in circulation was increased quite substantially by the cash transactions of the public authorities and by considerable increase in bank advances

(although this became somewhat slower in the Netherlands). In Italy, on the other hand, the cash operations of the public authorities—or at any rate of the Treasury—tended for a time to constrict internal liquidity, even though expenditure was rising rapidly. At the same time the Italian banks reduced their foreign indebtedness further; the increase in advances, although faster than before, was still kept within relatively narrow limits; purchases of securities by the banks appear however to have risen steeply. In France the public authorities' recent cash transactions and lending exerted a rather more expansionary influence. In Belgium the increase in bank advances appears to have slackened, but the cash transactions of the public authorities had a markedly expansionary effect.

In the period under review, conditions on the money markets in the Federal Republic of Germany and the Benelux countries tended to be tight. Particularly in Germany bank liquidity came under pressure owing to the balance-of-payments deficit, further increases in advances to customers, the greater impact of the minimum reserve requirements and the increasing amount of notes and coin in circulation; short-term interest rates rose perceptibly. In August the Bundesbank raised its discount rate to 4 %. The trend was similar in the Netherlands, but less pronounced because advances to customers were increasing more slowly. In Belgium the great demand for funds on the part of public authorities was largely responsible for the rise in interest rates. In Italy and France, on the other hand, no very significant changes occurred; in France the quantitative restriction on the expansion of bank advances was lifted at mid-year—as also in Belgium. In general it appears that the measures adopted by the United States to reduce its balance-of-payments deficit have also led to certain temporary increases in interest rates on the Community's money markets.

On the member countries' capital markets, particularly the bond markets, a few trends which had already been apparent in the first quarter became more pronounced in the second quarter and the summer months : in the Federal Republic of Germany interest rates rose more steeply owing to extensive new issues, many of them floated by public authorities, while investors appeared increasingly inclined to hold back; the average effective yield of the newly issued long-term securities went up to 7.3 %. The trend was similar in the Netherlands, although the strain was less acute. In the absence of any special tax arrangements (like the withholding tax in the Federal Republic of Germany), the interest level in the Netherlands became more attractive to foreign investors; a considerable part of a government loan floated in July was taken up by non-residents. Enterprises in France and those in the public sector in Italy issued more securities than usual for the time of year, but this did not cause any special movement in interest rates.

In the second quarter and the next two months there was no firm recovery in prices on the Community's stock markets. Share prices did indeed go up temporarily in most member countries, but only to fall again, so that by and large the tone of the market remained weak. This situation reflected a number of factors: private investors preferred on the whole to put their newly acquired savings into liquid types of saving or fixed-

interest bonds, while institutional investors, except the French, definitely tended to avoid the stock market; in the Federal Republic of Germany the increasing shortage of liquid funds was also causing difficulty. In Belgium and France, on the other hand, the easing of measures limiting bank advances gave a slight boost to the stock market. Lastly, the volume of securities sold in the Community by non-member countries is likely to have been greater than the volume of their purchases; in the Netherlands it was even necessary to quote reduced prices in order to dispose of all the American paper on offer.

B. Outlook

In the remaining months of 1965 the economic development of the Community may be marked by a further and slightly faster expansion of overall demand, due perhaps in the main to a more rapid increase in private consumers' expenditure.

The prospects for external demand (in terms of actual exports of goods and services) are on the whole decidedly good. It is, none the less, by no means impossible that the growth of the Community's visible exports to non-member countries may slow down slightly.

This loss of momentum may well affect exports to the United States. It may of course be that the internal business situation in the United States will not slacken to any significant extent. For one thing, expenditure on fixed assets is showing a further rapid advance, so that for the full year 1965 the growth rate of this factor may very well reach 12.5 % in value. Secondly, private consumers' expenditure should be stimulated appreciably by the reduction of certain taxes which took place in July, and by vigorous advances in almost all types of income. Although it had previously been assumed that once agreement was reached in the steel industry the reduction of stocks might have induced an appreciable slowing down of economic expansion, now that the dispute has in fact been settled it is expected on the contrary that the direct and indirect effects of the Vietnam affair will affect overall demand within the USA in the reverse direction. For domestic supply, then, the prospects of expansion are still good, though it may become rather less elastic owing to the scarcity of the "skilled labour" factor of production. The United States' gross national product for the full year 1965 may therefore even exceed the previous forecast of \$660 000 million in money terms; the increase in volume between 1964 and 1965 would be a good 4.5 %. In the coming months the general upward movement in imports should also continue. Steel imports from the Community can be expected to decline temporarily, and this, in view of the fact that a large proportion of Community exports to the US is composed of steel exports, could lead to the slow-down in exports in the coming months predicted above.

In the United Kingdom, on the other hand, economic growth will certainly remain very limited in the coming months. Private consumption will rise more slowly owing to the measures taken to curb spending and also to the more modest advance in incomes due to the weaker trend in the total number of hours worked; the rise will be particularly slow in the trend of consumption in terms of volume, as this will be affected by constant and appreciable price increases. Similarly, the slowdown in the growth of investment expenditure by enterprises, which is in any case expected to occur in the fourth quarter,

may in fact turn out to be quite pronounced. In addition, the expansion of public expenditure as a whole may after all gradually tail off. Finally, as exports will probably not provide any considerable additional stimulus, domestic production is hardly likely to rise very much. For the full year 1965, then, the gross national product in real terms may, at best, show an increase of 3 % compared with 1964, in spite of the relatively rapid growth experienced in the first quarter.

In the circumstances, the United Kingdom's imports may well slacken in the coming months, particularly as the spurt which followed the reduction of the import surcharge will gradually fade out. In any case, the Community's exports to the United Kingdom can hardly be expected to advance substantially in the coming months, and they may even again show a slight decline.

Demand from other industrial countries and from the developing countries should—at least until the end of 1965—continue to develop along the general lines it has been following since the beginning of the year, i.e. it should continue to expand, although less strongly.

In contrast to external demand, internal demand will certainly continue to rise more rapidly in the Community. In Italy and France the recovery of demand may become more marked; demand is still mounting rapidly in Germany and the Netherlands; only in the Belgo-Luxembourg Economic Union does expansion appear to be showing a tendency to slacken.

In the Community as a whole, there will hardly be any significant change in the rate at which expenditure on gross fixed asset formation is rising. The increase in public investment can perhaps be expected to be somewhat slower in Germany, particularly in building. Expenditure in this sector by the other member countries will no doubt be marked either by a very gradual quickening in the rate of increase or by the continuance of a more or less pronounced upward movement.

The rapid rise in expenditure on housing will continue in the Netherlands and, at a slightly slower pace, in France; in Germany too it will continue to mount, although not very rapidly. In Belgium, on the other hand, it may level off, and in Italy there is little chance that the decline in expenditure in this field can be halted in the coming months.

Expenditure by enterprises on fixed assets will continue in the Community as a whole to rise slowly, but perhaps slightly faster than before. In Germany the very rapid rate of increase may indeed slow down a little; in Belgium, too, and to a much lesser extent in the Netherlands, the increase in this sector may perhaps show a certain

tendency to slow down, and in Luxembourg it should even continue its downward trend. In France, however, where investment expenditure by public enterprises is in any case rising more quickly, it is possible that investment by private industry, which is still distinctly modest, may be favourably influenced by the greater buoyancy of business and by the measures already taken, or about to be taken, to ease financing. In Italy, too, there are signs that industrial investment may perhaps make a definite recovery during the second half of 1965.

The growth rate of expenditure on consumption might even increase somewhat more, particularly where private consumers' spending is concerned. Not only will the very rapid advance of private consumption in Germany and the Netherlands continue—owing primarily to further considerable wage increases and the effects of tax reductions—but in Italy and France, too, consumption should also rise at a noticeably more rapid pace than hitherto; it is only in the Belgo-Luxembourg Economic Union that the increase may turn out to be relatively slow.

Domestic supply may consequently be rather more strongly stimulated by overall demand than before, although as a result of higher prices the advance of demand in real terms lags behind that in money terms.

The effects of this stimulus are not, however, so rapid in agriculture, and some types of agricultural production will still suffer from the effects of the bad weather. The growth of industrial production may, however, show some acceleration. In Germany, however, and to a lesser extent in the Netherlands, expansion is clearly being hampered by certain more or less physical factors (manpower shortage, limitation of capacity); but their effects are unlikely to be very great and may be more than offset by the faster progress expected in Italy and France.

It is also very probable that the Community's imports from non-member countries will go up more vigorously in the second half of the year. For one thing, it seems that Germany's imports will after all expand again quite strongly, in the main because of the increasing gap between overall demand and domestic supply. The same development can be expected in the Netherlands, where purchases of raw materials and semi-finished goods, which are rising again, should also play a part. Secondly, the recovery of economic activity in Italy and France should lead to a more rapid increase in imports.

In view of the prospects for imports and exports described above, it may well be that in the coming months the Community's trade balance (customs returns, cif-fob) will at best be unchanged and may perhaps even tend to deteriorate slightly.

The price situation will no doubt continue to reflect the same tendencies as in the last few months: the prices of industrial products will probably continue to show only a very slight upward movement in France, the Belgo-Luxembourg Economic Union and Italy, although a more vigorous growth of demand in Italy may occasionally mean that

for certain items at least part of the recent increases in unit costs is passed on in the form of higher prices; in Germany and the Netherlands the upward trend in prices will persist. In addition, the prices of services, including tariffs for public utilities and transport, will certainly be raised again in all countries to allow for increased costs, and the structural factors that push prices up will continue to operate. Lastly, the higher food prices due to the bad weather may continue to exert an upward pressure on consumer prices, although this pressure should gradually fade, except perhaps in Italy.

Community product and expenditure (1)

	1962	1963 (3)	1964 (3)	1965 (4)
	At current prices (in '000 million u. a. (2))	% change by volume on preceding year		
Gross Community product	226.7	+ 4.3	+ 5.5	+ 4
Private consumption	138.0	+ 5.7	+ 4.4	+ 4.5
Public current expenditure	32.4	+ 5.9	+ 1.9	+ 4
Gross fixed asset formation	51.8	+ 4.5	+ 6.8	+ 3
Balance exports (5) less imports (5) (in '000 million, u. a., current prices)	+ 1.8	+ 0.6	+ 1.4	+ 3.0

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

(2) 1 u.a. (unit of account) = 0.888671 gm. of fine gold = \$1 US at official exchange rates.

(3) Actual figures.

(4) Commission forecasts.

(5) Goods, services and factor income.

By and large, economic developments since the beginning of the year and the prospects outlined above confirm the forecasts published in the last Quarterly Survey on the extent to which the main supply and demand aggregates for the full year 1965 will vary—in real terms—from those of 1964. Real gross Community product, then, will go up almost 4 %, and industrial production (as defined for the Index of the Statistical Office of the European Communities, i.e. excluding construction and food, beverages and tobacco) by about 4.5 %.

As the forecasts stand at present, it seems likely that overall demand in the Community will, taken by and large, continue to increase perceptibly in 1966. Production may expand somewhat faster.

The main factor contributing to this development should be the increase in internal demand; external demand, on the other hand, is expected to rise rather less than from 1964 to 1965, and so to contribute less to expansion.

Demand from the United States may be something of an exception. Here it had been expected that at some period in 1966 there would be an appreciable slackening of activity, but the latest information suggests that economic expansion will continue unabated. Of course, as more funds are now needed for the Vietnam conflict, it is doubtful whether a fresh reduction in direct taxation will in fact take place at the beginning of 1966, as had originally been planned in view of the exceptionally favourable trend in Federal revenue during the 1964/65 tax year. But instead of this additional stimulus, which may perhaps not materialize, other and more powerful stimuli may possibly be provided by the multiplier effect of an increase in the military budget. It seems perfectly possible that, in real terms, the gross national product for 1966 may be at least 4 % higher than in 1965. The demand for imports might increase relatively strongly.

In contrast to these prospects in the United States, economic developments in the United Kingdom during the first half of 1966 will doubtless reflect more strongly than hitherto the endeavours being made to re-establish external equilibrium; it would at least seem that this objective is to be further pursued, as recent measures or declarations of intent include controls on the building of industrial and business premises, the introduction of more restrictive provisions governing consumer credit, stricter supervision of payments transactions with abroad, plans to cut back various public or publicly assisted investment programmes relating to infrastructure or of a social nature, and a ceiling on the growth of government spending.

If this programme is fully realized, the growth of the gross national product in real terms may practically be brought to a standstill, and the unemployment rate may rise—some British economists think that it might reach 2.5 %. Although this would certainly not amount to a really critical level of underemployment of the labour factor, it would nevertheless arouse considerable political opposition within the country.

At all events, some slackening of business in the United Kingdom is highly probable, for the simple reason that the industrial investment cycle should in any case be entering upon a less expansionary phase. Imports from the Community can therefore hardly be expected to go up very much.

The prospects for economic expansion in the other EFTA countries taken as a whole seem more favourable, although there have for some time been increasing signs of

difficulties in some of them. The growth of the Community's exports to this group of countries may be most severely affected by the restrictive anti-cyclical policy which Switzerland has decided to maintain for a very long period—until spring 1967. It is of course possible that the Swiss may consider some relaxation possible before this date.

In the developing countries the prospects for demand from the United States are good, and as stocks of raw materials may perhaps be built up faster than before in view of developments in Vietnam, it is by no means impossible that the foreign exchange reserves of these primary producing countries will gradually cease to fall, or even begin to recover. There would, however, certainly be the usual time-lag before imports responded to such a development, so that the growth rate of the Community's exports to the developing countries may continue to fall for some time to come.

On the other hand, domestic demand within the Community in 1966 may expand rather more briskly than in 1965.

This forecast is based in the first place on the reasonable assumption that next year the recovery of economic expansion in Italy and France will continue and gain decidedly in strength. In addition, the growth rate will continue to rise a little in the Netherlands, and will begin to creep up again in Belgium. The progress made in these countries may be more than sufficient to offset the slight slackening that can be expected in Germany.

Gross fixed asset formation in the Community, and in particular the amounts expended by enterprises on fixed assets (including construction) seem likely to expand at about the same rate as in 1965. This composite picture is made up of trends that vary from country to country but which—and this is an important point—may bring about a better balance between investment levels in the different member countries. Thus in Germany the rather less expansionary outlook for exports, the growing pressure on profit margins, and last but not least the increasing difficulty of obtaining finance will certainly lead to some slackening of the investment boom; in the Netherlands the same factors will be decisive at least where the majority of small and medium enterprises are concerned, but they may be offset by exceptional factors such as purchases of ships and planes, and expenditure on housing will certainly continue to rise vigorously. In Italy the generally improved economic outlook and the increase in public investment could lead to a decisive recovery in expenditure by enterprises on fixed assets, although housing is only likely to pick up slowly. In France, too, the further improvement in the business climate and the increasing ability of financial institutions to provide funds should improve private industry's propensity to invest and thus speed up the expansion of total investment expenditure. In the Belgo-Luxembourg Economic Union, the prospects for heavier investment expenditure by enterprises do not appear to be particularly favourable.

When this Survey was being written, there was still too large an element of uncertainty regarding public expenditure in 1966 (for public investment, public consumption and transfers) for it to be possible to forecast the probable trend at all precisely. The drafts of the national budgets had either not yet been fully worked out or had not been approved by the Governments (Germany, Belgium, Luxembourg, Netherlands), or else they had not been adopted by the Parliaments (Italy, France).

The information available concerning the general trends is however sufficient for it to be possible to arrive at working hypotheses in forecasting the pattern of demand. The position with regard to such information has, moreover, improved this year, for the newly created Budget Policy Committee was in July already in a position to examine the main outlines of budget policy for 1966. It based its study on memoranda submitted by the Member States; the only countries which did not provide any information were the Netherlands and France, but the main outlines of the French draft budget were already sufficiently well known. The opinion adopted by the Budget Policy Committee took into account the advice tendered by the Short-term Economic Policy Committee on 28/29 June when the latter Committee issued a series of memoranda dealing with the preliminary economic budgets for 1966 (see below). The Budget Policy Committee's opinion has been transmitted to the Council.

Public expenditure appears to be rising somewhat faster, especially in Germany and the Netherlands and to a lesser extent in Belgium; the final figures for expenditure are also expected to show some (slight) acceleration in France, where the rate of increase will, however, still be relatively limited. In Italy public spending will very probably go up at about the same pace as in 1965—which was faster than in 1964.

Except perhaps in the Netherlands and France, there may be a general tendency to concentrate the increase in public expenditure more on current and transfer expenditure, which stimulate private consumers' expenditure, and less on investment.

Private expenditure on consumption will thus be given an appreciable boost from this side. In the Netherlands, the first part of the reduction in direct taxation may also begin to have an effect, and spending may also be stimulated by a readiness to discount the second part of the reduction, due to be made on 1 January 1967. In Germany further, but limited, tax reliefs arising from the 1965 tax amendment law will also make themselves felt. In addition, a decision has already been taken to make considerable improvements in social insurance pensions. In other member countries, too, incomes from public sources will continue to go up on a more or less appreciable scale.

Above all, the increase in total income from wages and salaries can be expected to continue. It may be slightly less in Germany—although this is not yet certain, because a somewhat slower increase in the level of agreed wages and some slackening in the total

number of hours worked may be offset by the wage drift due to persistent strains on the labour market; but the total wages bill will certainly go up more quickly in Italy and France and, above all, the trend in the number of hours worked should mean that in those two countries the rise will be more rapid in 1966 than in 1965. In the Belgo-Luxembourg Economic Union expenditure on consumption is also expected to continue rising. For the Community as a whole, then, it can be assumed that in 1966 private consumers' expenditure will increase somewhat more rapidly than in 1965.

According to present forecasts, and assuming normal weather conditions, production in 1966 should speed up slightly, both in the course of the year itself and when the figure for the full year is compared with that for 1965. The increase in real gross Community product might be 4.5-5 %—as against almost 4 % between 1964 and 1965.

Within this overall figure the pace of growth in France would rise from about 2.5 % in 1965 to nearly 4.5 % in 1966, in Italy from about 3 % to 4-5 %, in the Netherlands and in Belgium it would be at least as high as before at about 5 % and 3-3.5 % respectively, and in Germany somewhat lower, easing from about 5 % to 4-4.5 %.

The validity of these growth forecasts, and in particular of the assumptions contained in them regarding the greater propensity to invest that may develop in various member countries, depends of course on the continuation of normal political and economic conditions, particularly with regard to the development of the Common Market.

These forecasts for 1966 raise certain problems of equilibrium. It is not the Community's balance of payments which will provide the main difficulty. Here some deterioration in the trade balance and in the overall balance on current account is indeed a possibility, but the surplus will still presumably be such that it can be considered satisfactory. At the same time, however, it is by no means sure that this will be coupled with a corresponding deficit in capital transactions—as would be desirable. The trouble will still be that the flow of foreign capital into the Community remains excessive.

It would seem at any rate that the persistence of problems connected with internal equilibrium will prove to be of greater importance from the angle of economic policy in the Community. The prospects for demand and supply and for costs clearly show that there will still be upward pressure on the level of prices in 1966. The cyclical factors that push prices up may still be quite strong in Germany and the Netherlands; but in the other member countries the upward movement of prices should be weaker owing to the better balance between supply and demand and to the favourable influence of the relatively sharp increase in productivity which always tends to characterize the rising phase of the business cycle after a recession (reduction in costs). However, the large increases in costs recorded in those countries in the last few years might still affect prices to some extent; this applies particularly to the charges for public utilities and transport. In some member

countries a relatively strong influence will be exerted by certain autonomous and structural factors which cause prices to rise, especially in agriculture and the services sector.

At mid-year the Short-term Economic Policy Committee, following a practice that has now become established, examined the prospects and problems for economic development in the coming year, basing its study on the "preliminary economic budgets" of the Member States and on working documents provided by the Commission. In its opinion, the Committee stressed the danger of continued excessive price increases in the Community, particularly in the Netherlands and Germany. In fact those two countries that were singled out for comment are also the countries where the acute strains on labour market have persisted unabated.

The Short-term Economic Policy Committee's opinion on the preliminary economic budgets for 1966 is reproduced at the end of this chapter. Despite the latest developments in the business situation and some revision of forecasts, it is as valid as ever. The Commission has therefore little to add to the Committee's remarks and advice where short-term policy in the Community is concerned. Further details of what is required of economic policy in the member countries will be found in the chapters of this Survey which deal with the countries individually.

The problems of equilibrium that will arise in 1966, and to which short-term economic policy should be adjusted forthwith, do not seem to be as serious for the future of the Community as a whole as they perhaps were in the second half of 1963 and early 1964, before vigorous measures had been taken to deal with them—of which those recommended by the Council on 15 April 1964 were among the most important.

In 1963 and early 1964 the situation in the Community was generally marked by inflationary pressures exerted by demand, the degree of which varied from one member country to another. As such pressure was not only widespread but also varied in intensity, it produced a considerable imbalance within the Community and there was a danger that the inflationary troubles of one country might infect another. Since then, the success of stabilization measures in eliminating excess demand has been very considerable, especially in France and Italy, but also in Belgium. In France and Italy the trend towards stable prices must now be reinforced by means of a carefully directed policy based as far as possible on increased investments and designed to promote the recovery of economic expansion.

It is no longer true, as it was in 1963 and at the beginning of 1964, that demand within the Community is exerting any widespread and inflationary overheating. It is only in Germany and the Netherlands that the level of domestic demand is still too high and will remain so within the foreseeable future; in Germany it has risen substantially, while in the Netherlands it has perhaps declined a little. In the other member countries

supply is now generally very elastic in relation to the growth of domestic demand. Consequently those countries have so far been able to do a great deal, through intra-Community trade, to restrain the upward movement of prices especially in Germany.

Between the first six months of 1964 and the first six months of 1965, Germany's balance of visible trade with its EEC partners deteriorated by no less than DM 3 175 million (794 million u.a.), while its overall visible trade balance (i.e. including trade with non-member countries) deteriorated by DM 3 313 million. A comparison of these two figures shows that practically all the increase in the supply of goods which Germany achieved through its external trade came from other Community countries.

In principle, a deterioration in one member country's trade balance and in its overall balance on current account should, firstly, be regarded as very satisfactory when and in so far as this means that a previous, excessively high surplus has been reduced. This certainly applies in the case of Germany, for its external trade was showing particularly large surpluses at the beginning of 1964, owing to the highly inflationary situations in Italy, France and the Netherlands.

Secondly, a temporary deterioration in the position of one member country, is correct and desirable in so far as it leads to an improvement in the degree to which the factors of production are utilized in other member countries. Thus the economic situation in Italy and France has certainly been helped by the sharp increase in exports to Germany and by the fact that there has at least been a relative decline in their imports from that country. Had this not been so, both Italy and France might both have experienced a full-scale recession.

Lastly, a deterioration in one member country's trade balance and in its balance on current account should definitely be regarded—provided it is relatively brief—as beneficial, in that it may serve to reinforce a policy of internal stabilization. It must also be accepted as such by the other member countries even if they should be enjoying a high level of activity; in such circumstances, the deterioration in the position of one member country will, however, be more in favour of non-member countries than is at present the case in respect of Germany.

But a temporary deterioration in the balance of one member country can only be considered beneficial if it is in fact accompanied by adequate measures to promote internal stability. In other words, there can be no tolerating a concurrent inflationary development of domestic demand, which must be stamped out with all the requisite vigour.

Now it is precisely this danger, that the inflationary growth of domestic demand in Germany and the Netherlands may tend to persist, which is inherent in the prospects for 1966. Should this occur, the contributions to price stability that stem from a further deterioration in the German position—that of the Netherlands is supported by exports to

Germany—will still be largely neutralized by the expansion of that country's domestic demand. At the same time domestic demand in the other member countries, or at least in Italy and France, is expected to show renewed vigour. The Short-term Economic Policy Committee has even expressed the view that such a situation could lead to a recurrence of inflationary developments throughout the Community as soon as these other member countries have regained a markedly higher level of activity.

Be that as it may, those responsible for economic policy in Germany and the Netherlands obviously bear a great responsibility—particularly in Germany, because of its economic importance. It is to be hoped that this country, which at the end of 1963 and the beginning of 1964 had been the sharpest critic of the more strongly inflationary trend observed in other member countries (quite justifiably, in view of the danger that inflation might be passed on to other countries), will now itself take the requisite action. In other words, in view of what this would mean for the other EEC countries, and in the common interest, the upward movement of prices in Germany should no longer be combated almost exclusively by further increases in imports from other member countries, but by a sharper curb on the growth of domestic demand as well.

The economic policy so far followed in the Federal Republic of Germany has not proved sufficient to check the trend towards excess demand. Budget policy has certainly not been in line with the course recommended by the Council on 8 April 1965. Whereas in 1964 the Federal Government—but not all the public authorities at lower levels—had pursued a policy which was in line with the Council's recommendation and so contributed in large measure to the relative stability of prices achieved in Germany at that time, Federal expenditure went up by leaps and bounds in 1965, while at the same time revenue rose more slowly than before, owing to a considerable reduction in tax rates.

A similar—but less pronounced—trend has been apparent in the Netherlands; public expenditure in 1965 will be considerably higher than the original budget estimates, which—by and large—were in line with the Council's recommendation. In addition, a tax reduction which took effect in the Netherlands on 1 July 1965 also gave an appreciable further boost to the growth of domestic demand in money terms.

In the other member countries, the budget policies so far applied in 1965 are, in their overall effect at any rate, much closer to the recommendations that the EEC Council addressed to the Member States on 8 April 1965. This is particularly true of France, where the increase in public expenditure has followed exactly the pattern required by the present economic situation (a relatively rapid rise in investment expenditure in the widest sense of the term, and limitation of the growth of current expenditure). The same is true of Italy, the only member country exempted from the "5 % rule" in the Council's recommendation of 8 April 1965; but here the increase in expenditure has so far been channelled too much into schemes that will boost consumption. In Luxembourg, too, the line so far followed in public expenditure for 1965 appears to be consonant with the Council's recommendation—although this result was largely achieved at the expense of investment

here, too. In Belgium, on the other hand, public expenditure has risen quite substantially and the emphasis has in addition been mainly on current payments; but since the other elements of demand as a whole have been going up considerably more slowly, thus reducing the pressure on the country's resources, the overall increase in public expenditure poses fewer problems in Belgium, at least in the short term, than does the advance in such expenditure in Germany and the Netherlands. Serious problems of financing arise, however, in Belgium because of the increase in the overall deficit, and the sharp rise in public current and transfer expenditure could jeopardize what has so far been done to put the public finances on a sounder footing.

Unfortunately, it looks as though in Germany and the Netherlands public expenditure in 1966 will again tend to be very expansionary especially when considered in the light of the anti-cyclical and stabilization measures that need to be taken. The same applies, although to a lesser extent, in the Belgo-Luxembourg Economic Union. Budget policy in Italy would seem to be, in general effect at least, largely in line with what the situation demands, and for France this consonance holds good even for the more detailed aspects of its policy.

One of the criteria for judging trends in public expenditure in 1966 is the Council recommendation of 8 April 1965⁽¹⁾. Of course, looked at formally, this recommendation only applies up to the end of 1965. But study of the business situation and of the outlook for 1966 clearly shows that there is no reason why the Council's recommendation, or at least the principles underlying it, should not still be taken into account in the economic and financial policies to be worked out for 1966. This view appears, moreover, to be fully shared by the competent authorities in most member countries. At all events, when examining the broad outlines of budget policy for 1966, the Budget Policy Committee, which includes heads of budget departments at the ministries concerned, tried to see how far the budgets had been kept "within the framework... of the EEC Council's recommendation of 8 April 1965".

There is no contradiction between this attitude and the fact that the latest opinion issued by the Short-term Economic Policy Committee declares that, in view of the changes that have taken or might take place in the economic situation, it is no longer practical to apply to budget policy uniform criteria in the form found in the first Council recommendation of 14 April 1964. The Committee itself points out that these criteria had already been altered or relaxed by the Council recommendation of 8 April 1965. Moreover, the advice given by the Short-term Economic Policy Committee with regard to economic and financial policy for 1966 was entirely in line with what was recommended by the Council on 8 April 1965.

(¹) See annex to Quarterly Survey No. 2/1965.

The 5 % rule applicable to the increase in disbursements by public authorities ought to be strictly observed by Germany and the Netherlands in 1966. Of course, it is no use indulging in wishful thinking: in spite of all the measures to restrict such expenditure that have been announced at any rate by the Federal German Government, the increase will nevertheless be considerably more than 5 %. But to the extent that this occurs and that the excess expenditure is not balanced by the higher yield of taxes, calculated on the assumption of stable prices, the 5 % rule requires that corresponding increases should be made in rates and/or the charges made by public enterprises, in social insurance contributions, etc. The Netherlands Government has already hinted that it intends to raise indirect taxes appreciably in 1966 ⁽¹⁾.

These two countries will probably find that there is a further reason why they will need to aim at a considerable increase in revenue. If their Central Banks adopt a credit policy designed to promote stabilization, their capital markets will certainly not be able to provide the funds required to cover the heavier budget deficits—unless the demand from industry (including housing) for the capital needed for expansion were subordinated in an irresponsible manner to the needs of the budget, or unless there were a massive inflow of foreign capital. In framing their policy, the Central Banks will unfortunately have to take this latter possibility into account, and this could mean that they cannot make their policy as restrictive as they really should.

In view of these problems, every effort ought still to be made in Germany and the Netherlands to check the growth of public expenditure substantially. Care should however be taken to see that the action taken is not confined mainly to curbing investment expenditure while the faster growth of public current expenditure is left more or less untouched, for this would in the end mean that public investment dropped further behind as economic growth proceeded.

In France the budget policy envisaged for 1966—as far as can be seen from the draft budget for 1966—largely fulfils the requirements of the present economic situation. The principle of balancing the overall budget mainly by means of current revenue makes it unnecessary to establish a particular criterion. A somewhat faster increase in expenditure can do no harm, in view of the economic outlook in France—even if, as would probably be the case, this increase were not covered by the “non-inflationary” progression in tax revenue and by the higher charges that public enterprises are expected to make.

In Italy there would be no point in fixing a narrow quantitative limit to the growth rate of public expenditure; here, fiscal policy will have to continue exerting a fairly expansionary influence on the internal business situation for some time to come, and must be supported in this by credit policy.

⁽¹⁾ This Survey was compiled before the draft 1966 budget was published.

In Italy—and also in Belgium—some yardstick for the limitation of public expenditure should nevertheless be applied, inasmuch as all parts of this expenditure which do not serve directly or indirectly to promote investment should be met out of ordinary revenue. The adoption of this yardstick of a balanced ordinary budget makes two things essential : first, action to stimulate economic activity should in fact be taken mainly in the form of promoting investment; secondly, the Government's current expenditure must not be financed partly out of savings from the private sector (businesses and households) or by the creation of credit.

Short-term Economic Policy
Committee

Opinion on the preliminary economic budgets for 1966

1. At its meeting of 28-29 June 1965 the Short-term Economic Policy Committee examined the preliminary economic budgets for 1966 and the economic policy problems revealed by a study of tentative economic forecasts for 1966. The Committee finds that, according to the preliminary economic budgets, the outlook for economic growth, employment and the balance of payments is in general favourable. The prospects, on the other hand, for price stability and production costs, though improved, are still not as good as might be desired.

2. The budgets allow for a less dynamic expansion than in 1965 of the Community's exports to non-member countries: such information as is now available suggests that the expansion of demand, in both the industrial and developing countries, will continue to slow down. In particular, economic growth is likely to become less rapid in the United States. On account of its balance-of-payments difficulties, the United Kingdom will very probably be obliged to contain the growth of its domestic demand within very strict limits. Furthermore, world commodity prices are likely, for the most part, to be relatively weak and commodity exports may well lose momentum. This means that the countries exporting these products may well be forced to cut back their purchases from Community countries.

3. The forecasts in the budgets, on the other hand, suggest that internal demand in monetary terms for the Community as a whole will expand more than in 1965. In the Netherlands domestic demand will, in all likelihood, continue to forge ahead; in the B.L.E.U the expansion of demand will remain fairly steady. In Italy and to some extent in France, an acceleration is expected from the second half of 1965 onwards, due primarily to a faster increase in private consumers' expenditure. In Germany, although the industrial investment boom may show signs of weakening by 1966, it seems scarcely likely for the moment that private consumers' expenditure will follow a similar course.

4. On the basis of these estimates, the real increase in the gross Community product from 1965 to 1966 should be about 4.5 %, comparing with 4 % from 1964 to 1965. At this stage, however, the acceleration implied by the above figures still appears uncertain; it presupposes, in particular, a faster expansion of domestic demand in Italy and, to a lesser degree, in France.

5. The foreseeable trend of domestic demand and the fact that purchases of raw materials have, in general, tended to contract of late, point to a speed-up in the growth of the Community's imports; the result would be a deterioration of its trade balance in 1966. It seems, however, that an improvement in the terms of trade should partly offset this trend.

6. If the general assumptions adopted for the preliminary economic budgets prove sound, the labour market is likely to remain rather strained in Germany and—though to a lesser extent—in the Netherlands; in the Belgo-Luxembourg Economic Union there should be little or no strain, in France the situation should continue to improve, and in Italy unemployment is expected to decline steadily. This means continuing wage strains in Germany and, to a lesser degree, in the Netherlands, while in the other countries wage costs per unit of output may not yet be fully stabilized.

7. The Committee notes, moreover, that the upward movement of prices will persist. Although it is slowing down in all the Community countries, it nevertheless remains too fast in the Netherlands and Germany. Even in those countries where price increases engendered by the general economic trend are tending to become more moderate, certain independent or structural factors will continue to provoke increases, especially in agriculture and services.

8. The Committee concludes that in 1966 the authorities should concentrate on maintaining or strengthening those forces which make for a more balanced development of the Community's economy. On the one hand, steps must be taken to help revive activity in a way compatible with the re-establishment of internal stability in those member countries—Italy, France and, to a lesser degree, the Belgo-Luxembourg Economic Union—where the economic climate has for some time shown signs of deterioration. On the other hand, care should be taken to prevent an aggravation of strain in Germany and the Netherlands, where the expansion of supply is likely to lag behind that of overall demand. This policy would appear indispensable, not only in the interests of the two countries themselves, but also to prevent the persistence—once the other Community countries have reached appreciably higher levels of activity—of a strong German and Dutch demand for imports giving rise once more to inflationary developments throughout the Community.

9. The Committee believes that the objectives indicated above can best be pursued if the right "policy mix" is established: neither monetary policy, budgetary policy nor incomes policy would suffice by itself.

While it is true that monetary policy can contribute considerably to the re-establishment of internal equilibrium in countries where the expansion of overall demand is likely to be excessive, it must not be forgotten that a credit policy applied—for lack of action in other fields—too severely would have its drawbacks. Beyond certain limits a very restrictive monetary policy would be likely to encourage speculative imports of capital which would counteract measures to control domestic liquidity; dearer credit and financing difficulties could, moreover, assume such proportions that the growth of investment and, after a certain time, economic expansion itself would be seriously affected.

10. The Committee is consequently of the opinion that in the present circumstances full use should be made of budget policy to limit directly the expansion of overall demand. The Committee has the impression that, in view of the changes in the economic situation that have already taken place or are foreseen, uniform rules as set out in the Council's Recommendation of 14 April 1964, which have already been adjusted or relaxed to some extent by the Council in its Recommendation of 8 April 1965, are no longer appropriate.

In one group of countries, Germany and the Netherlands, the economic outlook argues in favour of a certain realignment of budget policy, which at present seems in the main to give too much encouragement to the expansion of domestic demand. In Germany the reduction of direct taxes, with effect from 1 January 1965, has been a sharp spur to domestic demand and its effects will certainly still be felt in 1966. Public expenditure, of both the local and Federal authorities, is also expanding appreciably; if this trend continues (it may even gather momentum) in 1966, it would hamper efforts to restore internal equilibrium. In the Netherlands the lowering of direct taxes, with effect from 1 July 1965, has had the same effects on domestic demand as in the Federal Republic of Germany; furthermore the increase in government expenditure planned for 1965 appears very appreciable. The Committee considers that in both countries budget policy for 1966 should, in line with the Council's recommendation of April 1964, aim at strictly limiting the growth of public expenditure and, in particular, expenditure influencing consumption directly or indirectly. In view, however, of the difficulties and inconvenience that would be caused by restricting for several successive years certain types of expenditure on social infrastructure, it may prove necessary to provide additional revenue for the Treasury if internal stability is to be achieved.

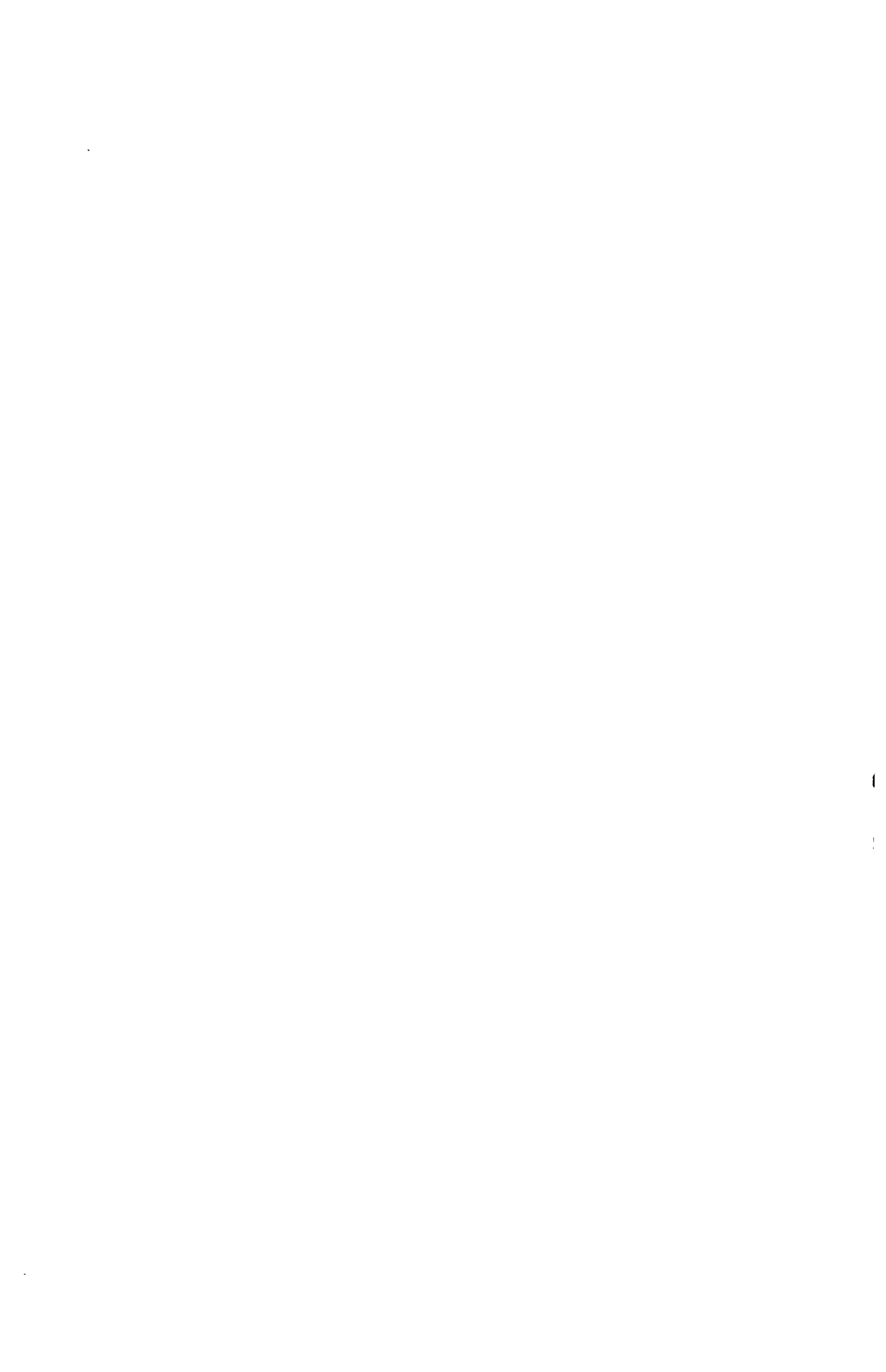
11. In the other Community countries, too, budget policy will have an important role to play, in the Committee's opinion, if the objectives set out in Section 8 of this opinion are to be attained. In Belgium, it would seem that, while the present economic outlook does not call for as strict a limitation of the growth of public spending as in Germany and the Netherlands, efforts to improve the structure of public finance should be pursued; recent trends of Treasury operations seem to indicate that this task, undertaken several years ago, now threatens to be jeopardized. Therefore, while it is advisable to encourage a cautious re-expansion of public investment, after the restraints applied in 1964, the public authorities should endeavour in 1966, in order to prevent an increase in the cash deficit, to set

the right pattern of public expenditure by reducing the proportion of spending devoted to consumption and income transfers.

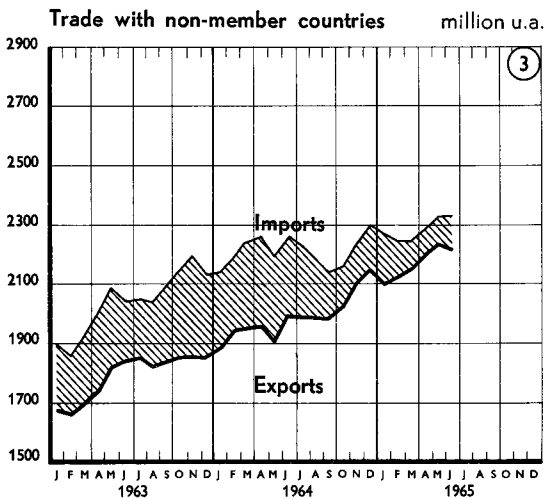
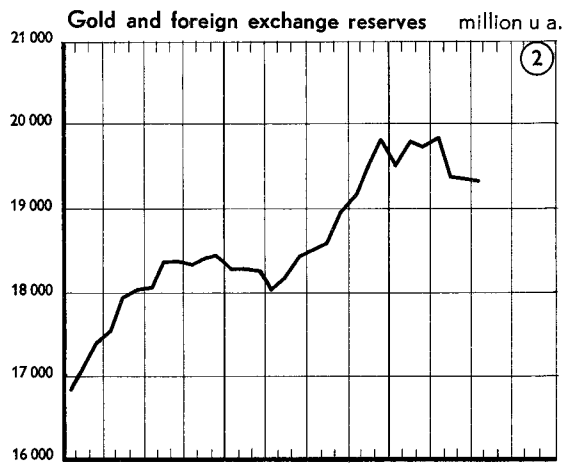
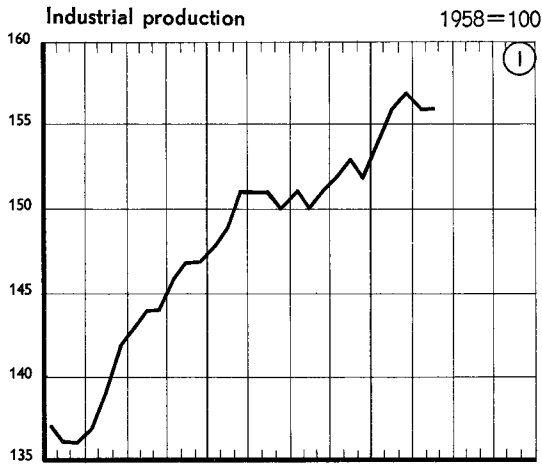
12. In Italy the expansion of the total expenditure of the central and local authorities will certainly be very considerable in 1966 as part of the policy of reviving public investment and investment by State-controlled companies. Steps should be taken to ensure that the impact of these measures does not come too late and is not concentrated into too short a period, in order to avoid strains arising at a moment when activity will have begun to expand at a distinctly faster rate. Again, as soon as this point is reached, and private incomes are therefore growing more rapidly, it would be advisable to avoid further incentives to consumption, such as those provided by certain budget decisions of recent months. Finally, in order to prevent an undue expansion of available money and near-money such as might well encourage inflation, the authorities should, when the economic growth rate has increased, resort as little as possible to short-term lending for the financing of the Treasury deficit. The efforts to encourage saving and channel a larger share of resources towards longer-term investment should therefore be continued.

13. As regards France, the Committee, while considering that the present line of budget policy tends to provide the bases for stable expansion, feels that measures adopted under this policy should seek to create conditions more favourable to the expansion of industrial investment. It would be advisable, firstly, to investigate whether tax reliefs designed to induce private enterprises to invest should not be increased and, secondly, to ensure in 1966 sufficient expansion of investment by public undertakings in view of longer-term requirements and of the fact that the capital goods industries are at present running below capacity. To prevent the re-emergence of a budget deficit prejudicial to stability, the effect of such a policy on public spending as a whole should be counterbalanced by a relatively less rapid expansion of expenditure directly or indirectly influencing consumption, while a way should be found as soon as possible of reducing the growing deficit of the social security system.

14. Past experience seems to prove that the re-establishment of monetary stability by recourse to the instruments of credit and budget policy alone is bound, in the majority of cases, to affect the level of employment. None the less, the easing of the labour markets in certain Community countries has not so far proved sufficient to limit the advance of wages to the growth of general productivity. The authorities should now concentrate on the introduction of an effective incomes policy; this is the only alternative to the re-establishment of financial equilibrium by means of too sharp a cut in industrial investment or public expenditure.



ECONOMIC INDICATORS



NOTES:

Source: Statistical Office of the European Communities.

Graph 1. Three-monthly moving averages of the seasonally adjusted index of industrial production, established by the Statistical Office of the European Communities. Excluding construction, food, beverages and tobacco.

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.

TABLE 1

	1963
Total area ('000 sq. km.)	1 167.5
Total population ('000)	176 986
Density of population per sq. km.	152
Working population ('000)	73 823
Working population, breakdown by main sector (%)	
— Agriculture	18
— Industry	44
— Services	38

TABLE 2

	Volume indices (1958 = 100)							Contri- bution (in %) to 1964 GNP
	1958	1959	1960	1961	1962	1963	1964	
Gross Community product	100	105	114	120	126	132	139	—
Industrial production	100	106	119	127	135	142	151	—
Visible imports	100	105	127	134	149	165	176	—
Private consumers' expenditure	100	104	110	117	125	132	138	60
Gross fixed asset formation	100	109	121	133	142	148	158	23
Visible exports	100	111	125	129	130	135	148	—
Intra-Community visible trade	100	124	152	174	198	230	259	—
Gross product per capita	100	104	112	117	121	125	131	—

TABLE 3

	Year	Jan.	Feb.	Mar.	Apr.	May	June	July	Aug.	Sept.	Oct.	Nov.	Dec.
Industrial production (1958 = 100)	1964	147	152	155	156	159	155	142	120	154	158	164	157
	1965	154	158	157	163	164	163						
Imports from non-member countries (cif, million u.a.)	1964	2 288	2 186	2 237	2 381	2 192	2 320	2 253	1 886	2 083	2 270	2 238	2 460
	1965	2 243	2 090	2 420	2 368	2 380	2 352						
Exports to non-member countries (fob, million u.a.)	1964	1 891	1 878	1 959	2 038	1 866	2 036	2 054	1 726	2 028	2 252	2 113	2 291
	1965	1 936	2 068	2 413	2 172	2 249	2 192						
Balance of trade (million u.a.)	1964	- 397	- 308	- 278	- 342	- 326	- 288	- 199	- 160	- 55	- 18	- 125	- 169
	1965	- 307	- 22	- 7	- 196	- 131	- 160						
Intra-Community trade (million u.a.)	1964	1 436	1 452	1 496	1 577	1 415	1 576	1 531	1 242	1 511	1 654	1 510	1 623
	1965	1 442	1 573	1 796	1 680	1 661	1 692						

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 the second quarter and the following summer months the economic situation of the Federal Republic of Germany was still marked by boom conditions.

The continued rapid expansion of total demand in money terms was based even more than before on the growth of domestic demand. If seasonal factors are disregarded, exports did not advance.

Demand for investment continued to rise sharply—more vigorously for equipment than for construction—but the main stimulus to expansion was provided by a faster increase in demand from private consumers.

With the labour market becoming even more strained, industrial production showed only a moderate upward trend. Nevertheless, it was about 7 % up in the second quarter on the level of the corresponding period of last year.

Imports, which had previously been rising very steeply, increased somewhat less rapidly, but this was mainly due to a more cautious attitude towards imports of raw materials and semi-finished goods. Imports of finished industrial goods continued to show a particularly marked upward tendency.

Prices rose more rapidly than before, but only a part of the increase was due to the general excess of demand and higher unit costs, and some of it also to higher food prices for which the bad weather was largely responsible. In August consumer prices were 3.9 % higher than a year before (cost-of-living index).

The balance of payments continued to deteriorate. Current items showed an adverse balance of DM 2 580 million and the overall balance closed with a deficit of DM 1 140 million. The Bundesbank's reserves of gold and foreign exchange dropped by DM 1 170 million.

Total demand should continue to expand very vigorously over the remainder of the year. Exports may possibly pick up again and, above all, domestic demand should again rise rapidly; demand for investment will show a further increase, which should again be quite substantial, and the faster growth of consumers' expenditure should be maintained.

Production will certainly go up again but—if seasonal factors are disregarded—more slowly than before, owing to physical limitations. The strains between total

demand and supply are likely to persist in spite of further increases in imports. As unit costs are likely to go on rising, there is a danger that prices will continue to show a quite appreciable upward tendency.

The prospects for 1966 do not point to any essential changes in the general level of activity, particularly if public budget policy does in fact develop in the way that at present seems likely.

Foreign demand and the upward trend in investment expenditure are, it is true, likely to have a rather less expansionary impact, but there can scarcely be any doubt that private consumers' expenditure will again increase very considerably.

On the whole the expansion of demand in money terms will also perhaps be somewhat more subdued than in 1965, and the same holds for production. While the growth of the real gross national product for 1965 is estimated at about 5 %, the Commission considers that an increase of more than 4-4.5 % is hardly to be expected in 1966.

This being so, the gap between total demand and domestic production would change very little. This betokens a danger of further price increases—despite the possibility of a fresh deterioration of the external balance on current account, which is not very desirable in itself either.

In view of these prospects, it is necessary not only that credit policy should remain restrictive but particularly that decisions on the public budget policy for 1966 should be such as to effect a permanent change in the trends at present apparent. The Federal Government has announced its intention to revise its policy in this way when drawing up its 1966 budget.

1. Recent developments

The expansion of exports of goods and services in the second quarter was relatively weak. Customs returns even appear to show slight falling-off in visible exports (seasonally adjusted), but this is probably due in part to chance factors. In any case exports of goods were 7.2 % higher (in value) than at the same time last year; in July they were again almost as much as 14 % higher than a year before.

The weakness of exports in the second quarter was particularly manifest in trade with the other EEC countries, where current stabilization policies prevented import demand from rising much—if at all—above the exceptionally high level of the corresponding period of last year.

Domestic demand is still the most important cause of the rapid expansion of total demand in money terms. Expenditure on gross fixed asset formation again rose rapidly in the last few months. But at present a clear distinction can be made between expenditure on construction and expenditure on equipment: expenditure on construction, at least to judge by turnover in the building industry proper, showed only a moderate increase in the second quarter—probably due in part, however, to the difficulty of finding suitable labour and the bad weather—but enterprises continued to step up their investments in equipment very rapidly in the last few months. One sign of this vigorous investment activity is the sharp increase in domestic sales of machinery, which in the second quarter were 14 % higher (in value) than at the same time last year, while imports of mechanical engineering products were more than 28 % higher than a year before.

Investment in stocks, on the other hand, hardly stimulated any additional demand. Replenishment of stocks of raw materials and intermediary products has clearly come to a halt, and has even sometimes given way to a slight reduction in the amounts held. The retail trade on the other hand, has continued to build up its stocks appreciably.

The favourable trend in consumers' expenditure was probably the decisive factor which induced the retail trade to act in this way, for not only has public consumption continued to rise but private consumers' expenditure in particular has shown a strong and even more rapid upward tendency. Retail sales in the second quarter and in July were almost 12 % higher than a year before (and respectively a good 8 % and 7 % higher by volume). In addition, with the start of the holiday period, expenditure on travel went up very sharply.

Private households spent more on consumption as their disposable incomes continued to rise. Incomes probably increased rather more than expenditure on consumption; the savings ratio should therefore turn out to have risen again slightly and the issue of peoples' shares by VEBA may also have contributed to this result.

True, the level of agreed wages on an hourly basis was only 7 % higher in the second quarter than a year before, but the statistics do not include all agreed fringe benefits, and these have in fact risen particularly quickly in some branches of industry, owing to the introduction of additional payments for the formation of wealth and to agreements on holiday pay. Furthermore, to judge by the partial indicators available, actual earnings again rose appreciably faster than agreed wages. Lastly, the growth of disposable incomes was also helped by substantial increases in certain social transfer incomes. If the rise in employment and the effects of tax reductions are also taken into account, net mass incomes in the second quarter of 1965 were about 11 % up on the same period of last year.

The amounts drawn from their business by self-employed persons would also seem to have been going up steadily.

It would have been well-nigh impossible for household incomes to rise so rapidly but for the constantly worsening strains on the labour market, which have now been apparent for some time. In the period covered by this Survey, the excess demand for manpower intensified further. At the end of August there were only 86 000 unemployed; at the same time the employment exchanges had 720 000 unfilled vacancies on their books, so that there were more than 8 vacancies for each person unemployed.

If industry succeeded in raising the number of persons in employment by over 2 % as compared with a year before, this was mainly because the number of foreign workers again increased considerably. The effect of this increase on the volume of employment was, however, partly offset by a drop in the average number of hours worked, due to agreements on shorter hours and longer holidays.

Nevertheless, in domestic trade and industry supply has now become very much less elastic; this is probably mainly due to the extreme shortage of labour and to the fact—partly related with this shortage—that capacities in many branches of industry are now stretched to the full. In any case, the Federal Statistical Office's index of production per working day, seasonally adjusted by the Bundesbank, shows that industrial production increased only slightly between the first and second quarter. In the second quarter it was nevertheless some 7 % higher than at the same time last year, and in July 3.2 % higher.

Agricultural production too has contributed very little to the growth of supply in the last few months. Fruit, vegetables and early potatoes were particularly affected by the bad weather. According to the first forecasts, the grain harvest should be considerably below the—admittedly exceptional—harvest of last year.

Domestic markets eased considerably, again owing to the rapid growth of imports of goods and services; the rate of increase was, however, no longer quite so high as before, especially because raw material imports were still hesitant. Nevertheless, according to customs returns, visible imports in the second quarter were up more than 22 % in value and a good 19 % by volume on the level of a year ago, the corresponding figures for July being 16 % and 12 % respectively. At the same time imports of finished goods continued to expand with exceptional vigour. In connection with holiday travel, which was encouraged by a rapid rise in disposable incomes and the bad weather at home, German tourists are likely to have considerably increased their spending abroad compared with last year.

The upward movement of prices persisted and quickened noticeably. To a great extent, the fresh deterioration in the price climate is due to the considerably higher food prices occasioned by the bad weather. Thus, between the beginning of January and the middle of August, agricultural producer prices, which had dropped by 3.3 % in the same

period last year, went up by 4.8 %. At the same time, however, industrial producer prices also showed a continuing tendency to rise; in August they were 2.7 % higher than a year before. Consumer prices for food rose very sharply; in August they were 5 % up on last year's level. Prices for other goods and services were 3.1 % higher than in the corresponding period of last year. In August the general cost-of-living index thus showed an annual rate of increase of not less than 3.9 %.

The situation of excess domestic demand is clearly reflected in the balance of trade, which was practically in equilibrium in the second quarter (according to customs returns) after achieving a surplus of some DM 1 100 million in the first quarter. In July there was indeed a fresh surplus of DM 122 million, but this was considerably less than a year ago (DM 227 million). In the second quarter there was an unusually sharp deterioration in the balance on services; the deficit amounted to DM 753 million, whereas there had still been a slight surplus (DM 44 million) in the corresponding period of the previous year. The decisive factor here was not so much the increase in foreign travel as the larger deficit with which the balance of investment income closed owing to the particularly high dividends paid by subsidiaries of foreign companies in the Federal Republic. As unrequited payments (including remittances by foreign workers) also tended to rise further, the balance of current items in the second quarter closed with a deficit of DM 2 580 million, compared with a deficit of DM 20 million in the first quarter of 1965 and a surplus of DM 550 million in the corresponding quarter of 1964.

The balance on capital movements (exclusive of variations in the banks' foreign exchange position) showed only a slight surplus (DM 73 million). However, with the residual items—some of them seasonal—not included in the statistics, there was a surplus of DM 1 360 million. The general balance of payments for the second quarter showed a deficit of DM 1 140 million. If seasonal and special factors are disregarded, the tendency to deficits in the balance of payments, which has been apparent since the second quarter of 1964, has clearly continued and gathered strength.

While the foreign exchange position of the banks improved slightly in the second quarter, the Bundesbank's gold and foreign exchange reserves fell by DM 1 170 million.

Not least because of this balance-of-payments situation but also owing, on the one hand, to the continuing keen demand for credit and capital from industry, and particularly from the public sector, and, on the other, to the restrictive credit policy, both the money and capital markets have been showing further signs of strain. The rates for day-to-day money were at times appreciably higher than Bank rate, and interest rates for bonds topped 7 %.

At the same time there was an exceptionally sharp increase in lending by banks. Total loans to business and private customers went up by almost DM 8 000 million. Short-term credits alone rose by not less than DM 3 500 million, i.e. by at least DM 1 000 million more than in the corresponding period of last year. Bank liquidities must therefore

still have been quite abundant—although increasingly squeezed, not only by the trend in the payments balance, but also precisely because of the expansion of credit.

Public cash transactions in the last few months provided a noticeable stimulus to overall liquidity; not only did the Bundesbank's cash holdings decline, but in addition cash advances were taken up.

2. Outlook

In the remaining months of 1965 total demand in money terms will continue to expand very vigorously, although the pace could slacken slightly.

Exports will certainly go up again. If seasonal factors are excluded, there was, it is true, no further increase in industrial orders from abroad in the second quarter, but they were still a good 5 % up on the same time last year (and even 11.5 % up in July). In addition, foreign orders booked by industry as a whole have been rising steadily since the beginning of 1963, so that a further increase in exports should be ensured under this head also. Finally, the improved business situation in some leading importer countries, particularly France and Italy, may well help exports.

The expansion of gross fixed asset formation is likely to remain fairly vigorous for the time being. The marked tendency of building projects to slacken, which was apparent in the first quarter, has hardly persisted. In terms of estimated costs, new public building contracts in the second quarter were up by 2.6 % (in July even by 30.4 %) on a year earlier. An even more marked expansion could be observed in all other sectors. In terms of estimated costs, new construction authorized for housing in the second quarter exceeded the level of the corresponding period of last year by 14.5 % (in July by 15.3 %). In addition, firms' construction projects have again risen very sharply—an indication that the upsurge of investment by them has not yet passed its peak. This is confirmed by the continuing—and only slightly slower—increase in domestic orders for capital goods, which in the second quarter exceeded the quite high level of the same time last year by over 10 %. According to the survey carried out by the Institute for Economic Research (IFO) in the Federal Republic of Germany in the spring, industry intends to invest some 16 % more in 1965 as a whole than in 1964.

Public current expenditure should continue to rise, but perhaps generally not so fast as the other elements of domestic demand.

On the other hand, private consumers will again increase their spending appreciably, and perhaps even at a faster pace than hitherto. The new collective agreements for

important branches of industry point to a continuing strong upward tendency of wage incomes. This should also be encouraged by the fact that actual earnings will probably again increase faster than agreed wages, owing to the labour market situation, which is more than likely to become further unbalanced following new agreements on shorter working hours.

National product and expenditure

	1962 ⁽²⁾	1963 ⁽²⁾	1964 ⁽²⁾	1965 ⁽²⁾
	At current prices (in DM '000 million)	% change by volume on preceding year		
Gross national product	354.5	+ 3.2	+ 6.5	+ 5
Imports ⁽¹⁾	65.3	+ 8	+ 10.9	+ 12.5
Private consumption	204.0	+ 2.8	+ 5.3	+ 6
Public current expenditure	53.1	+ 7.5	+ 0.6	+ 5
Gross fixed asset formation	90.2	+ 2.2	+ 10.9	+ 6
Exports ⁽¹⁾	69.0	+ 9	+ 9.5	+ 7.5

⁽¹⁾ Goods, services and factor income.

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

⁽³⁾ Commission forecasts.

Note :

(a) The difference between the figures for supply and those for utilization 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 from the member countries but are established and published on the sole responsibility of the Commission.

Owing to the very acute shortage of labour and the high level of capacity utilization, whether or not production expands more will largely depend on the progress that can be made with rationalization during the current period of high capital expenditure. Industrial production will certainly continue to rise, but the pace of growth is likely to remain slower than we have been accustomed to observing.

Imports will certainly continue to increase quite strongly, the more so as agricultural imports are likely to be high in the coming months on account of the moderate harvests.

Although total supply on domestic markets will thus go up again considerably, the present situation of excess demand must be expected to persist. The tendency towards considerably higher prices should continue in view of this situation and of the increases in wages and salaries, which still appreciably exceed advances in productivity.

By and large recent developments and the future outlook bear out the forecasts made for 1965 as a whole in the last Quarterly Survey, but the forecasts for the growth of foreign trade, and particularly for imports will have to be revised in an upward direction.

The pattern of the most recent data concerning the economy and economic policy confirms the view expressed in the last Quarterly Survey that 1966 will be marked by a continuing and quite substantial increase in overall demand. In addition to the influence of external demand, this should be sustained above all by consumer spending, stimulated not only by the upward movement of wages, which will probably again be strong, but also by the income transfers from public sources decided upon by Parliament in the last few months. A further factor, in addition to the reduction in income tax on 1 January 1965—the effects of which will still be felt in 1966—is that the “1965 tax amendment law” provided for further tax reductions for certain income groups on 1 January 1966. Lastly, expenditure on gross fixed asset formation should again go up, although certain investment projects may well be difficult, if not impossible, to carry out owing to the increasing shortage of bank liquidities and to higher interest rates on the capital market.

In view of the present prospects for demand, there can be no guarantee that the conditions for growth without strain will obtain in 1966 either. As manpower will certainly continue to be scarce, the elasticity of domestic supply will remain limited, even though capacity ceilings should again be pushed up by the recent high level of capital expenditure. The Commission therefore still considers that the gross national product in real terms is hardly likely to rise by more than 4-4.5 % between 1965 and 1966.

As demand in money terms will probably rise considerably more quickly, there is a danger of further price increases and perhaps also of a fresh deterioration in the balance on current account.

A considerably more restrictive policy would seem to have been called for even up to the present time. However, in one of its most important fields—public budget policy—the trend has been decidedly pro-cyclical, i.e. it has helped to intensify already excessive demand. As a result of the trend that is now discernible following decisions of the Parliament which will have the effect of increasing expenditure or reducing revenue, public budget policy in 1966 will provide further and even stronger stimulus to domestic demand in money terms. This is particularly true on this occasion of the Federal budget itself; but according to the partial information at present available, the subordinate territorial authorities also look more like speeding up their spending than otherwise in 1966.

If the sharp increase in public expenditure could only be met by limiting the scope for financing in the private sector, the growth of private demand would of course have to be curbed.

The Federal Government has declared that budget policy will have to be reviewed again in the autumn when the 1966 budget is prepared. It is urgently to be hoped, not only in the interest of the Federal Republic itself, in view of the threat to the stability of the internal purchasing power of the D-mark and to its competitive position, but in that of its partners in the Community and of the EEC as a whole, that this review will lead to a budget policy essentially in keeping with the present business situation—and it would of course be best if a brake were put on the growth of expenditure. If this did not succeed to the extent required, measures to increase revenue would also have to be taken.

To a certain extent the decision to adopt a budget policy that will do less to stimulate expansion and will not endanger the value of the currency will be the easier to take since the strains on the capital market are and will remain acute and it will therefore not be possible—or at least not without another considerable increase in interest rates—to finance the higher deficits that are now tending to emerge. The banking system, too, will probably not be in a position to step into the breach to any significant extent by expanding credit. Above all, the local authorities will quite soon be experiencing difficulty in carrying out their programmes.

A decisive factor in this connection—and also for other reasons, i.e. the need to check the investment boom in industry—is, of course, that credit policy should steadfastly maintain its restrictive course. By a recent increase in Bank rate (from 3 ½ % to 4 % on 13 August 1965), the Bundesbank has shown that it has no intention of changing course but rather is seeking through its rates to confirm those of the money and capital market and thus also to make bank loans more expensive. At the same time, however, the Bundesbank has partly relaxed an other restrictive measure—reduction of the banks' rediscount quotas, which had already been decided upon and was much more decisive than the slight increase in Bank rate that has now taken place; at all events, only half of this reduction will take effect for the time being.

It must of course be borne in mind that there are limits to what credit policy can do; it must strive to ensure that the money and capital markets do not become so narrow and interest rates so high as again to attract large quantities of capital from abroad. As borrowers of capital, and in view of their housing policies, the public authorities do not want interest rates to rise either. Attempts were therefore made in July to ease the situation by intervening on the demand side of the capital market (ban on new issues of bearer bonds for which licences are required under § 795 of the Bundesgesetzbuch (Legal Code)). In addition talks were held with the most important public borrowers, in order to adjust the demand for capital to the probable supply. After agreement had been reached on the main aspects of voluntary limitation, the authorities began to grant licences again on a smaller scale.

Further developments on the capital market will depend decisively on how far it proves possible to achieve the objectives set by the capital market talks, i.e. either really to limit the demand for capital or else to spread it so effectively as to avoid simply damming up urgent needs. A good example in this respect is the solution adopted in North-Rhine-Westphalia, where the maximum permitted interest burden on borrowing by local authorities has been fixed at 7.6 %. There is also a similar—but somewhat lower—interest ceiling for the Federal Government and its Special Funds. It is most earnestly to be hoped that in the interest of market stabilization the other large authorities will in fact adopt this type of voluntary limitation with regard to interest offered and capital demand in general. This would specially help to improve the psychological climate of the bond market in the short term.

Not least in view of these considerations, important decisions are needed regarding public budget policy and the limits on new borrowing in 1966. Otherwise the choice would be restricted to three courses : either to revise the budgets already adopted, or to exert so much extra pressure on the Bundesbank that it gave in over its credit policy and thus also helped to supply funds for the capital market, or else to resort to considerable borrowing abroad. The second choice and the third—in so far as the latter is at all possible—would certainly be calculated to encourage inflationary tendencies rather than the contrary.

3. The economic situation in West Berlin

West Berlin's rapid economic growth was maintained in the second quarter.

The vigorous expansion of economic activity was mainly due to the strong increase in demand, which still continued unabated from earlier quarters. Thus exports of goods continued to rise very appreciably; their annual growth rate in the second quarter was almost 15 %. Deliveries to West Germany also maintained their upward movement with practically no slackening. In the second quarter they exceeded the value of the corresponding period of 1964 by about 11 % (in July by 7.2 %).

Expenditure on gross fixed asset formation probably rose more rapidly, with spending on construction particularly expansive. But expenditure on equipment is also likely to have risen faster than hitherto—to judge by the available partial indicators and the strong increase in purchases of engineering products from West Germany. Owing to the vigorous advance in net mass incomes, which in the last few months have gone up even faster than in West Germany, private consumers' expenditure also expanded vigorously.

Strains on the labour market have become more intense. At the end of August the number of unemployed stood at 5 850—its all-time low—while registered vacancies again stood at the high 1962 level.

According to the index per working day, industrial production in the second quarter was up almost 15 % on the level of the corresponding period of last year (in July + 12 %); its growth rate was thus noticeably higher than in West Germany. In certain branches of industry the trend was, however, sometimes very different from that in West Germany.

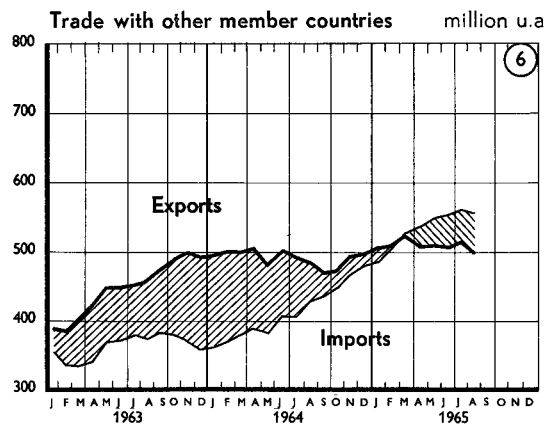
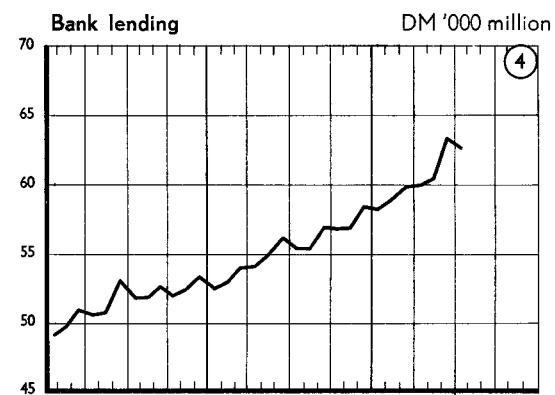
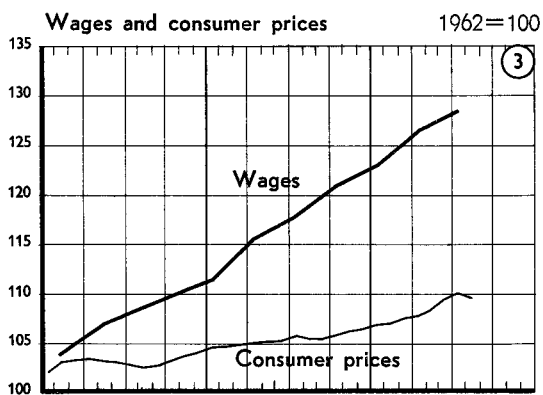
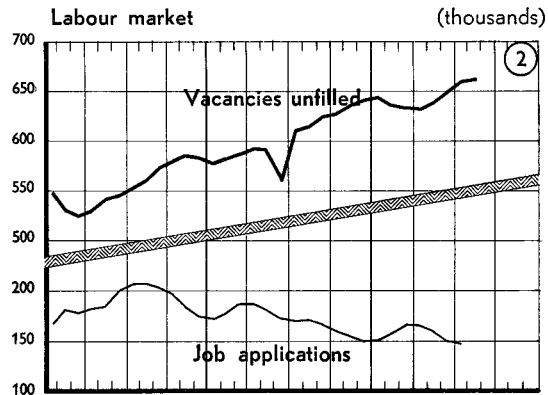
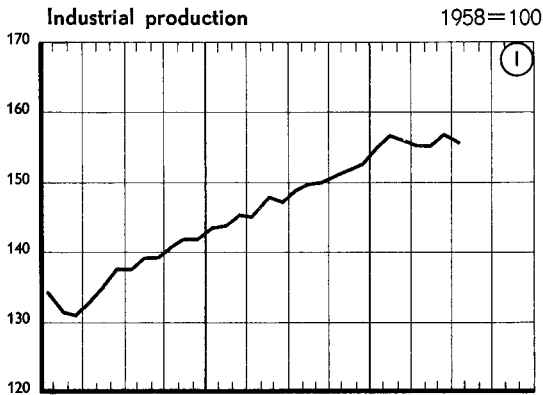
Purchases of goods from West Germany again rose faster than sales to that area, the balance on visible trade showing a deficit of DM 181 million, or some DM 76 million more than in the corresponding quarter of 1964.

As in West Germany—and for practically the same reasons—consumer prices have been rising more rapidly. At mid-August the cost-of-living index was 3.3 % higher than at the same time last year.

With regard to the outlook for the further trend of economic activity, the growth of demand and production can be expected to continue. As new orders received by industry in the last few months went up again and increasingly exceeded sales in the same period, the backlog of orders has again clearly grown.

The economic situation in Berlin has for some time been influenced to a considerable degree by the trend of orders in the electrical engineering industry. It would therefore perhaps be possible to avoid sharp increases in strain in future if public orders to this branch of industry were more regularly spaced out.

ECONOMIC INDICATORS



NOTES:

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

Graph 1. Source: Statistisches Bundesamt. Index seasonally adjusted by the Bundesbank. Moving averages of 3 months.

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.

TABLE 1

	1963
Total area ('000 sq. km.)	248.5
Total population ('000)	57 606
Density of population per sq. km.	232
Working population ('000)	26 880
Working population, breakdown by main sector (%)	
— Agriculture	12
— Industry	48
— Services	40
Percentage share of gross domestic product	
— Agriculture	6
— Industry	51
— Services	43
Gross product per capita (DM)	6 538

TABLE 2

	Volume indices (1958 = 100)							Contri- bution (in %) to 1964 GNP
	1958	1959	1960	1961	1962	1963	1964	
Gross national product	100	107	116	123	128	132	140	—
Industrial production	100	108	120	127	133	137	148	—
Total imports	100	117	137	148	165	178	198	19
Private consumers' expenditure	100	105	113	120	127	131	138	56
Public current expenditure on goods and services	100	109	117	126	140	151	152	15
Gross fixed asset formation	100	113	126	137	146	149	165	26
Total exports	100	113	127	132	137	149	163	20
Gross national product per capita	100	106	114	118	122	124	131	—
Gross national product per person gainfully employed	100	106	113	118	122	125	133	—

TABLE 3

	Value indices (1958 = 100)							Values at current prices (million u.a.)	Total (%)
	1958	1959	1960	1961	1962	1963	1964	1964	1964
Visible exports									
Total	100	111	130	144	151	166	184	16 215	100
Intra-EEC	100	113	140	167	188	227	246	5 910	36.4
To non-EEC countries	100	111	126	135	137	143	161	10 305	63.6
Exports of food, beverages and tobacco									
Total	100	111	122	127	136	153	190	348	2.1
Intra-EEC	100	114	125	127	137	169	207	136	0.8
To non-EEC countries	100	110	119	127	136	151	181	212	1.3
Exports of raw materials and manufactures									
Total	100	111	130	144	151	166	184	15 867	97.9
Intra-EEC	100	113	140	168	189	228	247	5 774	35.6
To non-EEC countries	100	111	126	135	137	143	161	10 093	62.3
Visible imports									
Total	100	115	137	149	167	177	199	14 613	100
Intra-EEC	100	130	159	181	211	229	269	5 097	34.9
From non-EEC countries	100	110	130	137	152	159	174	9 516	65.1
Imports of food, beverages and tobacco									
Total	100	115	120	129	155	143	154	3 003	20.5
Intra-EEC	100	125	143	165	191	191	209	1 054	7.2
From non-EEC countries	100	112	112	117	143	126	135	1 949	13.3
Imports of raw materials and manufactures									
Total	100	115	143	156	171	189	214	11 610	79.5
Intra-EEC	100	131	166	186	218	243	290	4 043	27.7
From non-EEC countries	100	110	136	145	155	171	188	7 567	51.8

TABLE 4

	Year	Jan.	Feb.	Mar.	Apr.	May	June	July	Aug.	Sept.	Oct.	Nov.	Dec.
Industrial production (1958 = 100)	1964	134	141	148	148	158	151	142	137	153	159	166	155
	1965	150	152	152	163	163	161	147					
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	178					
of which :													
home orders	1964	153	158	168	182	163	174	177	153	179	190	181	172
	1965	161	167	193	188	185	178	173					
foreign orders	1964	190	193	187	200	176	193	178	156	190	203	203	206
	1965	187	195	222	199	201	200	198					
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					
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	142				
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				
Total visible exports (million u.a.)	1964	1 240	1 289	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				
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				
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				
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					

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. Note 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

In the last few months the French economy has again shown a more pronounced upward trend, owing to a slight recovery of demand.

Exports again increased very strongly, the rise even being somewhat more rapid in the early summer. In addition, domestic demand provided stronger stimulus to economic activity. Although enterprises in the private sector did not yet increase their expenditure on fixed assets, at least they did not reduce their stocks further but, on the contrary, have begun to build them up again in many fields. The public authorities also followed a more expansive spending policy. But, above all, private consumers' expenditure appears to have risen rather more sharply—in response to a return to more favourable employment and income trends.

The growth of domestic production has been more pronounced. In June industry surpassed the results it achieved in the corresponding period of last year and regained its previous peak of April 1964. Imports have also risen—although still very hesitantly.

The underlying price climate remained calm; as a result of certain increases of a structural and fortuitous nature in the prices of food and services, the level of consumer prices nevertheless rose between March and July rather more than in the four preceding months.

In view of the swift improvement in visible trade, the balance on current account closed with greatly increased surpluses. However, largely because special payments of considerable size (redemption of loans, IMF drawings) were made at the same time, the official gold and foreign exchange reserves rose only slightly between the end of March and the end of July.

In the remaining months of this year the upward movement of the economy should become somewhat stronger, and should increasingly gather speed in 1966 particularly. Admittedly the growth of exports might tend to slacken, but the expansion of domestic demand will probably intensify. First, public investment will in any case almost certainly continue to rise vigorously and at the same time investment by enterprises in the private sector should again also increase more noticeably. Secondly, as incomes must be expected to rise, private consumers' expenditure will in all likelihood provide greater stimulus.

In view of these prospects for demand, the forecasts in the last Quarterly Survey for the growth of the real gross national product should remain valid (some 2.5 % in 1965 compared with 1964, and nearly 4.5 % in 1966 compared with 1965). It should be possible to achieve this faster growth with relatively stable prices and without any significant deterioration of the current payments balance, for, although post-inflationary and structural factors tending to push up prices will still cause some increases, hardly any important cyclical factors with this effect are likely to make themselves felt.

Of course, whether this forecast comes true will depend on whether the French economy can continue to develop in an advancing common market within the Community. In addition, economic policy must continue to avoid any more definitely expansionary budget administration for the purposes of engendering a considerable—and possibly still strongly consumer-orientated—speed-up in the growth of demand; rather should greater investment activity (particularly by private enterprises) be encouraged. This is in fact the direction in which French economic policy is at present moving.

1. Recent developments

The quite vigorous underlying trend for exports of goods and services to rise continued in the second quarter and even quickened slightly at the beginning of the summer. According to customs returns, exports of goods in April/June were on the average about 11 % and in July almost 17 % higher, in value, than in the corresponding period of last year. The growth of exports to other EEC countries remained particularly dynamic; in addition, there was a marked improvement in exports to non-member countries, particularly to the United States and also to the franc area.

At the same time there were more signs of a slight recovery of domestic demand.

With regard to the development of gross fixed asset formation, private industry does appear to be still rather reluctant to increase its expenditure on building and equipment. However, in the last few months, enterprises in the public sector have revised their investment programmes, which in any case already provided for considerable increases in expenditure compared with 1964, in an upward direction. The State also continued to be a very active investor. Finally, expenditure on housing probably rose again with undiminished vigour. In the second quarter the number of building starts was about 10 % higher than a year ago, and that of completions as much as 20 % higher.

Since the spring, investments in stocks have ceased to exert a restrictive influence and the run-down appears to have come to an end in most branches of industry. The retail trade may even have already begun to rebuild its stocks to some extent in view of the improving sales position.

In the last few months private consumers' expenditure did in fact increase rather more vigorously than before. An INSEE survey carried out among retailers shows that turnover has gone up more appreciably—particularly in textiles, clothing and furniture. In the second quarter new car registrations also rose rather more than usual for the time of year. In addition, spending on services connected with the holiday season probably rose appreciably.

The rather more vigorous growth of private consumption was above all determined by an increase in earned incomes, favoured not only by the trend in the volume of employment but also by a more vigorous rise in hourly wages. Hourly wage rates in trade and industry went up by 1.7 % in the second quarter, compared with 1.3 % in the first. In addition, wages and salaries in the public services were raised by 2 % on 1 April. Finally, there was a quite considerable increase in transfer incomes in the second quarter and in the summer months because unemployment pay and various social security benefits went up. Guaranteed minimum wages (SMIG) had been raised by 2 % on 1 March, and this also helped consumption.

Domestic production again showed a more marked upward tendency in response to the slight recovery in overall demand.

According to the seasonally adjusted INSEE index (excluding construction) industrial production, which had still been showing a declining trend at the turn of the year, went up by 1.6 % between the first and second quarter. In June it was slightly higher than in the corresponding period of last year and regained its previous peak of April 1964. This recovery was concentrated mainly in the consumer goods sectors producing cars, textiles and clothing, and in the building materials industries, while growth in the capital goods sector hardly increased at all, and there was even a marked slowdown in expansion in the energy sector and chemicals at mid-year.

There has been a further advance in building output, supported by strong public and private demand, particularly for housing; in the second quarter output was about 7 % higher than in the corresponding period last year.

Agricultural production has also risen quite considerably. Although prospects for the harvest were affected to some extent by the wet weather in July, grain harvests and wine production should turn out very much better than last year. Output of livestock products, too, is above last year's level.

With domestic production again developing rather more steadily, the employment situation has clearly become stabilized. During the second quarter, if seasonal factors are discounted, the total number of persons in paid employment in trade and industry showed no further reduction; the number of hours worked per week even went up by rather more than usual for the time of year. For the time being, however, the labour market was still showing signs of easing, for the birth-rate "bulge" children are now entering the labour market and immigration, in which there has so far been only a slight decline, is still high. However, in this respect, too, the situation is likely to change, as the last INSEE business survey before the summer holidays showed that firms expecting to need substantially more new workers in the autumn months.

Imports of goods and services have so far responded much less than domestic production to the new rise in overall demand. Their decline has indeed been halted, but they have not yet evinced any marked underlying tendency to expand. According to customs returns, imports of goods in the second quarter were still 3 % lower in volume than in the corresponding period of last year, and in July they just reached last year's level. Imports of finished industrial goods rose slightly, while those of raw materials and semi-products were still showing great hesitation and food imports were stationary.

Prices were influenced by the same factors as in the first quarter. The underlying upward tendencies remained weak: producer prices of industrial goods were stable, and there was only a slight increase in their retail prices. On the other hand, structural or fortuitous factors again led to quite substantial increases in the prices of food (fruit and vegetables) and services (rents and doctors' fees). In addition, the charges for certain public services (transport, gas, electricity) were again raised. According to the INSEE index of 259 articles, living costs went up by 1.2 % between March and July—following an increase of 0.9 % in the previous four months. In July they were 3.1 % higher than at the same time last year.

The continuing export boom, coinciding with a still quite hesitant expansion of imports, led to a further rapid improvement in the balance of trade. According to customs returns, visible trade, particularly with other EEC countries, even showed a slight surplus in July—for the first time for two years. The balance of current transactions is therefore also likely to have closed with a large surplus. In particular because the balance of capital transactions was adversely affected at mid-year by interest and redemption instalments and the early repayment of a loan, which together amounted to FF 1 060 million, and also owing to the United Kingdom's drawings on the IMF, the official gold and foreign exchange reserves (gross) rose by only FF 101 million (to FF 26 346 million) between the end of March and the end of July.

Although transactions with abroad did less to increase internal liquidities than in the first quarter, the supply of money (notes and coin in circulation plus sight deposits) has been increasing a good deal more rapidly since the end of March. For one thing, the recent cash transactions of the Treasury have not had an inhibiting effect as previously,

but have in fact been tending to encourage expansion. At all events, Treasury indebtedness increased by FF 71 million in the second quarter, whereas it declined by almost FF 90 million in the same period of last year. But above all lending to industry and private individuals, particularly short-term lending, began to rise again very rapidly. Between the end of March and the end of June the banks and credit institutions increased the total volume of their outstanding loans by no less than FF 4 040 million. In the second quarter of 1964 their lending expanded by only FF 1 770 million.

In the second quarter there were also signs of a certain recovery in demand for capital on the part of industry. The total volume of capital issued (excluding public loans) was, to be sure, rather lower than a year ago—but this was only because enterprises in the public sector and the public savings institutes had brought forward the time-table of their issues to the first quarter. In any case, the sums borrowed on the capital market by private industry and trade in the second quarter were notably higher than a year ago.

2. Outlook

When the summer holidays are over, the recovery of the French economy should progress further; in the remaining months of 1965, the general pace of economic growth should become somewhat faster—a prospect already studied in detail in the last Quarterly Survey (No. 2/1965).

Demand from abroad can be expected to continue to stimulate expansion. Support for this view is to be found both in the way in which economic activity is likely to develop in the most important customer countries and in the good opportunities for French sales at almost stable prices, provided by very abundant harvests, unused productive capacities and shorter delivery dates. Some slackening in the further growth of exports towards the end of 1965—compared with an exceptionally steep increase in the first half of the year—cannot, however, be completely ruled out.

On the other hand, domestic demand may well gather strength in the autumn months.

In any case total expenditure for gross fixed asset formation should continue to expand at the previous rate owing to the continued rapid increase in spending on construction and equipment by the State and enterprises in the public sector. Demand for housing will also continue to show a strong upward tendency. Finally, one cannot rule out the possibility that the propensity of private firms to invest may be favourably influenced both by the gradual improvement in the general economic climate and by the measures taken or to be taken to ease financing.

Investment in stocks should also continue to exert a favourable influence on overall demand.

Secondly—and most important—a stronger increase can be expected in expenditure on consumption by households. Their disposable incomes should rise rather more rapidly than before. Not only will the tax reductions made for 1965 first begin to make themselves felt in the autumn, but in addition the favourable effects of certain factors on gross income will then become marked: these include the expected improvement in the employment situation, a further rise in wage and salary rates—*inter alia* in the guaranteed minimum wage and in wages and salaries in the public service—and the new increase in various social security benefits.

Demand should therefore provide more stimulus to production, particularly to industrial production. According to the EEC business survey, entrepreneurs themselves are expecting production to improve in the autumn months—particularly in consumer goods and—to a lesser extent—in industries which manufacture capital goods.

Imports should also show a more marked upward trend than hitherto, mainly because trade and industry can be expected gradually to rebuild their stocks of raw materials and intermediate products. As exports will probably again expand considerably, it is hardly likely that this will result in any deterioration of the trade balance.

The underlying price climate will probably not deteriorate either. In general, supply is sufficiently elastic to be able to satisfy, at approximately stable prices, the increase in demand which, as expected, is slowly getting under way—the more so as unit costs should be favourably affected by the better utilization of capacity. Furthermore, the general ban on increases in producer prices, which was imposed in the autumn of 1963, is still virtually in force; it has as yet been relaxed only in a few sectors by means of voluntary stabilization agreements. However, as structural upward price trends are still at work (particularly in the services sector), the, albeit moderate, rise in the consumer price level will continue.

The economic developments of the last few months and the outlook for the rest of the year substantially correspond to the forecasts published in the last Quarterly Survey (No. 2/1965). Thus the previous estimates of the probable growth of the real gross national product and of its components in 1965 as a whole, compared with 1964, still hold good. At constant prices the real gross national product will increase by about 2.5 %, compared with 1964.

Nor is there any reason to modify what was said in the previous Quarterly Survey with regard to the outlook for economic activity in 1966. Of course there is still quite a large element of uncertainty in these forecasts—because they are largely based on data which it is not possible to determine more precisely at the present time, such as indus-

trialists' capital projects and the budget estimates. It can, however, be assumed with a considerable degree of probability that the pick-up in general economic growth which has slowly begun will continue into the new year and gather momentum.

As the pace-setter for expansion, domestic demand should increasingly replace foreign demand, the increase in which might well slacken if, as is likely, the upward movement of world economic activity is less strong than in 1965.

National product and expenditure

	1962 ⁽²⁾	1963 ⁽²⁾	1964 ⁽²⁾	1965 ⁽³⁾
	At current prices (in FF. '000 million)	% change by volume on preceding year		
Gross national product	356.3	+ 5.1	+ 5.4	+ 2.5
Imports ⁽¹⁾	48.2	+ 12.7	+ 11.9	+ 3
Private consumption	229.7	+ 6.6	+ 4.3	+ 3
Public current expenditure	48.0	+ 2.6	+ 3.0	+ 3
Gross fixed asset formation	70.2	+ 6.8	+ 10.2	+ 5
Exports ⁽¹⁾	51.3	+ 8.6	+ 7.5	+ 7.5

⁽¹⁾ Goods, services and factor income.

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

⁽³⁾ Commission forecasts.

Note :

a) The difference between the figures for supply and those for utilization 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.

In the first place, investment by private firms will probably begin to rise notably along with investments in the public sector which, in any case, are certain to show a further vigorous increase. At all events a first survey carried out in industry by the INSEE in June this year shows that investment plans for 1966 were already more op-

timistic at that date than were the corresponding plans for 1965 a year before. The new measures since announced by the Government to ease financing should further encourage the propensity to invest, so that these plans may perhaps have to be revised in an upward direction—all the more so because the need to increase technical capacities might again become apparent fairly quickly in some industries where production will rise.

Secondly, demand should be increasingly stimulated by households' expenditure on consumption. Incomes will rise more appreciably than in 1965, simply because of the probable trends in employment—but also perhaps because wages will again increase at a slightly faster pace.

With these prospects for demand, domestic production and imports should show a quite pronounced upward tendency. In the Commission's view, it is perfectly possible that there will be an increase of almost 4.5 % in the real gross national product for 1966, compared with 1965, with a broad balance at the same time maintained on the commodity and labour markets.

If this forecast is to materialize, an essential condition is, however, that the French economy should be able to continue to develop in future as part of a progressive common market—to the emergence and particularities of which the French economy has been increasingly geared in the last few years. In addition, it is important that French trade-cycle policy should maintain essentially the same orientation as hitherto.

In the last Quarterly Survey (No. 2/1965) it was pointed out that French trade-cycle policy as a whole conforms to the requirements of the present situation and of probable future developments, and thus also to the Council recommendations. In this respect there has been no change in recent months either. The policy of avoiding any special general measures of stimulation, or even measures to stimulate consumption directly, and of providing cautious support and encouragement for the propensity to invest, is still the right one—now that numerous indicators confirm that growth has begun to speed up again.

In fact any premature, artificially induced, rapid expansion of demand primarily directed towards consumption should be regarded as dangerous. There can be no doubt that it would be accompanied in the quite near future by the risk of new imbalances and of new price and wage strains. Instead of this, a more lively expansion of investments—particularly by private firms—is eminently desirable. If such investments receive appropriate encouragement, it will be possible in the longer term again to achieve more balanced and sufficiently rapid economic growth, because these investments widen the scope for supply and help to reduce costs.

The steps so far taken to stimulate investment and the further measures to this end already announced for the autumn are adequate for this purpose. Indirect inducements which serve above all to improve the possibilities and terms of financing predominate.

The additional capital development loans at very low interest rates which the State is to make to public and private concerns, and which will amount altogether to FF 1 000 million, are to be raised by the issue of government bonds on the capital market.

In addition, it proved possible in the last few months progressively to abolish further precautionary measures taken in pursuance of the stabilization programme of the autumn of 1963 : with effect from 1 July, the direct quantitative limit on the expansion of bank loans was discontinued—with the proviso, however, that the banks should in future continue to avoid any undue expansion of credit.

In practice, it is true, budgetary policy no longer has an inhibiting influence on overall demand—this is, moreover, no longer necessary—but the principles of a cautious pattern of expenditure and a balanced budget are still applied.

This is shown fairly clearly—as far as the State budget is concerned—by the draft Finance Act for 1966 which the Government laid before the National Assembly in mid-September. Definitive expenditure is to rise by 6.96 %—hardly any faster than was laid down in the preliminary estimate for 1965 (6.88 %). There has also been little change in the pattern of this expenditure. Nevertheless—in spite of various economies—the increase in military and current civil expenditure appears to be somewhat higher than for 1965, whereas capital expenditure for civilian purposes is to rise rather less.

This definitive expenditure is to be offset by revenues which will expand very much more slowly the increase being 6.63 % as against 12.73 % for 1965. This reflects, in the first place, the consequences of the decline in economic activity which has just been halted. Secondly, the effect of the tax reductions—mainly affecting unearned and low incomes—already decided upon in 1965 and of the further ones now proposed by the Government for 1966, will be to reduce the growth of tax revenue (by about FF 1 700 million).

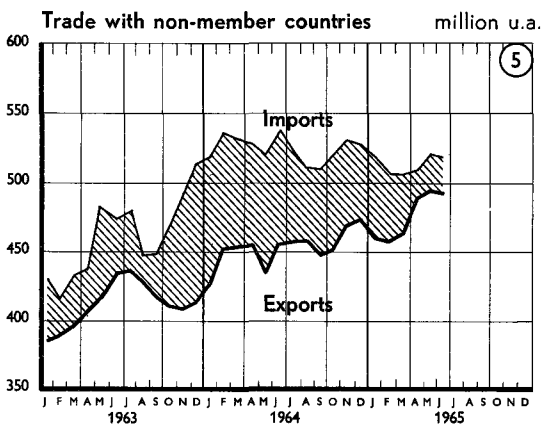
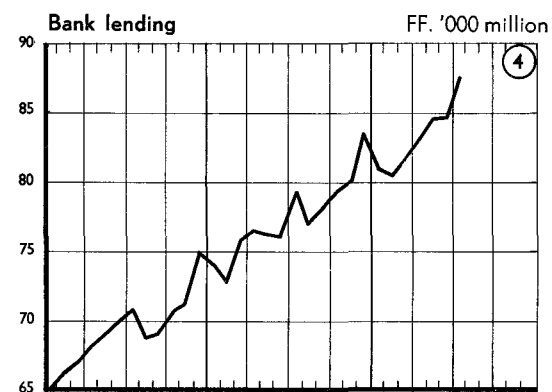
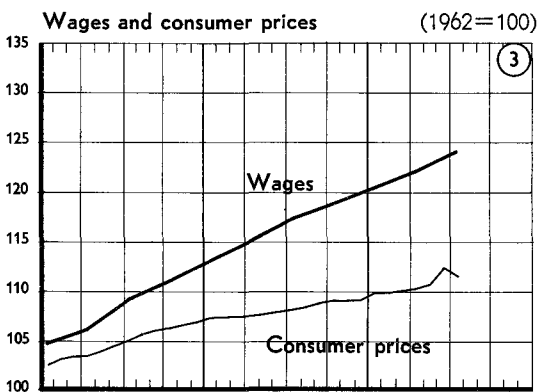
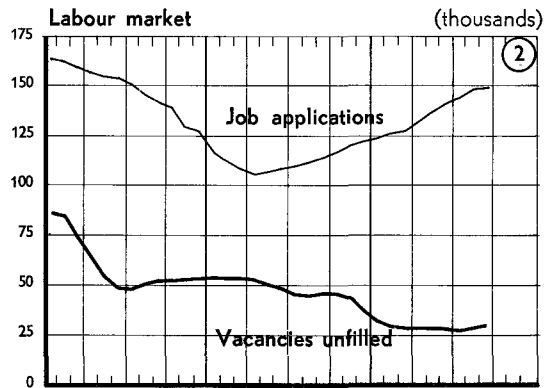
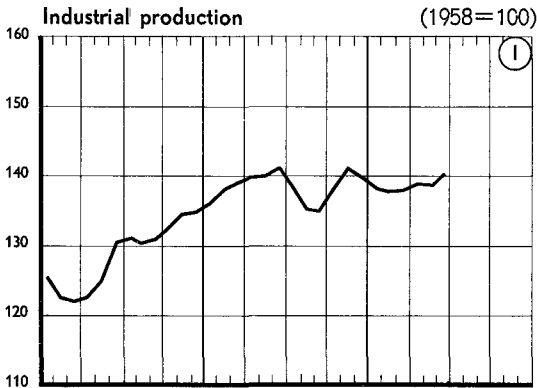
In these circumstances balancing the overall budget posed very difficult problems. If the Government wanted to avoid cancelling the special capital development credits—which would not have been advisable in view of the economic outlook—the only alternative was to transfer the expenditure on certain financing operations from the Treasury to special credit institutions which will have recourse to the capital market or some other form of savings. This “debudgetization” has mainly been adopted for housing subsidies, which are now allocated directly by the Caisse des dépôts et consignation, only the corresponding interest subsidies being included in the budget.

The economic effect of this “debudgetized” expenditure appears to be the same; the process of financing has simply been “short-circuited” to some degree. It is, however, extraordinarily difficult at the present time to pass a final judgment on the 1966 Finance Act, as the precise extent of the “debudgetization” which has taken place is still not known, and also because the presentation of the budget and the arrangement and deli-

mitation of the individual items in it have been changed, so that it hardly seems possible without reservations to compare it with the 1965 budget.

The measures designed to provide a further stimulus to the formation of private savings capital, announced at the same time as the 1966 Finance Act, are of great importance from the point of view of anti-cyclical policy; these are an increase in the ceiling for savings bank deposits, the introduction of a standard tax-rate for the interest on liquid savings, and full tax exemption for the interest on immobilized long-term savings. These measures will certainly help to improve the machinery for financing investment, and will thus facilitate the new upswing in economic activity.

ECONOMIC INDICATORS



NOTES:

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

Graph 1. Source: INSEE. Series seasonally adjusted. Moving averages of 3 months.

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 Cr dit. 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.

TABLE 1

	1963
Total area ('000 sq. km.)	551.2
Total population ('000)	47 850
Density of population per sq. km.	87
Working population ('000)	19 298
Working population, breakdown by main sector (%)	
— Agriculture	20
— Industry	39
— Services	41
Percentage share of gross domestic product	
— Agriculture	11
— Industry	41
— Services	48
Gross product per capita (FF)	8 266

TABLE 2

	(Volume indices 1958 = 100)							Contribution (in %) to 1964 GNP
	1958	1959	1960	1961	1962	1963	1964	
Gross national product	100	103	111	115	123	130	137	—
Industrial production	100	103	110.5	116.5	124	131.5	140	—
Total imports	100	98	115	123	133	150	168	15
Private consumers' expenditure	100	102	108	114	122	130	135	64
Public current expenditure on goods and services	100	107	109	113	118	121	125	13
Gross fixed asset formation	100	102	109	121	130	139	153	21
Total exports	100	112	131	139	143	155	167	14.5
Gross national product per capita	100	102	108.5	112	117.5	121	126.5	—
Gross national product per person gainfully employed	100	103.5	111.5	114.5	121	125.5	131	—

TABLE 3

	Value indices (1958 = 100)							Values at current prices (million u.a.)	Total (%)
	1958	1959	1960	1961	1962	1963	1964	1964	1964
Visible exports									
Total	100	110	134	141	144	158	176	8 990	100
Intra-EEC	100	134	180	213	239	272	307	3 487	38.8
To non-EEC countries	100	103	121	120	117	125	138	5 503	61.2
Exports of food, beverages and tobacco									
Total	100	99	136	159	155	189	216	1 436	16.0
Intra-EEC	100	147	228	287	291	391	457	557	6.2
To non-EEC countries	100	89	115	131	124	143	162	879	9.8
Exports of raw materials and manufactures									
Total	100	111	133	138	142	153	170	7 554	84.0
Intra-EEC	100	133	174	204	233	258	239	2 930	32.6
To non-EEC countries	100	105	122	118	115	122	134	4 624	51.4
Visible imports									
Total	100	91	112	119	134	156	180	10 067	100
Intra-EEC	100	111	151	171	206	255	307	3 762	37.4
From non-EEC countries	100	85	101	104	114	128	144	6 305	62.6
Imports of food, beverages and tobacco									
Total	100	84	89	87	104	110	126	1 782	17.7
Intra-EEC	100	154	180	158	217	299	376	347	3.4
From non-EEC countries	100	79	83	82	97	97	109	1 435	14.3
Imports of raw materials and manufactures									
Total	100	93	119	130	144	171	197	8 285	82.3
Intra-EEC	100	107	148	172	205	251	301	4 416	33.9
From non-EEC countries	100	88	109	114	121	141	159	4 869	48.4

TABLE 4

	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	139	142	142	144	144	146						
Building : number of permits issued ('000)	1964	39.8	39.3	43.1	47.6	41.5	47.6	51.0	33.3	44.2	67.9	47.3	72.5
	1965	38.8	45.1	46.0	43.9	44.3							
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							
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	828	681				
Total visible exports (million u.a.)	1964	731	751	768	771	705	797	754	554	697	834	806	823
	1965	688	782	896	839	853	823	881	656				
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	- 42	+ 53	- 25				
Official gold and foreign exchanges reserves (gross, million u.a.)	1964	4 481	4 494	4 477	4 533	4 630	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				
Money supply (FF '000 million)	1964	147.5	146.6	148.5	148.6	149.0	152.1	156.5	154.8	155.2	155.8	154.5	162.0
	1965	159.4	158.3	159.9	161.9	162.6	166.4	170.7					

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

Economic activity continued to recover in the second quarter and, as far as can already be assessed, in July also.

From the angle of demand, the sharpest rise was once again in exports of goods and services. The value of goods exported in the second quarter was a good 22 % above the particularly high level of the same period in 1964. Exports of services, too, seem to have expanded vigorously.

Domestic demand, on the contrary, remained sluggish on account of the still hesitant trend of gross fixed asset formation: both building demand and investment in plant and equipment actually seem to have suffered a further setback. Private consumers' expenditure however rose again, mainly as a result, it is true, of the total number of hours worked again moving closer to the normal level, of fresh wage increases, improved family allowances and larger cost-of-living bonuses.

On the supply side, production has made distinct progress in agriculture and even more in industry (excluding building and construction) and in the services sector. According to the ISTAT index, seasonally adjusted by ISCO, industrial production rose by 3.5 % from the first to the second quarter; the gross index was 3.5 % higher than in the second quarter of 1964. But not all branches of industry benefited from this expansion; textiles, in particular, were still weak, and the activity in building and construction appears if anything to have declined.

Unemployment went up again, largely on account of the situation in the building industry and also probably because the improvement in the total number of hours worked was once again due mainly to the longer hours put in by those already in employment.

Supply from abroad has probably tended to rise further, though imports were hindered by a lengthy strike of customs officials. The value of visible imports in the second quarter was still 7 % below the figure of a year earlier, which was itself depressed by the slackening in business activity.

The upward movement of prices, which had previously levelled out appreciably, became somewhat more pronounced; the main cause was the shortage of some crop products owing to the bad weather. Wholesale prices in July were 1.6 % higher than in July 1964 and consumer prices were 4.4 % up.

For the April-July period the balance of payments showed a heavy surplus (nearly Lit. 450 000 million), as the surplus on current transactions grew once again and the capital account improved further. The net increase in official gold and currency reserves amounted to Lit. 309 000 million.

Economic growth may well continue in the second half of 1965 and gradually increase its momentum. This acceleration is however conditional on an upturn of investment in plant and equipment; there are in fact a number of signs that such a recovery has begun. Production will in any case rise further, and it is quite possible that the predicted 3 % growth of the real gross national product for the full year 1965 will be achieved. Further price rises and the possible deterioration of current account are likely to be moderate.

These tendencies will probably continue next year and become more marked. The expansion of exports which can once again be expected, but which is likely to be slower than previously, will continue to be an important factor in maintaining the level of business activity. Domestic demand, especially investment in plant and equipment and private consumption, will in all probability continue to grow, but faster. The 1966 prospects for investment in building and construction, however, are still uncertain, if not decidedly unfavourable. The gross national product in real terms may none the less increase by 4-5 % from 1965 to 1966.

If there is to be real growth on this scale—it might be even greater—and if there are at the same time to be greater stabilization of prices and costs, increased employment, and no fresh deficits in the balance of payments, the emphasis in short-term economic policy must be on promotion of investment rather than on those forms of expenditure which directly contribute to consumption.

1. Recent developments

Exports of goods and services again expanded very vigorously. The seasonally adjusted values of visible exports (based on customs returns) rose from the first to the second quarter even a little faster than from the fourth quarter of 1964 to the first of 1965, although the prolonged strike of customs officials in May and June probably had a restrictive effect on the trend of trade.

The value of goods exported in the second quarter was a good 22 % above the already high level of the corresponding period in 1964. As export prices have if anything declined slightly, the growth rate by volume was even higher.

Exports of iron and steel, chemicals and capital goods showed the steepest rises. From the geographical angle the highest growth rates were for deliveries of goods to the other member countries, in particular the Federal Republic of Germany and the Netherlands.

Exports of services may have increased more rapidly as a result of the upward trend in the tourist trade and in remittances from Italians working abroad.

Domestic demand in the second quarter, on the other hand, probably remained sluggish; this was entirely due to the continuing decline of expenditure on growth fixed asset formation. The adjusted figures for investment in building and construction, in particular, seem to have declined. The amount of public works, it is true, again advanced in lively fashion as a consequence of the expansionary short-term economic policy; in April and May, at any rate, their value was—despite the bad weather, and excluding new housing financed by public funds—11.5 % higher than a year earlier, and it appears to have gone on rising vigorously. Other building investment, on the other hand which accounts for some four-fifths of total expenditure on building and construction, presumably declined further. Until April at least—more recent indicators are not available—activity in the building sector as a whole seems to have been almost stationary, though at this time of year there is normally a sharp rise. According to the quarterly sample surveys made by ISTAT, the number of workers employed in building increased from January to April far more slowly than is usual at this season; the increase was only 16 000, against 124 000 a year previously. Moreover, investment in plant and equipment probably declined further. The figures available on production, imports and exports of capital goods support this assumption.

Investment in stocks, on the other hand, may have picked up somewhat in harmony with the trend of demand and production, especially in the shape of stocks of raw materials and semi-finished goods, works in progress and finished goods held by dealers.

Consumer spending also continued to expand, at least as rapidly as in the first quarter. Not only did public current expenditure continue to rise in value—expenditure on staff tended to increase in the second quarter—but also private consumers' expenditure continued to move distinctly upwards, with mass incomes expanding further and private consumers' propensity to spend remaining at least high. The growth of farm incomes is also likely to have helped increase consumption.

In any case, the production of industrial consumer goods and imports of consumer goods grew distinctly, while exports of such goods seem if anything to have stagnated. Domestic purchases of consumer durables rose particularly fast, especially purchases of passenger cars. In the second quarter the number of new registrations was higher than that of a year previously for the first time in twelve months (by 27 %, though here the particularly low level of registrations a year ago must be borne in mind). In July the upward tendency persisted.

The total wages bill may have grown further. Agreed minimum wages and salaries per person employed and per hour went up again from the first to the second quarter, mainly because of an appreciable raising of family allowances on 1 April and also on account of the new collective wage agreements in some industries and a further, but relatively small, increase in cost-of-living allowances under sliding-scale agreements in most of industry. Furthermore the trend of the total number of hours worked⁽¹⁾, which had been declining in 1964, may have levelled out further. According to the ISTAT sample surveys—more recent statistics are not yet available—the number of wage and salary earners has none the less shown a seasonal rise from January to April, while twelve months before there had been a reduction of 45 000 owing to the weakening of economic activity at that time. But probably of greater importance is the fact that the number of working hours per person employed is tending to rise : in April there were 424 000 fewer on short time than in January, while in 1964 the corresponding seasonal reduction had been only 90 000 (source : ISTAT).

As a general pattern, present recovery of business activity seems to be having less effect on the number of persons in employment than on the number of hours worked, just as the weakening of activity in 1964 had at first led chiefly to a reduction of working hours. This probably also explains why the number of unemployed continued its upward trend at any rate until April 1965; in that month it was 673 000 (3.4 % of the labour force), 39 % more than in April 1964 (source : ISTAT).

On the supply side, agricultural production in the second quarter remained on the whole at much the same high level as in late 1964. Livestock production appears to have maintained its slow upward movement. Of crop products the fruit harvest suffered most from the bad weather.

Industrial production, on the other hand, advanced even more rapidly. The ISTAT index, seasonally adjusted by ISCO, rose from the first to the second quarter by 3.5 %, after a 0.7 % growth from the fourth quarter of 1964 to the first quarter of 1965.

⁽¹⁾ The number of wage and salary earners multiplied by the number of working hours per head.

In the second quarter of 1965 the gross index was for the first time since mid-1964 higher than a year earlier—3.5 % up—when however it had been suffering from the trend of business. In June, the highest previous figure for seasonally adjusted industrial production (January 1964) was exceeded by 1.5 %.

The greatest progress was made in the production of private cars, iron and steel, and food products. The trend of output remained weak, on the other hand, in the textile industry, which for a long time has been going through a structural crisis, and to a lesser degree in most capital goods industries, although in the latter there were signs of some recovery in May and June. According to advance information, seasonally adjusted industrial production was somewhat lower in July than in June, but higher than the monthly average for the second quarter. At the moment the August production figures are available for iron and steel only. According to these figures the production of steel was no less than 36 % and that of iron as much as 63 % higher than twelve months before.

Building output may have declined again. On the other hand, the information at present available points to a continuance of the upward trend noted in the services sector since last autumn.

Supply from abroad grew further. Visible imports may, seasonal movements apart, have risen at a somewhat slower rate by volume and value from the first to the second quarter than from the last quarter of 1964 to the first quarter of 1965. It must be remembered, however, that the strike of customs officials in May and June probably slowed down the customs clearance of imports. Once allowance is made for this, the growth rate of imports has perhaps not decreased; customs returns, however, show them to have been still 7 % in value below the level of a year before.

Imports of intermediate products, and even more of raw materials, increased with particular vigour. Deliveries from the other member countries expanded at more or less the same rate as those from the non-member countries. Imports of services may also have made further progress.

The upward trend of prices, which had levelled out further in the first quarter, became somewhat more marked again in subsequent months. The weather appears to have been mainly responsible for this, as in some cases crop production was affected. In April, May and June there were at any rate appreciable increases in the wholesale prices of foodstuffs. Despite a further decline in the prices of industrial goods, the overall index of wholesale prices consequently began to rise again from May—the first rise for 4 months; from June to July, however, it eased somewhat as the price of crop products fell back again. In July it was 1.6 % higher than in July 1964, compared with 1.1 % in March.

The increases in food prices that occurred up to June were immediately passed on to the consumer, and together with other factors such as higher fares for public transport in some towns, they prevented the earlier levelling-out of consumer prices from continuing into the second quarter. One reason why the gap between the level of consumer prices in July this year and a year earlier was smaller than it had been in March (4.4 % as against 5.5 %) is that the upward movement of consumer prices was considerably faster in 1964.

The trade balance improved further in the second quarter; it even showed a small surplus (Lit. 6 000 million, compared with a deficit of Lit. 283 million a year before). At the same time net receipts from services expanded considerably. As a result the surplus on current account (as defined for statistics on exchange operations) increased far more sharply than is usual at this season: Lit. 252 000 million as opposed to Lit. 71 000 million from January to March. As the capital account began to show a surplus at the same time, the surplus on the overall balance of payments was no less than Lit. 277 000 million; in July alone it amounted to Lit. 172 000 million. That official gold and currency reserves (net) from March to July rose by only Lit. 309 000 million was entirely due to the banks making a further considerable reduction in their short-term external indebtedness. The rise in official net reserves does not however reflect the IMF's gold sales to Italy—a good Lit. 20 000 million—which were made in May in connection with the United Kingdom's drawing on the IMF, as this increase in the gross gold reserves was offset by a corresponding increase in the short-term indebtedness of the monetary authorities. At the end of July the official net reserves totalled Lit. 2 657 000 million and corresponded to the value of some seven months' imports; in August they seem to have risen vigorously once more.

The banks' domestic liquidity benefited considerably from the trend in the balance of payments. In the second quarter, however, this trend was more than offset by the seasonal expansion in the circulation of notes and coin and, even more, by Treasury cash surpluses. The inflow of funds from some public bond issues in the period under review far exceeded the cash deficit—which once again increased in size—produced by other Treasury transactions. The ensuing net reduction of liquidity, a vigorous increase in the commercial banks' security holdings and perhaps also some recovery of the demand for credit—in the second quarter bank loans were 2.8 % higher than a year earlier (first quarter 1.6 %)—were probably the main reasons why the banks had now, after a considerable length of time, to borrow once again from the Central Bank. The volume of Lombard and rediscount credit of the monetary authorities increased from March to June by some Lit. 200 000 million.

The security market showed divergent tendencies. On the one hand the demand for shares remained sluggish, even though share prices again rose more distinctly at the end of August. On the other hand investors continued to show a very lively interest in

bonds. There was no decline worth mentioning in the yield of fixed-interest-bearing securities, as a considerable number of bonds were again issued. Almost all these new issues were sponsored by bodies in the public sector (in the widest sense).

2. Outlook

The current recovery of economic growth may continue to gather strength until the end of the year.

Foreign demand will, it seems, expand appreciably once more, even though some slowing down in the rate of growth is probable. At any rate the prospects for the world economic situation are on the whole not unfavourable. In addition the short delivery periods which Italian industry can offer thanks to its present great elasticity of production still provide it with a considerable competitive advantage over many other countries.

The trend in exports, however, may be hindered somewhat by the pick-up of domestic demand. Be that as it may, the results of both the EEC business surveys and the *Mondo Economico* "Forum" survey suggest that businessmen still consider the export outlook for the second half of 1965 with confidence.

The growth of domestic demand in the second half of the year may be perceptibly more rapid than previously. The decline in expenditure on investment in plant and equipment as a whole may slowly come to an halt. On the other hand, despite the measures taken by the authorities to encourage a recovery of the building sector, investment in building and construction may well remain slack for a while; investment in housing, which accounts for a good half of all building and construction investment, may continue to tend very distinctly downwards: unsold new dwellings (value) seem to have accumulated at rather a high level. The number of dwellings planned in the larger urban areas was in April and May about one third lower than a year before (source: ISTAT). Only public works, a bare fifth of overall investment in building, may show further lively growth, largely as a result of the anti-cyclical "super-decree" ⁽¹⁾ which took effect on 16 March. In the sphere of industrial and other business building a number of industries, particularly electricity and petroleum, were undertaking larger-scale works (dams, oil

(1) See the last two Quarterly Surveys.

pipelines); but the impact of these schemes will probably not influence the total figures to any great extent.

The prospects for investment in plant and equipment appear more favourable. In the spring there was no increase in the number of businessmen who believed that greater production was possible within the limits of their capacity should the flow of orders be stepped up; this was the first time for a considerable period that there was no increase. The fact that, in the meantime, industry as a whole has again reached and even slightly exceeded its former production record points to a recovery in the utilization of capacity, especially when it is recalled that, in view of the recent reductions in investment, the growth of capacity can no longer have been very great. The time may be nearer when expenditure for expansion will become of interest in some industries at least. The earning power of many enterprises may indeed be decidedly strained, but this provides a strong incentive to invest in rationalization and modernization, especially as the increasing importance of foreign trade calls for greater competitiveness on the international plane. Lastly, official policy can probably be expected to continue favouring investment, and in this connection the latest information shows that in the capital goods industries the backlog of domestic orders has again shifted to a figure near normal.

Investment in stocks may rise appreciably towards the end of the year. A further reduction in stocks of finished goods held by manufacturers is likely to be more than offset by increases in stocks of raw materials and semi-finished products and by a recovery of investment in stocks by dealers.

Consumption expenditure, both public current expenditure and even more private consumers' expenditure, will certainly also show an appreciable further rise. Mass incomes can be expected to expand further and households to maintain their propensity to spend at its current high level. The continuing crisis in building and in parts of the textiles industry—two particularly labour-intensive sectors—will, it is true, act as a brake on the total of wages and salaries in the next few months, but the growth of incomes earned by workers and salaried employees in the remaining sectors may more than offset this factor. In addition, cost-of-living allowances were once again increased considerably in August under the sliding wage scale. Lastly, social security transfer incomes will rise sharply in the second half of 1965 as a result of the recent changes affecting social insurance pensions.

These prospects for demand suggest that the expansion of supply will probably be maintained and perhaps accelerated in late 1965. Given normal weather, agricultural output as a whole will probably tend to grow. Industrial production may expand again; this assumption is largely confirmed by the fact that here too, according to the EEC business survey, the backlog of orders has been returning more closely to normal. The building trend, on the other hand, is likely to remain weak.

Imports are expected to grow faster in the second half of the year, and the trade balance may therefore tend to be less good than in the first half of the year. The balance of current payments will nevertheless still show considerable surpluses.

The upward tendency of the price level—consumer prices at least—will probably continue. Rising costs will, it is true, be a factor of less importance than before as production increases and the utilization of capacity improves; but the recovery in the expansion of demand might encourage managements to attempt to pass on, in part at least, earlier sharp increases in unit costs and in this way to restore their profit margins. The tariffs of some public enterprises may also be raised because of costs. In addition structural factors will continue their upward pressure on prices. The foreseeable trend of demand, however, will probably not be so expansionary in the near future as to allow of any appreciable acceleration of the upward movement.

These short-term economic prospects—and the trend as far as it can be analysed to date—confirm by and large the last Quarterly Survey's forecasts of the main results for the full year 1965 by comparison with 1964. In particular the assumption of a growth rate of some 3 % for the real gross national product still appears to be valid. In the light of latest developments, however, there is likely to be an even more appreciable decline in gross fixed asset formation investment and a faster increase in exports than was expected three months ago.

The outline given in the last Quarterly Survey of the probable future trend of the Italian economy in 1966 still seems valid ⁽¹⁾. The growth rate of the gross national product in real terms may be between 4 and 5 %. It is still assumed that the expansion of overall demand in 1966 will be brisk but the part played by foreign demand will probably be greater than previously predicted, that of domestic demand correspondingly smaller. Mainly because the difficulties in the building sector will take some time to remedy, the growth rate for gross fixed asset formation had to be adjusted downwards somewhat.

The aim of short-term economic policy will still have to be the recovery of economic expansion; but at the same time expansion must be guided so that the tendency for prices and costs to level off is not compromised and no fresh deficit introduced in the balance of payments. As a main goal, investment must still be encouraged, both public

⁽¹⁾ See Quarterly Survey No. 2, p. 70.

investment and that of private and State-controlled enterprises. This would lead not only to a considerable acceleration of business activity in general—with effects on employment and consumer demand in particular—but would also help to lower costs and increase the real possibilities of balanced economic growth.

National product and expenditure

	1962 ⁽²⁾	1963 ⁽²⁾	1964 ⁽²⁾	1965 ⁽²⁾
	At current prices (in Lit. '000 million)	% change by volume on preceding year		
Gross national product	24 789	+ 5.3	+ 3.0	+ 3
Imports ⁽¹⁾	4 365	+ 21.3	— 5.7	+ 2
Private consumption	15 006	+ 9.9	+ 2.6	+ 3
Public current expenditure	3 645	+ 6.7	+ 3.8	+ 5
Gross fixed asset formation	5 846	+ 7.3	— 10.1	— 9
Exports ⁽¹⁾	4 357	+ 6.2	+ 10.7	+ 16

⁽¹⁾ Goods, services and factor income.

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

⁽³⁾ 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.

The readiness of private companies as a whole to make such investments already seems to be growing; it should perhaps be supported by further tax and credit incentives linked as closely as possible with investment and by measures to create a normal situation in the capital market.

After the sharp deterioration in the profitability of enterprises over the last year or two, action to lower costs is essential. From the angle of credit policy this means that not only the supply of credit must be maintained at a sufficiently high level, but also that the cost of money must be decreased directly.

Action on the above lines is also essential in order to overcome the crisis in the building sector as speedily as possible. It will be likewise necessary to improve the psychological climate of the building market and to abstain from measures which have a restrictive effect on a part, at least, of private demand for houses and flats.

Budget policy must still concentrate the expansion of public expenditure as far as possible on investment, and limits will have to be placed on the growth of other expenditure—and they will have to be observed—in order to ensure that the fillip imparted by the budget as a whole is not too strong and not too difficult to check should need arise. In promoting expansion priority should be given, where possible, to expenditure which can be taken in hand relatively quickly, so that at a later stage of the upward trend the growth of government spending could if necessary be slowed down rapidly enough.

Finally, further efforts should be made to relate wage policy more closely to the economic situation; in this the public authorities and state-controlled enterprises could set an example. Here it should be kept in mind that as demand is revived, it is permissible that private consumers' expenditure to rise more steeply than before, but that the necessary increase in mass incomes must at present be achieved rather through an increase in numbers employed than through an increase in hourly earnings. In particular, further rises in unit costs must be avoided; indeed a reduction is desirable if there is to be no delay in achieving more employment coupled with stabilization of prices. Undue wage rises in weak sectors, especially if they are also labour-intensive, can greatly delay or even prevent a rapid solution to the crisis.

Since June, that is since the last Quarterly Survey was completed, the Government has taken or prepared some further steps of importance from the angle of short-term economic policy. In particular it has submitted the budget for 1966, which provides for a total expenditure of Lit. 8 013 000 million, 9 % more than the expenditure proposed for 1965. Total revenue was estimated at Lit. 7 121 000 million (6.5 % up), and the deficit at Lit. 892 000 million, or Lit. 235 000 million more than the year before. This increase is explained mainly by a sharp rise in repayments of earlier loans.

Government aid measures concern principally the building and textile industries. According to a decree law adopted in September, the purchase of dwellings is to be facilitated mainly by raising the limits on loans for buyers and by granting lower interest rates and longer repayment periods for building loans. The necessary additional funds will, according to reports, probably be provided by an amendment to the regulations on the minimum reserves of credit institutions; from the angle of liquidity this would amount to a reduction of reserve ratios.

Under a law now being prepared, the textile industry will benefit from a number of tax and credit concessions for firms that submit plans for rationalization (including mergers) and specialization, provided the plans are approved. Unemployed textile

workers will receive more aid than at present, above all with a view to their reinstatement in industry.

The new arrangements for social insurance pensions, which came into force in July with retroactive effect from 1 January 1965, are of a predominantly social nature and will raise pensions very considerably.

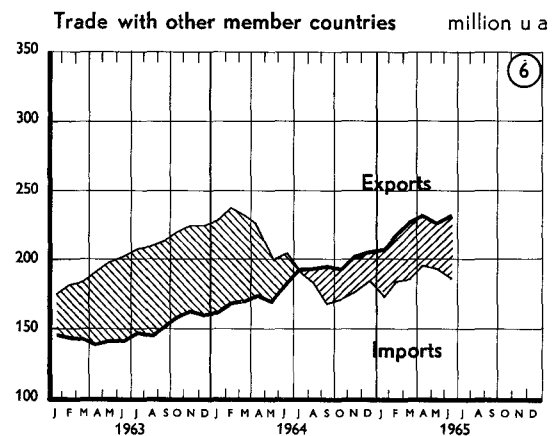
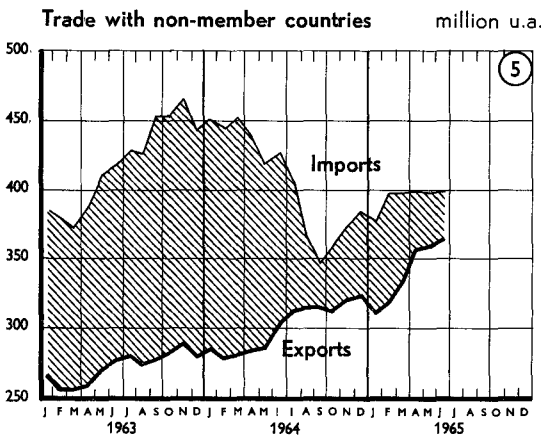
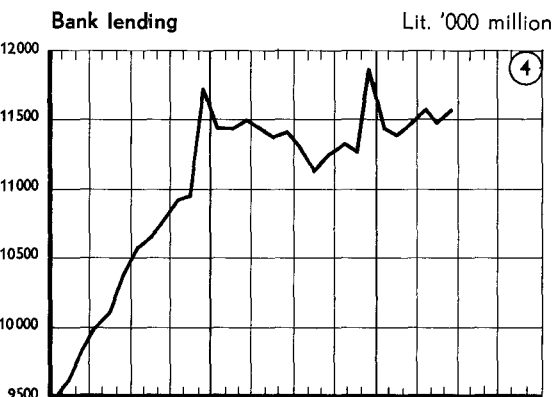
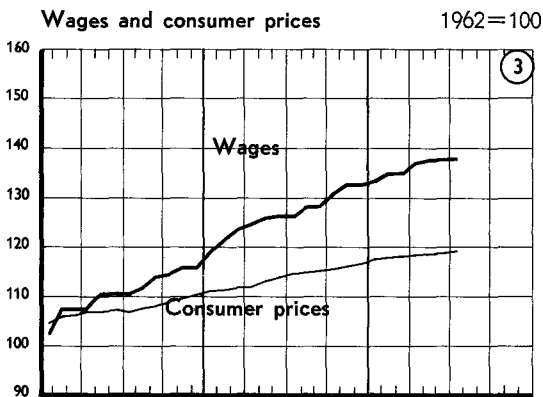
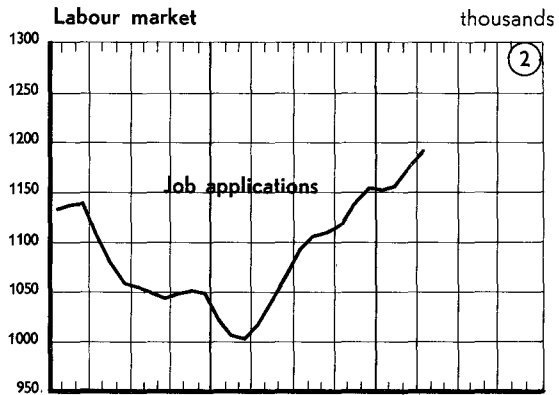
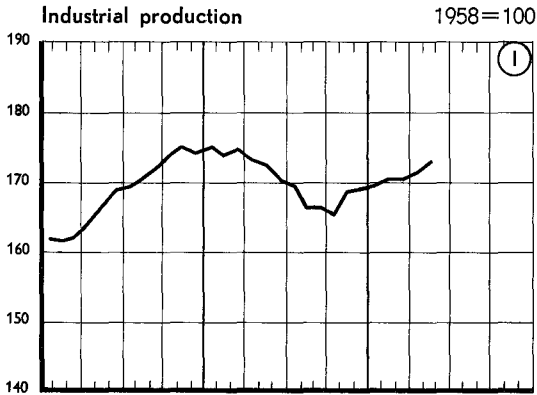
The Government intends, furthermore, to increase the funds available for export credits and to extend the corresponding government guarantees. Moreover demand for certain capital goods will be encouraged by fiscal and credit measures.

By and large the results that can be expected of these measures appear to conform with the needs of short-term economic policy and so—once again in broad terms—to comply with the recommendation put forward by the EEC Council of Ministers on 8 April 1965. Nevertheless, the measures taken to date still do not seem to be enough to bring about a really appreciable recovery of investment by the mass of private enterprises. Something more still needs to be done in this direction.

In budget policy there is a risk that the measures taken may channel expansion too much in the direction of consumer goods. The budget estimates for 1966 point to a rapid growth of current expenditure (10 % as against 1965), while “expenditure on capital account”, which is for the most part devoted to investment, will apparently undergo an appreciable reduction (9 %). If, however, account is taken of the additional expenditure which will be made under supplementary budgets—according to reports a good Lit. 150 000 million—there will in fact be a slight increase in “expenditure on capital account”. It is therefore not certain whether the public expenditure on investment which does not appear in or is only partly reflected in the central government budget, and is to be financed chiefly through the capital market, will rise appreciably.

Those responsible for control of the public purse would do well to keep these short-term economic requirements constantly in mind. It is of course not only the figures shown for revenue and expenditure in the current budget that exert an influence on cash expenditure: a considerable role is also played by the policy applied in respect of unexpended credits.

ECONOMIC INDICATORS



NOTES:

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

Graph 1. ISTAT series, seasonally adjusted by ISCO; moving averages of 3 months — excluding construction.

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.

TABLE 1

	1963
Total area ('000 sq. km.)	301.2
Total population ('000)	49 949
Density of population per sq. km.	165
Working population ('000)	19 630
Working population, breakdown by main sector (%)	
— Agriculture	27
— Industry	41
— Services	32
Percentage share of gross domestic product	
— Agriculture	15
— Industry	45
— Services	40
Gross product per capita (Lit.)	560 600

TABLE 2

	(Volume indices 1958 = 100)							Contribution (in %) to 1964 GNP
	1958	1959	1960	1961	1962	1963	1964	
Gross national product	100	107.3	114.6	124.1	132.0	138.9	143.0	—
Industrial production	100	110.7	125.6	138.4	151.4	164.2	166.4	—
Total imports	100	109.9	150.4	173.5	199.7	242.2	228.3	17
Private consumers' expenditure	100	105.2	111.9	120.6	129.5	142.3	146.0	61
Public current expenditure on goods and services	100	103.9	110.3	115.7	120.8	128.9	133.8	16.5
Gross fixed asset formation	100	110.0	126.6	142.2	154.6	165.9	149.1	21
Total exports	100	116.4	138.6	161.1	178.4	189.4	209.7	18
Gross national product per capita	100	106.6	112.9	121.9	128.8	134.2	136.1	—
Gross national product per person gainfully employed	100	106.5	113.9	123.2	132.5	141.7	146.2	—

TABLE 3

	Value indices (1958 = 100)							Values at current prices (million u.a.)	Total (%)
	1958	1959	1960	1961	1962	1963	1964	1964	1964
Visible exports									
Total	100.0	114.1	143.9	165.1	184.0	199.0	234.9	5 056.3	100.0
Intra-EEC	100.0	130.7	177.8	216.6	268.0	295.6	373.6	2 265.9	38.0
To non-EEC countries	100.0	108.9	133.2	148.9	157.6	168.6	191.2	3 690.4	62.0
Exports of food, beverages and tobacco									
Total	100.0	104.4	110.2	121.9	139.6	134.9	138.2	705.1	11.8
Intra-EEC	100.0	118.1	132.9	152.5	188.2	171.9	187.0	354.3	5.9
To non-EEC countries	100.0	96.3	96.7	103.9	110.7	113.0	109.3	350.8	5.9
Exports of raw materials and manufactures									
Total	100.0	116.6	152.4	176.0	195.2	215.1	259.2	5 251.2	88.2
Intra-EEC	100.0	136.3	198.2	245.5	304.1	351.5	458.2	1 911.6	32.1
To non-EEC countries	100.0	111.5	140.5	159.7	166.9	179.7	207.6	3 339.6	56.1
Visible imports									
Total	100.0	106.2	149.7	165.6	192.0	239.0	229.3	7 231.3	100.0
Intra-EEC	100.0	131.5	191.6	224.6	276.1	362.1	345.9	2 364.6	32.7
From non-EEC countries	100.0	99.2	138.1	149.3	168.7	205.0	197.0	4 866.7	67.3
Imports of food, beverages and tobacco									
Total	100.0	102.0	136.2	143.4	153.9	242.4	248.1	1 355.1	18.7
Intra-EEC	100.0	115.3	164.4	162.3	178.5	309.0	357.5	278.1	3.8
From non-EEC countries	100.0	99.8	131.5	140.2	149.8	231.3	229.9	1 077.0	14.9
Imports of raw materials and manufactures									
Total	100.0	107.1	152.5	170.2	200.0	238.3	225.3	5 876.9	81.3
Intra-EEC	100.0	133.6	195.1	232.6	288.7	368.9	344.5	2 086.5	28.9
From non-EEC countries	100.0	99.1	139.7	151.4	173.2	198.8	189.3	3 789.7	52.4

TABLE 4

	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	173.0	(185.3)					
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						
Private consumers' expenditure: turnover of department stores (1958 = 100)	1964	254	210	255	246	277	300	280	232	290	355	239	513
	1965	270	215	249	303								
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	544.6	393.1	630.3	595.3	615.2	573.9						
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	560.2	645.5	589.9	584.0	616.4						
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	- 83.7	- 33.0	+ 15.4	- 5.4	- 31.2	+ 45.6						
Official gold and foreign exchange reserves (net, million u.a.)	1964	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	3 797.3	3 873.9	3 755.8	3 811.5	3 895.5	4 032.3	4 250.4					
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							

() Provisional figures.

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. Note 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

Overall demand continued its vigorous upward trend in the second quarter and, as far as can be said at this stage, on into the summer months. Expansion was due more than before to domestic demand, and the increase in demand from abroad slowed down slightly.

Nevertheless, visible exports again went up; customs returns show that the value of goods exported was 9.6 % higher than in the second quarter of 1964.

Domestic demand continued to rise at a brisk pace, though the expansion of gross fixed asset formation may have lost momentum—mainly because of a tendency for the growth of fixed investment by firms to slow down. The upward trend of public spending was also rather more moderate than in the first quarter. On the other hand, private consumers' expenditure advanced at an even faster tempo, thanks to the sharp rise in wage and salary incomes and in social transfers which occurred early in the year, and also to increased purchases in anticipation of further considerable rises in income—rises which in fact came through at the beginning of the third quarter, the most important being the first instalment of an income-tax cut and an additional 1 % on annual wages in the form of a bonus.

The rapid increase in overall demand induced a further marked expansion in domestic supply. The trend of industrial production moved up at a slightly faster pace. According to the CBS unadjusted index, production per working day was 6.6 % up on the second quarter of 1964. Considerable further advances were made in building as well. Agriculture was the only sector in which—owing to the bad weather—there appears to have been hardly any contribution to the expansion of supply.

Imports also went up more quickly, chiefly as a result of further demand for consumer goods. The balance of trade and the overall balance of current payments deteriorated slightly, the latter showing a deficit of Fl. 258 million for the quarter.

Despite a continuing high rate of productivity and a considerable influx of manpower, the tendency for strain on the labour market to ease slightly disappeared, and at the end of the quarter there were about four times as many unfilled vacancies as unemployed persons.

The upward price trend became markedly steeper, though this was partly due to the exceptional rise in the price of vegetables, potatoes and fruit resulting from the bad

weather. The retail price index in July was no less than 6 % higher than a year before.

The outlook for the economy until the end of the year is decidedly one of continuing expansion. Exports should again go up briskly, and the rise in public expenditure on investment and in private consumers' expenditure might even speed up. The growth of domestic production will certainly be maintained, and imports may well rise appreciably, in part because of action to replenish stocks of raw materials.

The current outlook, together with developments to date, warrants a slight upward revision of the forecast growth in real GNP from 1964 to 1965, which now seems likely to reach 5 %.

The Commission expects a growth rate of at least the same order in 1966. The probable trend of domestic demand, especially that of public spending, seems to hold out the prospect of further rapid expansion in overall demand. In addition, the outlook for exports still seems relatively favourable. But it is by no means certain that economic developments in 1966 will occur against a background of satisfactory equilibrium. This is less true of the external equilibrium; here the threat is mainly one of further increases in costs per unit of output and in prices. Short-term policy, particularly budget policy, must therefore be designed to keep a tighter rein on the expansion of domestic demand in money terms.

1. Recent developments

Exports of goods and services continued to expand. Although the trend in visible exports—at least according to adjusted figures based on definitions used in the national accounts—probably slowed a little from the first to the second quarter, expansion was still quite considerable.

Customs returns show that exports of goods in the second quarter were still 9.6 % in value and 11 % by volume higher than in the corresponding period of 1964. Provisional figures for July and August seem to confirm that the expansion of exports is slackening somewhat.

Foreign sales of chemicals and metal products again rose rapidly, but there was a decided drop in exports of vehicles. On the whole, exports of farm products expanded more vigorously than those of manufactures.

There was some recovery in sales to non-member countries, particularly those outside Europe (especially the United States and Africa), while exports to other Community countries increased relatively slowly; this slackening was mainly due to a reduction in Germany's imports as an extensive programme of arms deliveries ran down, and it may therefore be no more than temporary.

Domestic demand again showed a marked upswing, though the increase in expenditure on gross fixed asset formation may have levelled off slightly; the expansion of private consumers' expenditure, on the other hand, was if anything rather more rapid.

Enterprises increased their spending on gross fixed asset formation—to judge from higher output in the investment goods industries, increased imports of capital goods, and the growth of industrial and commercial building—but the increase was probably rather slower than before. A shortage of liquid funds brought about by measures calculated to place a brake on expansion and by the rise in production costs seems to be having some effect on the propensity to invest; the big firms are not seriously affected, if at all, but the smaller firms certainly are. Public expenditure on investment appears to have contributed little to expansion in the second quarter; there was however, a sharp increase in expenditure on housebuilding.

Investment in stocks will probably prove, on the whole, to have been sluggish, chiefly because managements adopted a cautious attitude to holdings of raw materials and semi-manufactures in view of the tendency for prices on world markets to fall and the shortage of liquidity to become more serious.

The figures at present available indicate that public current expenditure on goods and services probably went up at a slightly slower pace. Private consumers' expenditure, however, may well have been rising even a little more rapidly than in the preceding months. It was about 12.5 % in value and about 8 % in real terms higher than in the second quarter of 1964.

The rise in purchases of consumer durables continued at a rapid pace. There was heavy demand for motor-cars in particular, and as more and more houses were completed purchases of furniture and electrical household appliances kept rising correspondingly.

The expansion of consumer spending was probably due chiefly to the considerable increase in wage and transfer incomes in the early months of the year. But spending in anticipation of further increases in disposable income seems also to have had some effect. In the second quarter itself there were no very significant rises in agreed wages. In July, however, a bonus equivalent to 1 % of annual wages was granted in nearly all industries, and the first instalment of a Fl. 500 million-a-year income tax reduction became effective.

Moreover, collective agreements were renewed in important sectors such as the metallurgical industry; in a number of cases the renewal of wage agreements with their "normal" wage increases was coupled with other agreements which for a number of years ahead established a certain link between the trend of wages and rises in the cost of living.

At the end of July agreed wages in industry were more than 5 % higher than at the end of December 1964. Actual earnings probably rose even more sharply as a result of the continuing wage drift.

There were no signs of a further easing of the strain on the labour market. Unemployment figures reached, it is true, a monthly average of 26 900 in the second quarter as against 22 300 in April-June 1964, and the number of unfilled vacancies was also lower throughout the quarter than it had been a year before; but this was partly due to a number of special factors such as the effects of the rainy weather on agriculture and building, together with the after-effects of measures limiting expenditure on public works, so it cannot be claimed that the strain on the labour market is easing. Some important sectors, particularly metal production and metal products, still suffered from a severe shortage of manpower, especially skilled workers. At mid-year the number of unfilled vacancies in the economy as a whole was, after seasonal adjustment, about four times as great as the number of unemployed, despite a net increase in imported manpower. These tendencies seem to have continued in July and August.

The sharp increase in overall demand made for a marked expansion of both domestic supply and supply from abroad. After the somewhat quieter trend in the first quarter, industrial output may well have risen slightly more rapidly. According to the CBS index, production per working day was again—as in the first quarter—6.6 % up on the previous year. A further appreciable increase in numbers employed, together with measures of rationalization, contributed again to a considerable advance in building output, despite the fact that the weather was less good than in 1964. Expansion probably continued in the services sector too.

Agriculture was the only sector that made hardly any contribution to the expansion of supply. Unusually heavy rainfall seems to have caused significant losses in a number of crops.

Imports of goods and services rose appreciably. Although visible imports in the second quarter were not as high as the year before—they were down 1.1 % in value and 1.2 % by volume—this was only because imports in the second quarter of 1964 were for a while quite exceptionally high as a consequence of soaring wages and of special purchases of investment goods. Seasonally adjusted figures for imports (as defined for the national accounts) registered a not inconsiderable recovery after having declined since the middle of last year. This trend seems to have continued into the summer.

While imports of consumer goods expanded very rapidly and those of capital goods kept on rising, purchases of raw materials and semi-manufactures grew only slightly.

In spite of the lively increase in supply, prices continued to go up in the second quarter. The trend was even more pronounced than in the first three months of the year. The retail price index in June was 3.4 % higher than in March—after a 2.6 % increase between December and March. The year-to-year growth rate in July was no less than 6 %.

Most of this increase was due to the effect of bad weather on food crops; in June fruit and vegetable prices were 27 % higher than in June 1964. But prices for other products and services also maintained their upward trend—not only because certain charges (transport, postal and telegraph services) were increased but also because of the continuing pressure of costs.

Wholesale prices too have increased steadily since the winter as a result of higher food prices and the continuing upward trend of prices for finished products.

Although the trade account closed as in the first quarter with a deficit of some Fl. 900 million (customs returns), there is an evident tendency for the balance to deteriorate, and only an improvement in the terms of trade prevented the deficit from being heavier. It was, however, far below the figure for the second quarter of 1964—a post-war record of Fl. 1 460 million.

The current account (on a transactions basis) showed a second-quarter deficit of Fl. 258 million, as against a surplus of Fl. 58 million in the preceding quarter but a deficit of Fl. 838 million a year earlier. As the capital account also showed a deficit (however slight), the overall balance of payments was well in deficit. When transactions with the IMF (totalling Fl. 217 million) are left out of account, gross official gold and foreign exchange reserves fell by Fl. 225 million between March and June, and the banks' net foreign holdings by Fl. 317 million.

The constricting effect on internal liquidity of transactions with abroad in the second quarter was offset by the sharply expansionary effects of the Government's cash transactions. The increase in demand for short-term bank loans may well have slackened off a little: the penalty deposits that the banks must keep interest-free at the Central Bank if they overstep the quantitative limits placed on the expansion of bank advances were reduced from Fl. 202 million at the end of May to Fl. 153 million at the end of June. But the expansion of medium- and long-term credits remained lively, chiefly because of increased borrowing by local authorities. Interest rates on the money and capital markets were moving upwards, especially long-term rates.

In July the first long-term government loan of 1965 was issued; this was for Fl. 300 million, a considerable proportion of which was subscribed by non residents.

2. Outlook

The rapid expansion of overall demand will continue until the end of the year, with the main stimulus probably coming from domestic demand.

Demand from abroad (i.e. the value of goods and services exported) will, it is true, also increase further. According to the last CBS business survey the flow of orders from abroad seems to have been brisk. The competitiveness of Dutch exports generally has probably not yet been seriously impaired by rising production costs. And the rapid expansion of domestic demand is likely to keep only a limited quantity of products at home that might otherwise have been exported.

The growth of exports is nevertheless likely to be rather weaker than in the second half of 1964. In certain industries the factors of rising costs and/or pressure of internal demand could after all have some effect, but the chief factor affecting total exports will be the completion of certain arms deliveries. Lastly, the loss of agricultural output as a result of bad weather may have a negative effect. (Over the twelve months ending July 1965 agricultural exports accounted for some 27.5 % of total visible exports.)

Expenditure on gross fixed asset formation will certainly increase more markedly, but here too there may be some slackening in the pace of expansion. In a number of sectors, including energy and chemicals, there are strong inducements to capital expenditure for the extension of plant, and the major concerns in these industries are probably still in a position to obtain the necessary funds to boost investment expenditure; on the other hand, there are branches of industry where extension is no longer considered so urgent. The major factor, however, is that financial difficulties among medium-sized and small firms have generally reached a point where even the growth of investment in rationalization may begin to suffer—no matter how necessary it may be considered in view of rising costs.

A further advance in industrial building may none the less give some support, inasmuch as expenditure on plant and equipment depends in part on completions of this sector. Furthermore, expenditure on housing is likely to keep rising very quickly, partly owing to the continuing improvement in physical facilities for raising output in this field. Public expenditure on investment could make a further—if only moderate—contribution to the expansion of domestic demand after the hesitant developments observed in recent months.

In contrast to the forecast for exports and investment, consumption expenditure is if anything likely to go up still faster than before. The growth of public current expenditure on goods and services will be affected by higher wages and salaries in the public sector: here a non-recurrent payment of 2 % of the annual wage is to be made in October. Private consumers' expenditure will probably rise more quickly—mainly as a result of the 1 % bonus paid in July, to be followed by a further payment of 1 % of the annual wage at the end of the year, of the tax cut, of the conclusion of new wage agreements, and perhaps of a reduction in the proportion of disposable incomes going into savings. It is quite possible that consumers, if they expect an increase in indirect taxation at the beginning of 1966, will make before the end of 1965 certain purchases that they would otherwise have made later.

In view of these prospects on the demand side, supply may also be expected to show a further appreciable increase, though the increase in industrial output may be limited by factors such as the persistent shortage of manpower. In July the backlog of orders in industry generally represented as many days' output as in March. The position of building and services was similar.

Despite the considerable rise in productivity due mainly to investments made in recent years, strain on the labour market as a whole is therefore hardly likely to disappear, though in some industries overemployment might give way to full employment.

The recovery in the growth of imports of goods and services may persist during the second half of 1965 in view of the livelier expansion of consumer demand and—even more important—the tendency to replenish stocks of raw materials and semi-manufactures. Even if the terms of trade should improve further, the trade balance will tend to deteriorate quite appreciably as imports go up and the growth of exports probably slows down. The overall balance on current account can be expected to deteriorate in sympathy.

Nevertheless, the swift expansion of nominal demand, together with the further increases in unit costs already noted and the perhaps slighter increases that can still be expected, hold out little prospect of achieving stability of prices, especially consumer prices; the latter may move distinctly upwards, even if the trend is perhaps temporarily inhibited as the effects of dearer food resulting from bad weather cease to be felt.

This outlook, coupled with developments to date, broadly confirms the quantitative forecasts for the full year 1965 made in the last Quarterly Survey. As the growth of exports for the year is likely to be a little higher and, even more important, as imports will not increase so much, the growth rate of GNP in real terms may be rather higher than was first assumed (about 5 % instead of 4.5 %).

There is no doubt at all that overall demand will continue to expand in 1966. This is indicated not only by the likelihood that exports will perhaps go up at a still somewhat faster rate—mainly because of the expected revival of demand for imports

in some member countries—but also by the certainty of a sizeable increase in public spending and the continuation of the relatively rapid expansion of private consumers' expenditure, reinforced by the effects on wages of continuing strain on the labour market and by the second instalment of the cut in direct taxation. Even if this second instalment is held back until the last possible moment—1 January 1967—some anticipatory effect must be reckoned with. Enterprises' expenditure on investment may also rise considerably in 1966, at least if an expected accumulation of special expenditure (on ships and aircraft) is included. And there will be further rises in expenditure on housing.

National product and expenditure

	1962 ⁽²⁾	1963 ⁽²⁾	1964 ⁽²⁾	1965 ⁽²⁾
	At current prices (in Fl. '000 million)	% change by volume on preceding year		
Gross national product	48.09	+ 3.6	+ 7.5	+ 5
Imports ⁽¹⁾	23.67	+ 9.6	+ 13.9	+ 5.5
Private consumption	27.98	+ 7.1	+ 6	+ 6
Public current expenditure	7.19	+ 2.8	+ 0.2	+ 1.5
Gross fixed asset formation	11.55	+ 3.9	+ 15	+ 5
Exports ⁽¹⁾	24.30	+ 6.4	+ 11	+ 8.5

⁽¹⁾ Goods, services and factor income.

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

⁽³⁾ 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 forecasts are approximations based on recent 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.

Imports may be expected to mount vigorously. Not only will the expansion of final demand attract more imports: imports of raw materials and semi-manufactures are also likely to increase markedly.

In these circumstances GNP may again show much the same growth rate as it did from 1964 to 1965.

It is, however, more than doubtful whether satisfactory conditions of equilibrium will be achieved in 1966. The principal danger is of further price increases.

A further deterioration of the domestic purchasing power of the guilder should not be accepted without a struggle by the authorities responsible for short-term economic policy. In the past two years—from mid-1963 to mid-1965—consumer prices rose by no less than 12.5 %. Even when it is remembered that mid-1965 prices were distorted by the effects of bad weather on vegetables, potatoes and fruit, and that the abnormal increases may to some extent be reversed, this comparison clearly shows that in the Netherlands there is not just creeping, but full-scale inflation. There is already some risk that this might lead to a change in the behaviour of transactors and of whole groups of the population: that they will gradually begin to take inflation for granted, include it in their calculations, and think in terms of material assets and cost-of-living indices. This would provide further stimulus for the inflationary process.

These developments have not yet had a seriously prejudicial effect on Dutch competitiveness; but the change in economic thinking and behaviour and the expectation of excessive nominal rises in income from year to year might well induce such an acceleration of the upward trend of costs that the balance of payments would eventually undergo a dangerous deterioration.

Moreover, price stability is one of the most important economic objectives of the EEC Treaty. It may well be that it is just the differences between the structure of Dutch production and exports and the production and exports of the other Community countries which, in conjunction with the low initial level of wages in the Netherlands, promoted the expansion of Dutch exports so strongly that for a while increases in costs and prices could not be avoided unless changes on a corresponding scale were accepted in exchange rates. It is also possible that in the future certain structural changes—particularly the growing importance of natural gas as an export commodity and as a substitute for imported fuels—will tend to have a favourable effect on the country's current account. Meanwhile, however, incomes and prices have gone up so much, and the basic pattern of the current account seems to have changed so much in consequence, that there is no longer much prospect of the surpluses hitherto regarded as desirable continuing to grow as before. In these circumstances internal stabilization should be perfectly possible. Whether the current account would then really show too big a surplus again, we should perhaps wait and see.

The Government is clearly determined to combat increasing costs and prices. It is preparing to stiffen its direct price policy; under a recent decision, for instance, hotel and restaurant prices must not be more than 4 % above the level charged on 1 Octo-

ber 1964. A considerably more important point, however, is that the forecast sharper rise in government expenditure in 1966 is likely to be matched by increases in indirect taxation ⁽¹⁾.

The decisive factor will be whether these tax increases have a severe enough effect to keep overall demand within the requisite bounds. The further increase in prices resulting from higher indirect taxation should in no way be considered inflationary; the contrary is the case. Nevertheless, the dangers of possible social complications naturally limit the extent of such tax increases. If in view of this the tax level cannot be set high enough, an attempt will have to be made to tighten up on public expenditure.

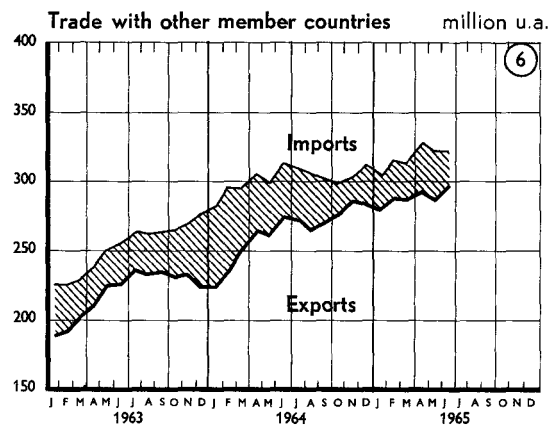
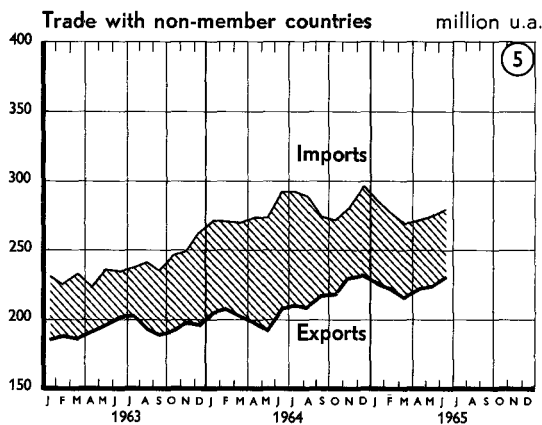
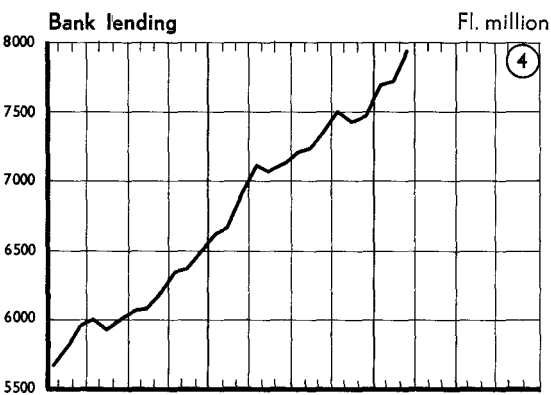
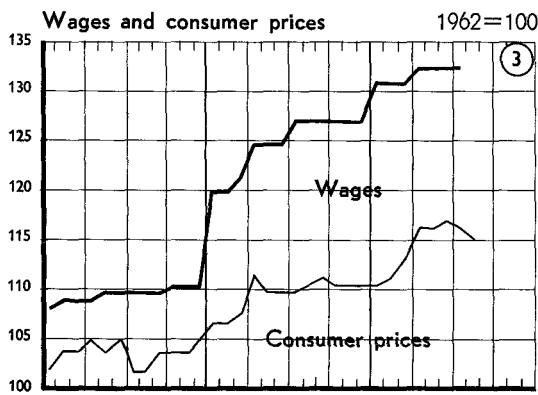
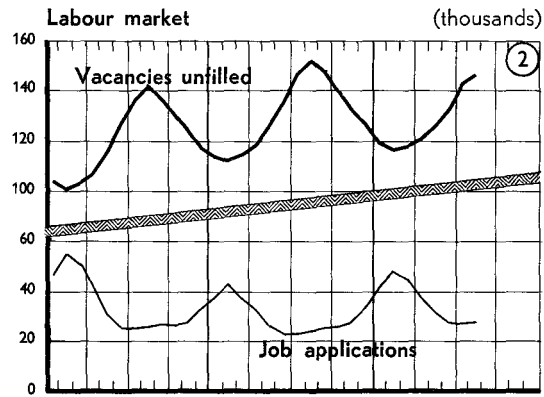
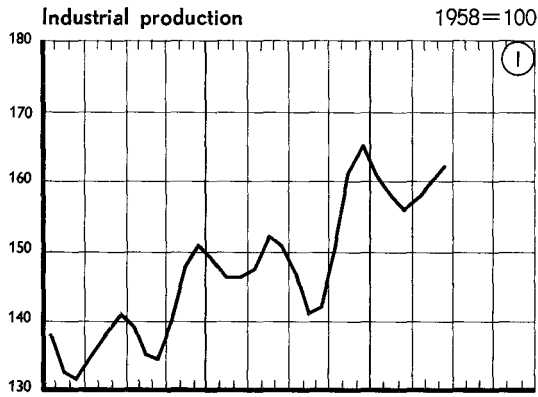
Increased taxation should be concentrated as directly as possible on consumer demand; it is important that it should not affect the ability of smaller firms to invest. Today these investments make little contribution to the growth of demand in any case. And this is one of the reasons why the principal aim of stabilization policy should no longer be to tighten up restrictions on money and credit. The monetary authorities do not in fact seem to be envisaging any such move. On the contrary, the limits placed on the expansion of bank advances in the September-December period are slightly more generous than last year.

As regards wage policy, there is a clear tendency towards greater freedom in collective bargaining and agreements in the various industries. The resultant differentiation will certainly help to raise productivity. But at the same time it reduces the possibilities of using wage policy generally as a means of achieving the greatest possible stabilization of unit costs and prices. Correspondingly more importance attaches to the classic instruments of short-term economic policy—and in these circumstances to fiscal policy in particular.

Of course, those responsible for money and credit policy must keep to their restrictive line; and it is this policy which in large measure decides how far the public authorities can increase their indebtedness. Should these authorities prove unable to implement a fiscal policy capable of stabilizing prices and costs, there would indeed be no other solution than to attempt to tighten credit policy again after all. That this might be at the expense of subsequent economic growth is the risk that would have to be taken if budget policy were too sharply expansionary.

⁽¹⁾ This report was drawn up before the provisions of the draft budget for 1966 were known.

ECONOMIC INDICATORS



NOTES:

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

Graph 1. Source: Centraal Bureau voor de Statistiek. Index adjusted for number of working days. Moving averages of 3 months.

Graph 2. Source: CBS. Moving averages of 3 months.

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.

TABLE 1

	1963
Total area ('000 sq. km.)	33.5
Total population ('000)	11 967
Density of population per sq. km.	357
Working population in 1961 ('000)	4 289
Working population, breakdown by main sector in 1961 (%):	
— Agriculture	10
— Industry	42
— Services	48
Percentage share of gross domestic product:	
— Agriculture	9
— Industry	41
— Services	50
Gross product per capita (Fl.)	4 360

TABLE 2

	Volume indices (1958 = 100)							Contribution (in %) to 1964 GNP
	1958	1959	1960	1961	1962	1963	1964	
Gross national product	100	105	115	119	122	126	(136)	—
Industrial production	100	109	120	125	131	136	(146)	—
Total imports	100	114	133	141	152	167	(190)	51
Private consumers' expenditure	100	105	111	118	123	132	(140)	58
Public current expenditure on goods and services	100	99	105	110	117	121	(121)	15
Gross fixed asset formation	100	112	125	133	138	143	(164)	25
Total exports	100	112	126	130	138	147	(163)	50
Gross national product per capita	100	104	112	114	115	118	(125)	—
Gross national product per person gainfully employed	100	104	111	113	(114)	(116)	(123)	—

() Provisional figures.

TABLE 3

	Value indices 1958 = 100							Values at current prices (million u.a.)	Total (%)
	1958	1959	1960	1961	1962	1963	1964	1964	1964
Visible exports									
Total	100	112	125	134	143	154	181	5 808	100
Intra-EEC	100	119	138	153	169	198	242	3 233	55.7
To non-EEC countries	100	107	116	120	124	123	137	2 575	44.3
Exports of food, beverages and tobacco									
Total	100	114	120	121	130	142	155	1 388	23.9
Intra-EEC	100	127	135	139	153	171	193	812	14.0
To non-EEC countries	100	103	108	106	110	116	122	576	9.9
Exports of raw materials and manufactures									
Total	100	111	127	139	147	159	190	4 420	76.1
Intra-EEC	100	116	140	160	176	210	264	2 421	41.7
To non-EEC countries	100	108	118	125	129	125	142	1 999	34.4
Visible imports									
Total	100	109	125	141	148	165	195	7 055	100
Intra-EEC	100	115	137	166	177	203	242	3 671	52.0
From non-EEC countries	100	104	117	123	126	137	161	3 384	48.0
Imports of food, beverages and tobacco									
Total	100	109	113	120	127	147	171	955	13.5
Intra-EEC	100	110	127	180	168	188	229	182	2.6
From non-EEC countries	100	109	111	110	121	140	161	773	10.9
Imports of raw materials and manufactures									
Total	100	109	127	145	151	168	199	6 100	86.5
Intra-EEC	100	116	137	165	177	204	243	3 489	49.4
From non-EEC countries	100	102	118	127	128	136	160	2 612	37.1

TABLE 4

	Year	Jan.	Feb.	Mar.	Apr.	May	June	July	Aug.	Sept.	Oct.	Nov.	Dec.
Industrial production (1958 = 100)	1964	146	186	149	152	143	152	144	137	153	169	164	166
	1965	148	147	166	159	152	158						
Investment (Fl. million)	1964			3 295			4 017			3 899			4 078
	1965			3 757									
Building (Fl. million)	1964			1 362			1 682			1 783			1 613
	1965			1 545			1 814						
Private consumers' expenditure (1958 = 100)	1964	155	145	157	156	170	157	178	157	163	179	170	190
	1965	173	159	170	181	185	178						
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					
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					
Balance of trade (million u.a.)	1964	- 137	- 123	- 109	- 161	- 107	- 137	- 152	- 49	+ 2	- 76	- 62	- 92
	1965	- 77	- 75	- 99	- 108	- 76	- 63	- 122					
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	2 001	(2 053)	(2 041)				
Money supply (Fl. '000 million)	1964	14.31	14.31	14.29	14.51	14.99	15.08	15.10	15.10	15.13	15.01	15.27	15.45
	1965	15.53	15.56	15.67	16.05	16.62	16.82						

() Provisional figures.

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. Note and coin circulation, excluding cash holdings of monetary institutions. Sight deposits with credit institutions.

E. B.L.E.U.

Belgium

The slackening in the growth rate of overall demand, which was due not only to weaker domestic demand but also—no doubt temporarily—to a decline in foreign demand, acted as a further brake on the growth of economic activity in Belgium.

The seasonally adjusted figures for visible exports appear to have remained at the same level as in the previous quarter. The expansion of domestic demand continued to slow down, and gross fixed asset formation in particular showed an increasing tendency to flatten out caused mainly by the downward trend of public investment and the more hesitant rate of growth in housing; but industrial investment continued its moderate upward trend.

There does not appear to have been any great increase in public expenditure on consumption, and the growth rate of private expenditure on consumption slackened on account of the slower increase of private incomes and probably also of a stronger propensity to save.

Domestic production consequently lost some of its impetus, and this in turn tended to ease the strain on the labour market slightly. The seasonally adjusted figures for industrial production did not rise between the first and second quarters. The INS gross index of industrial production was 3 % higher than for the second quarter of 1964.

Imports of goods and services showed only a slight upward trend; of the increase in the imports of goods between the first and second quarters, a part was due to making good the ground lost through dockers' strikes in the first quarter.

The balance of trade showed a deficit of Bfrs. 1 900 million, which was therefore approximately Bfrs. 3 400 million below the very high surplus of imports achieved in the second quarter of 1964. Since in the aggregate the balance of current payments was favourable and capital movements showed a considerable surplus, the overall balance of payments was also highly favourable. The net gold and foreign currency reserves held by the Banque de Belgique rose from March to June by as much as Bfrs. 7 100 million.

In the coming months demand as a whole will continue decidedly quiet, although foreign demand will probably stimulate economic activity rather more

strongly. Despite the fact that enterprises will continue their rationalization investment and that government expenditure on investment will probably pick up somewhat, expenditure on gross fixed asset formation is, largely because of some slackness in housing, unlikely to show any appreciable increase. The increase in expenditure on consumption may slow down slightly, although it will remain one of the main pillars of economic activity.

There will probably be a continued though modest increase in supply, and industrial production may make only hesitant progress for some time to come. Building activity may well be sluggish. The trend in imports of goods and services should remain relatively quiet.

The price climate is unlikely to show any notable improvement, as retail prices continue to rise—mainly owing to higher costs.

Despite the slower expansion of the Belgian economy, the gross national product may rise between 1964 and 1965 by as much as some 3 %.

The outlook for 1966 is that overall demand will probably continue to increase, although the forecasts on gross fixed asset formation have now become rather more uncertain. From 1965 to 1966 the real gross national product may again rise by about 3-3 ½ %.

The Belgian authorities recently relaxed some of the measures by which they placed a brake on the rate of economic growth, and they have even taken or announced a number of measures that will again contribute to expansion. In view not only of the still fairly general shortage of labour and the continuing tendency for prices and costs to rise on the domestic market, but also of the problems facing the Treasury it would not, for the present at least, seem advisable to pursue a policy whose general effect would be to speed up the growth of domestic demand in money terms.

1. Recent developments

Exports of goods and services, which had been rising with exceptional rapidity since the end of 1964, slowed down considerably in the second quarter of 1965.

The seasonally adjusted figures for exports of goods during this period failed to rise above the level reached in the January-March period. Customs returns show that

the value of goods exported was 9.6 % higher than in the second quarter of 1964, after a corresponding increase of 14.9 % in the first quarter.

The tendency for the increase in exports to other Community countries to slacken may prove to have been very marked, mainly owing to the fact that sales to the Netherlands and Italy were less brisk, although this is probably a passing trend. There was also, however, a tendency for the growth of exports to non-member countries to lose momentum, largely owing to a drop in exports to the United Kingdom.

Although exports of textiles, machinery and glassware slackened to some extent, exports of iron and steel products, particularly to non-member countries, continued their upward trend, while deliveries of transport equipment even quickened their pace.

The growth of domestic demand continued to level off and since the winter it will on the whole have contributed but little to economic activity.

In expenditure on gross fixed asset formation there was further confirmation of the trend towards stabilization which had been apparent for some months past. However, investment in plant and equipment by undertakings seems to have advanced to some extent; in particular, there was increased investment in non-industrial building (business houses, banks, insurance companies, etc.) and in rationalization in industry. The continuation of a number of major investment schemes which were already under way also had an effect on the rate of growth.

The upward trend in housing, on the other hand, showed increasingly clear signs of weakening, and may even have levelled out already. The main factor in this development has been the limited availability of funds, due in part to the continuing rise in costs. In addition, the change in business conditions which had been observed for some months past tended to discourage private owners from purchasing certain types of building, such as detached houses and luxury flats, the acquisition of which could easily be postponed.

Public investment continued to lose momentum, expenditure by the central Government reacting more noticeably than that of local authorities.

Investment in stocks may have decreased during the period under review; the growth of stocks of industrial finished goods slowed down and, in particular, investment in stocks of raw materials and semi-finished products was decidedly hesitant.

Following the heavy spending caused by wage and salary increases in the public service during the first quarter, public expenditure on consumption does not appear to have increased to any appreciable extent during the second quarter.

Finally, the growth rate of private consumers' expenditure appears to have slackened somewhat, in conjunction with the slower increase in disposable income and perhaps, too, with a change in the relative amounts devoted to consumption and to saving, which may be a reflection of the more cautious psychological reaction usual during transitional periods in the economic cycle.

The disposable income of households probably increased more slowly between the first and second quarters partly because of the rather less rapid rise in wages and salaries but even more owing to the tendency for the total number of hours worked to level out. A considerable proportion of the wage and salary increases awarded since the beginning of the year is attributable to the operation of the sliding wage scales, particularly those awarded in January and July (for the public service sector, in August). Nor does there seem to have been any appreciable increase in transfer incomes during the second quarter.

Overall supply adjusted itself in large measure to overall demand. In particular, the growth rate of industrial output slowed down once again, apart from seasonal and fortuitous fluctuations, and in fact practically levelled out. Nevertheless, according to the INS index, industrial output was 3 % up on the level for the same quarter of last year, when however business had not been particularly lively; for the first quarter, the year-to-year increase had been 4 %.

While some branches, such as energy and metal manufacture, continue their strong upward trend, others, such as chemicals and textiles, only reached their earlier level and yet others, such as food, paper, clothing, and footwear, even declined.

In the building industry, there seems to have been a trend towards stabilization; the clearest evidence of this is to be found in the statistics on new starts and on unfilled vacancies. It must, however, be borne in mind that the bad weather affected building adversely.

The exceptionally poor weather also hampered agricultural output, particularly crops. The numbers of livestock showed a slight increase.

The trend towards easier conditions on the labour market which had been apparent since the second half of 1964 continued during the second quarter of 1965. This has resulted rather in less demand for additional manpower and in local shortening of working hours than in any really significant amount of unemployment. Although the number of registered wholly unemployed persons tended to rise steadily (the figure reached 27 800 in July, or 7 500 more than in July 1964), the number of unemployed but employable persons receiving public assistance still amounted to only 0.8 % of the total number of employed persons covered by the social security scheme. The number of persons on short time amounted to 12 300 in July, or 1 100 more than a year earlier. The number

of new immigration permits issued was 40 % lower than in the first quarter and fell as much as 22 % below the figure for the second quarter of 1964.

Imports of goods and services continued to move upwards although in the case of goods the forces making for expansion were weak. The growth rate for imports of goods was higher than in the first quarter, and the customs returns show that in terms of value the level reached during the second quarter of 1964 was exceeded by 4.4 %; it must however be borne in mind that imports during the first quarter were hampered by a number of fortuitous factors, such as the dock strikes in Antwerp and the United States, so that the import figures for the second quarter are in part the result of making up lost ground.

The quiet trend of purchases abroad was mainly attributable to the process of adjusting stocks of raw materials and semi-finished goods to the level of production and sales. The cautious attitude to stocks led to a somewhat slower increase in imports from non-member countries; imports from Community countries, however, continued to expand, albeit at a modest rate.

Wholesale prices tended to level off even more definitely than before, whereas retail prices maintained their upward movement.

During the past few months, wholesale prices have remained more or less at the same level as at the beginning of the year. This applies particularly to finished goods, whereas prices for raw materials and semi-finished goods eased slightly. In July, the overall index was only 0.5 % above the level reached at the same period last year. Retail prices, on the other hand, have since the winter risen even more steeply than before, owing to the higher prices of foodstuffs, particularly meat, potatoes, and vegetables, and to a lesser extent, of certain finished industrial goods, in addition to which there has been a practically uninterrupted rise in the cost of services. Between March and July the retail price index rose almost 2 %, and in July it was 3.4 % higher than a year earlier.

Customs returns show that in the second quarter there was a deficit on trade of Bfrs. 1 900 million, compared with a surplus of Bfrs. 4 700 million in the previous quarter and a deficit of Bfrs. 5 300 million in the second quarter of 1964. The current account nevertheless showed a surplus of Bfrs. 2 200 million, compared with a figure of Bfrs. 4 500 million in the previous quarter: while the capital transactions of the public authorities remained in balance, private capital movements showed a considerable surplus, most of it no doubt due to direct investment by non-residents. The overall balance of payments consequently showed a surplus of Bfrs. 5 100 million—three times as high as in the previous quarter.

The net gold and foreign currency reserves held by the Banque de Belgique rose during the period between the end of March and the end of June by Bfrs. 7 100 million, while the foreign exchange held by commercial banks dropped by about Bfrs. 2 000 million.

The money and capital markets were rather tight during the second quarter. There was a considerable inflow of liquid resources from abroad, the tendency for enterprises to seek increased credit has been easing, and private individuals have shown some readiness to increase their near-money deposits with financial and credit institutions; but the Government required considerable funds, and these were largely raised on the money market. The State loan issued in May, amounting to a gross sum of Bfrs. 10 000 million, proved somewhat difficult to place. Furthermore, it is the money market which will have been mainly affected by the steps taken by the United States to improve its balance of payments. Rates of interest rose more on this market than on the capital market. In August, however, rates on short-term loans eased slightly.

2. Outlook

The phase through which the Belgian economy is at present passing, with its rather slow but, on the whole, more balanced expansion of supply and demand, should last until the end of 1965.

Foreign demand, in terms of actual exports of goods and services, will no doubt contribute once again to economic activity, although not so powerfully as during the same period last year.

Exports to other Community countries should continue their upward trend, mainly because exports to Germany and the Netherlands, Belgium's main trading partners, can be expected to expand further and because Italy and France will gradually increase their imports. On the other hand, the anti-inflationary measures taken in the United Kingdom, some weakening in the pace of expansion in the other OECD countries, and the more hesitant growth of demand in the developing countries may mean that the increase in exports to non-member countries is relatively slight.

No appreciable rise in expenditure on gross fixed asset formation is likely in the coming months. As regards investment by private enterprises, the steady rise in unit costs coupled with the difficulty of passing on these increases in prices, particularly in the export field, has altered the profit and loss position in some important branches to an extent which inhibits the propensity to invest—particularly as the possibility of demand increasing in the future is no longer viewed so optimistically. Nevertheless, greater efforts are being made in the matter of rationalization investment, with the aim of lowering costs. Another factor is that a number of large-scale investment schemes by foreign firms will make a considerable contribution. On the whole, therefore, investment expenditure by private firms may be expected to show a slight upward trend.

On the other hand, to judge by the latest figures on the number of starts and of new building permits issued, expenditure on housing may well slacken off somewhat during the coming months. This assumption is reinforced by the fact that some time usually elapses before expenditure of this type reacts to changes in the business climate and to increased difficulties in financing.

Although an upturn in public investment is likely, this will probably not yet make any great contribution to the expansion of gross fixed asset formation as a whole.

Private consumers' expenditure will doubtless again lose some of its momentum, although it will remain one of the main factors driving the economy forward. The nominal disposable income of households will probably continue to increase, particularly as further wage increases on the basis of sliding wage scales have either been awarded already or can be expected. Expansion will however probably be slow, since the trend in the total number of hours worked can hardly be expected to supply an impetus and since wage increases awarded on the basis of wage agreements and the rise in actual earnings may well be inhibited by the change in the business climate and the rather less tight conditions on the labour markets; finally, no appreciable increase in transfer incomes and other non-wage incomes is likely before the end of the year.

If these assumptions on the future trend of demand prove to be accurate, overall supply will increase slowly, particularly domestic production. The expansion of industrial production may none the less be decidedly hesitant for some time to come. The last business survey in fact showed that businessmen had become more cautious in their forecasts of future production, although here it must be borne in mind that their judgments were probably influenced by seasonal factors. As far as the building sector is concerned, activity should tend by and large to level out during the coming months.

Since it is unlikely that there will be any great change in the trend of imports, the trade account, seen as a whole, may in the aggregate show slight surpluses, comparable with the average of those recorded in the first six months of the year.

Prices will perhaps be relatively stable, and wholesale prices may even drop, while retail prices may still, despite the quieter expansion of demand, tend to rise on account of higher unit costs, particularly in the services sector. This trend is partly attributable to structural features peculiar to the Belgian economy and to the repercussions of the sliding wage scale.

To judge by the latest economic trends and the outlook for the coming months, there would appear to be no reason to make any great change in the forecasts published in the last Quarterly Survey regarding foreseeable variations in the principal aggregates covering the supply and utilization of goods and services for the full year 1965. However, the growth rate of the real gross national product may amount to only 3 %, against the 3.5 % estimated earlier. Private consumption will probably increase less than had at

first been supposed, and gross fixed asset formation will advance little if at all. On the other hand, net exports will move upward more strongly than had been expected.

As regards the outlook for 1966, there is no reason to make any great change in the forecasts contained in the last Quarterly Survey, particularly as a number of important decisions, including those on the Government's budgetary policy for 1966, have not yet been taken at practical level. There appears, nevertheless, to be a tendency for the Government to speed up its expenditure, not only through the removal of temporary restrictions on public investment expenditure, but even more through an increase in current expenditure, most of which increases consumption. The rise in exports will continue, although at a slower pace; private consumers' expenditure will also continue to advance steadily, while investment expenditure may expand more rapidly, with foreign firms probably investing on a much wider scale in industry.

All in all, an increase of 3-3.5 % in real national product from 1965 to 1966 is still considered possible.

National product and expenditure

	1962 ⁽²⁾	1963 ⁽²⁾	1964 ⁽²⁾	1965 ⁽²⁾
	At current prices (in Bfrs. '000 million)	% change by volume on preceding year		
Gross national product	647.2	+ 4.8	+ 5	+ 3.0
Imports ⁽¹⁾	230.5	+ 8.7	+ 12.5	+ 6.0
Private consumption	434.7	+ 5.5	+ 4	+ 3.5
Public current expenditure	80.4	+ 11.5	+ 3	+ 2
Gross fixed asset formation	127.4	+ 1.9	+ 7.5	+ 0
Exports ⁽¹⁾	233.9	+ 7.0	+ 13	+ 10.0

⁽¹⁾ Goods, services and factor income.

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

⁽³⁾ 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.

An important factor in this connection is that the authorities responsible for short-term economic policy decided in July 1965 to rescind the quantitative limitations imposed in January 1964 as part of the restrictive credit policy. In addition, the decision requiring the banks to maintain a 1 % minimum reserve, in force since July 1964, was suspended with effect from 15 July 1965. However, the policy of moderation in the growth of bank credits is still being pursued, particularly as regards consumer credit, loans for dealings in real estate and building, and loans for maintenance of stocks. The banks are still to exercise restraint in extending credit, particularly for the purposes mentioned, but control by the Banque de Belgique will in future be based on selective and qualitative criteria, rather than on overall and quantitative factors. It must also be ensured that medium and long-term credits are not financed from monetary sources.

At the end of July, the new Government laid its general economic programme before Parliament. In connection with short-term economic policy, the most important feature of the programme is that the Government intends to apply more flexibly and where necessary to improve the laws of 17 and 18 July 1959 on reactivation of the economy. In addition, the Government has announced improved facilities in connection with depreciation allowances on new investments and the preparation of an "anti-cyclical tranche" of public works. Export credits (particularly for capital goods) are to be more easily available and—as far as is compatible with the relevant provisions of the European Treaties—the rebates of turnover tax on exports will be improved. Finally, it is intended to take a number of measures to increase the efficacy of the capital market.

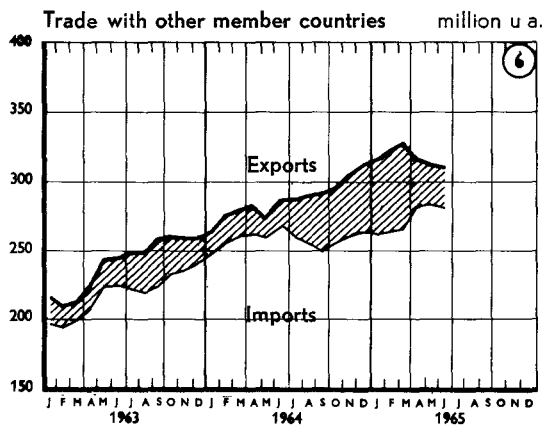
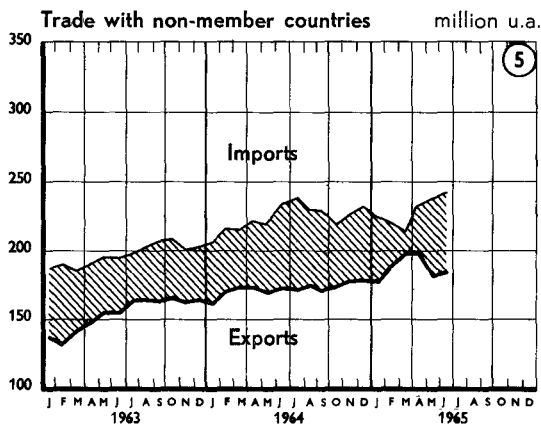
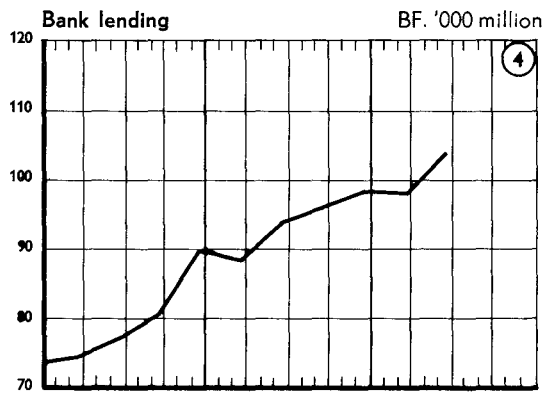
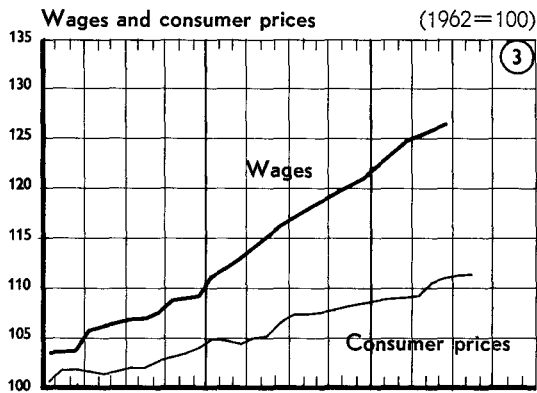
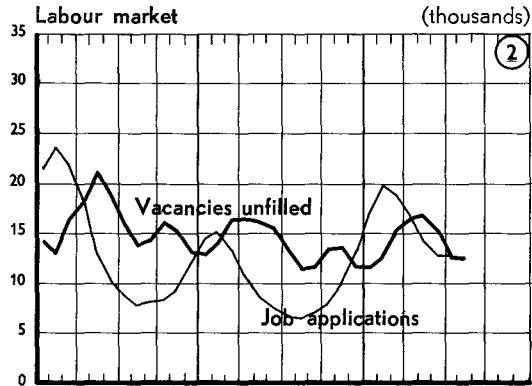
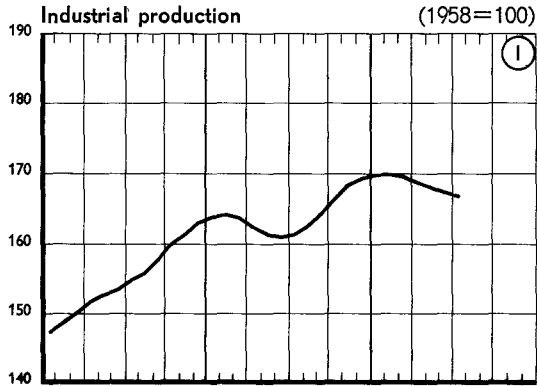
In the budgetary field, there will be considerable expenditure over and above the sums approved for 1965. In spite of the additional revenue, mainly from direct taxes, which is likely to occur as a result of the more lively expansion of business in 1964, the heavier expenditure may well absorb the surplus budgeted for and even lead to a deficit on the ordinary budget.

This budgetary policy raises a number of problems, since employment in Belgium is still at a very high level—the number of fully employable unemployed, although a little higher than in the previous year, is very low—and both prices and costs are still rising. The relatively slow rate of economic growth in real terms need not be a cause for concern: it is partly the cause and partly the effect of a process of improving and adapting the economic pattern which will pave the way for a more rapid and balanced growth. In any event, structural difficulties cannot be overcome by immediate pursuit of expansion on a broad front—they would at best be concealed, and the result would be a sharper rise in prices. Another factor is that the Government's budget policy of greater expansion has run into considerable financing difficulties.

This is another reason why budget policy in 1966 will need to be very cautious. The Government has in fact announced its intention of "keeping the budget for 1966 and for the following years within limits compatible with the growth rate of the gross national product".

In view of present trends in expenditure and the likelihood that developments in the business situation will lead to some reduction of the rate at which revenue has been expanding, further important decisions will doubtless be necessary to keep increases in expenditure (including possible reductions of tax rates resulting from adjustments to the tax system) within the limits laid down for this year, and so to avoid any further deficit in the ordinary budget. Naturally, efforts must be made to restrict current rather than investment expenditure, not only on anticyclical grounds but even more because of the requirements of structural policy. Finally, the need to place the State budget on a sounder footing is another argument in favour of such a policy, if it is desired to avoid taking measures to increase ordinary revenue—and in view of current developments in the business situation it would certainly be well to avoid such measures.

ECONOMIC INDICATORS



NOTES:

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

Graph 1. Source: Institut National de Statistique. General index, seasonally adjusted.

Graph 2. Source: Office National de l'Emploi. Moving averages of 3 months.

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.

TABLE 1

	1963
Total area ('000 sq. km.)	30.5
Total population ('000)	9 290
Density of population per sq. km.	305
Working population ('000)	3 590
Working population, breakdown by main sector (%)	
— Agriculture	6
— Industry	45
— Services	49
Percentage share of gross domestic product :	
— Agriculture	7
— Industry	41
— Services	52
Gross product per capita (Bfrs.)	75 100

TABLE 2

	Volume indices (1958 = 100)							Contri- bution (in %) to 1964 GNP
	1958	1959	1960	1961	1962	1963	1964	
Gross national product	100	103	108	113	119	125	131	—
Industrial production	100	101	110	115	126	135	145	—
Total imports	100	112	126	135	146	159	179	39
Private consumers' expenditure	100	102	108	110	115	122	127	67
Public current expenditure on goods and services	100	105	111	113	123	138	142	13
Gross fixed asset formation	100	109	122	136	140	142	153	20
Total exports	100	107	117	127	139	149	168	39
Gross national product per capita	100	102	107	112	117	121	127	—
Gross national product per person gainfully employed	100	103	109	112	115	119	(124)	—

() Provisional figures.

TABLE 3

	Value indices (1958 = 100)							Values at current prices (million u.a.)	Total (%)
	1958	1959	1960	1961	1962	1963	1964	1964	1964
Visible exports									
Total	100	108	124	129	142	159	183	5 580	100
Intra-EEC	100	111	138	152	179	214	254	3 494	62.6
To non-EEC countries	100	106	111	109	111	113	125	2 086	37.4
Exports of food, beverages and tobacco									
Total	100	100	107	123	160	207	214	327	5.9
Intra-EEC	100	115	128	152	200	261	275	241	4.3
To non-EEC countries	100	81	78	84	106	134	132	86	1.6
Exports of raw materials and manufactures									
Total	100	108	125	129	141	156	181	5 253	94.1
Intra-EEC	100	110	139	152	177	210	252	3 253	53.2
To non-EEC countries	100	107	113	110	112	112	124	2 000	35.9
Visible imports									
Total	100	110	126	135	145	163	188	5 901	100
Intra-EEC	100	111	130	146	159	184	215	3 146	53.3
From non-EEC countries	100	109	123	125	133	145	165	2 755	46.7
Imports of food, beverages and tobacco									
Total	100	107	108	109	120	131	153	716	12.1
Intra-EEC	100	113	118	127	131	153	178	277	4.7
From non-EEC countries	100	103	104	99	115	120	141	439	7.4
Imports of raw materials and manufactures									
Total	100	110	129	139	150	169	194	5 185	87.9
Intra-EEC	100	111	131	148	162	187	220	2 869	48.6
From non-EEC countries	100	110	123	130	137	151	170	2 315	39.2

TABLE 4

	Year	Jan.	Feb.	Mar.	Apr.	May	June	July	Aug.	Sept.	Oct.	Nov.	Dec.
Industrial production (1958 = 100)	1964	160.2	156.8	163.7	171.5	155.4	168.7	145.0	154.9	170.8	183.4	172.7	172.7
	1965	161.9	159.6	178.4	171.5	165.3	173.5	135.5					
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	121.3	128.2	143.2									
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	107.2	117.5	111.4	121.4						
Private consumers' expenditure (1961 = 100)	1964	117.3	118.1	120.2	122.6	122.1	125.4	126.1	123.5	123.1	124.0	123.7	129.4
	1965	125.5	128.2	123.9	132.7								
Total visible imports (million u.a.)	1964	492	475	481	515	479	513	485	418	477	503	536	529
	1965	451	474	539	552	506	514	506					
Total visible exports (million u.a.)	1964	451	449	468	490	426	434	453	372	476	522	485	500
	1965	501	520	571	507	478	548	509					
Balance of trade (million u.a.)	1964	-- 41	-- 26	-- 13	-- 23	-- 53	-- 28	-- 31	-- 46	-- 1	-- 19	-- 1	-- 29
	1965	+ 50	+ 46	+ 32	-- 45	-- 28	+ 34	+ 3					
Official gold and foreign exchange 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	1 998	(2 044)	(2 008)				
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	209.7	304.2	311.8	307.3					

() Provisional figures.

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'Economie 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. Note 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

During the second quarter the rate of economic expansion in Luxembourg continued to slacken, mainly owing to the fact that external demand remained stagnant.

The figures for exports of goods and services appear, after seasonal adjustment, not to have exceeded the level reached during the first quarter, due to a persistent lull in exports of iron and steel products.

Domestic demand expanded at a decidedly slow rate. There was probably a further decrease in the total of gross fixed asset formation following a further reduction in investment in plant and equipment by enterprises. The increase in private consumers' expenditure showed signs of slowing down, the main reason being that incomes were expanding distinctly less rapidly.

The growth of supply also slowed down appreciably. The seasonally adjusted figures for industrial production in the second quarter eased slightly—they were incidentally a bare 0.4 % higher than a year earlier—and there seems to have been only a very hesitant increase in imports.

There has been no appreciable change in the situation on the labour market, despite some signs of easier conditions.

Since the end of the winter, the rise in prices seems to have speeded up slightly, and in July the cost-of-living index was 3.9 % higher than a year earlier.

The coming months should see little change in the trends affecting the overall situation, unless there should be a sustained recovery in the world demand for steel. The expansion of overall demand will probably be slight and will mainly be due to private consumers' expenditure, which may well show an upward trend, albeit a gradual one. On the other hand, any appreciable increase in domestic production is unlikely. Be that as it may, it seems that the estimate made for the growth of real gross national product for the full year 1965 (1.2 %) may prove correct.

In view of the continuing pressure of costs and prices and the absence of any appreciable labour reserves, it would appear advisable to cling to an extremely cautious short-term economic policy, particularly in connection with the national budget.

1. Recent developments

Exports of goods and services remained at the level reached during the first quarter. The seasonally adjusted figures show that visible exports were virtually unchanged, mainly owing to a slight easing in deliveries of iron and steel products to other Community countries. Exports to non-member countries, however, appear to have advanced more hesitantly than hitherto.

Domestic demand probably continued to expand at the fairly slow rate apparent during the first quarter.

Gross fixed asset formation continued to lose ground, and there appears to have been a further reduction in the amount of investment in plant and equipment by enterprises, since several large-scale projects are nearing completion and no new investment projects of like importance have taken their place.

In housing, expenditure may have increased during the second quarter, but the seasonally adjusted figures show that public investment has, at the most optimistic estimate, merely remained at the same level as in the previous quarter.

The growth of private consumers' expenditure again showed signs of slackening, owing in part at least to the slower rate at which the income of households was increasing; this in turn was a consequence of the increasingly weak rise in the total number of hours worked. Another factor was that wages were certainly not rising as rapidly as before in either the private or the public sectors. Finally, households have probably shown a greater propensity to save during the past few months.

The increase in public expenditure on goods and services seems to have been slight.

The seasonally adjusted figures for industrial output showed a slight tendency to ease, after establishing a new record in February. In the second quarter they were only 0.4 % higher than a year earlier, after a corresponding rise of 5 % in the first quarter. In July, output actually fell slightly short (0.9 %) of the level attained in July 1964.

The low level of industrial production is largely attributable to a drop in the production of iron and steel, as well as to a considerably lower output of iron ore. In the building sector, the rate of expansion is likely, despite the recovery shown by housing, to have been fairly modest.

Imports of goods and services do not appear to have grown appreciably. On account of the weaker expansion of demand and production, visible imports may have been rather hesitant, apart from the larger quantities of raw materials that have no doubt been imported by a number of new industries.

A slight tendency for conditions on the labour market to ease appears to have continued, with an improvement in the possibility of meeting the demand for labour by employment of foreign workers. However, after a decrease between the middle of 1963 and the end of 1964, the number of vacancies registered has been rising since the beginning of the year, mainly as a result of the demands made by a number of industrial firms that have recently settled in Luxembourg. There is therefore still a serious shortage of labour, particularly of skilled labour.

Prices continued their upward trend and, to judge by the cost-of-living index, rose rather more sharply than during the winter. During the second quarter, the index was 3.4 % above the corresponding figure for 1964—against 2.9 % for the first quarter. In July the year-to-year increase rose to 3.9 %. This trend was due mainly to the effect of the poor weather on certain crops and the gradual abolition of subsidies for butter and beef; but the cyclical trends towards higher prices still seem to be present also.

2. Outlook

The increase in overall demand will probably remain decidedly hesitant during the coming months.

It is hardly likely that external demand—in terms of exports of goods and services—will stimulate economic activity to any great extent. It is true that in July there was a slight increase in the flow of orders received to the iron and steel industry from both member and non-member States; but considerable uncertainty surrounds future developments, particularly the treatment of stocks in the main steel-consuming countries. On the other hand, the fact that the new industries are commencing production will gradually be reflected in export figures.

In spite of the likely increase in public expenditure on investment, overall expenditure on gross fixed asset formation may well diminish once again. While the increase in public expenditure may well be rather limited, investment by enterprises may well fall back considerably. In addition, factors such as difficulty in providing finance, which could arise in connection with a more cautious policy on the part of the State Savings bank, may place a brake on housebuilding activities.

On the other hand, there should be a further, if rather weak, expansion in private consumers' expenditure. In particular, there will be a continued increase in agreed wages, much of it due to the steady rise in the cost-of-living index, which incidentally brought the sliding wage scale into play for most branches of industry only last July.

Moreover, the total wages bill may rise owing to the effects of the Grand Ducal Decree of 25 June 1965 revising the arrangements governing the minimum wage. However, developments in the total number of hours worked and in the propensity to save of households may limit the impact of higher wages on private consumers' expenditure.

The seasonally adjusted figures for domestic production should not vary widely from the level already reached. The index of industrial production may even show some signs of weakness, but it must be borne in mind that it does not yet include the output of the new industries.

Consumer prices will probably continue their upward trend. Food prices may well continue to rise, largely as a result of the weather experienced in the past few months; at the same time the rise in production costs and in the price of imported goods, together with structural factors, will affect the level of domestic prices for manufactured goods and services.

National product and expenditure

	1963	1964 ⁽²⁾	1965 ⁽³⁾
	At current prices (in Lfrs. '000 million)	% change by volume on preceding year	
Gross national product	27 086	+ 6.5	+ 1.5
Imports ⁽¹⁾	23 253	+ 9.5	+ 2.1
Private consumption	16 408	+ 5.5	+ 3.5
Public current expenditure	3 407	+ 2.5	— 2
Gross fixed asset formation	8 809	0	— 13
Exports ⁽¹⁾	21 915	+ 13.0	+ 4.5

⁽¹⁾ Goods, services and factor income.

⁽²⁾ Commission estimates based on calculations made by STATEC as part of the economic budget.

⁽³⁾ 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.

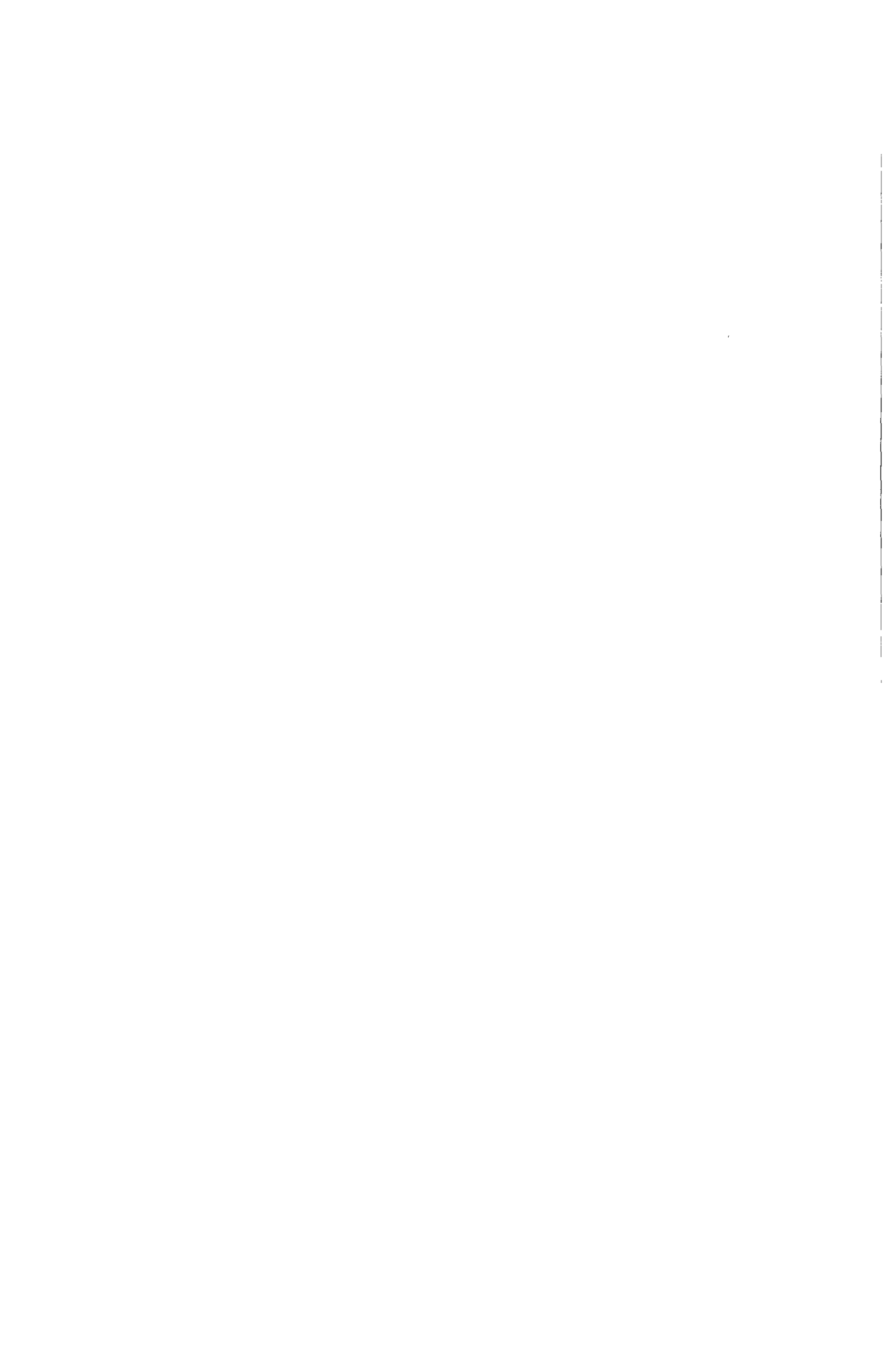
Even when the most recent prospects for economic developments in Luxembourg until the end of 1965 are considered, there appear to be no grounds for any appreciable amendment of the quantitative forecasts for the full year published in the last Quarterly Survey (No. 2/1965). The gross national product in real terms should be only 1-2 % higher than in 1964.

Unless there is a lasting recovery in world demand for steel and steel products, the outlook for Luxembourg for 1966 offers little prospect of expansion. Apart from private consumption, the main stimulus should come from exports by the new industries and from public expenditure on investment, which is likely to expand once again, whereas investment expenditure by private firms may well fall back.

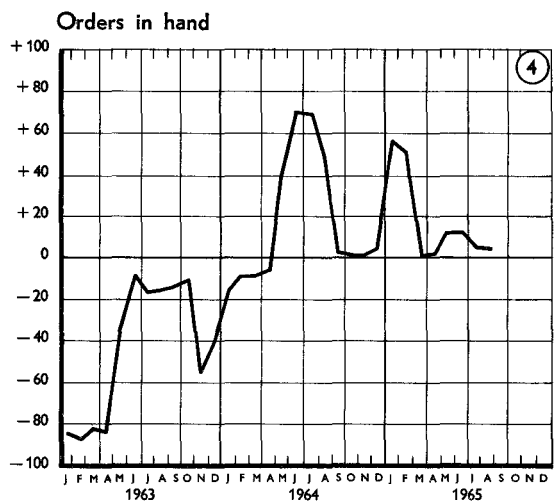
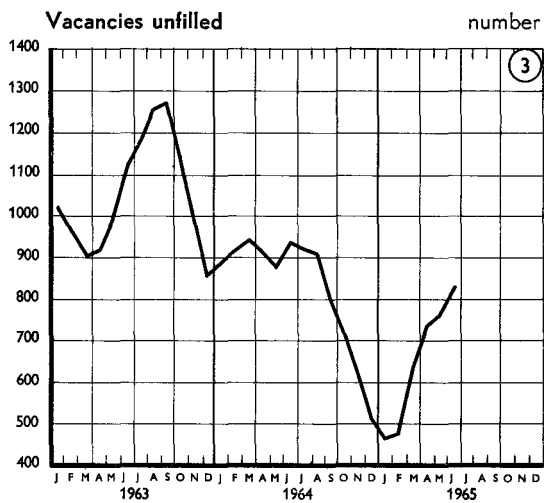
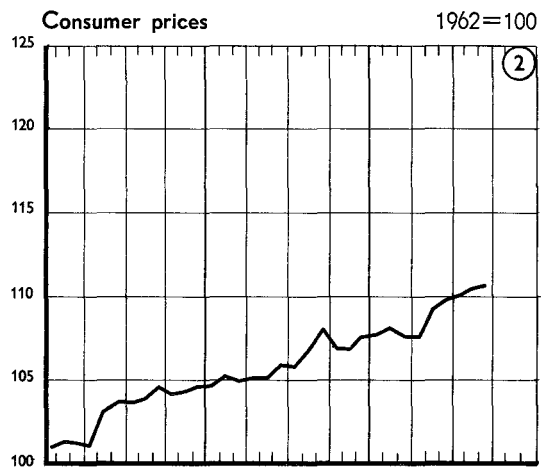
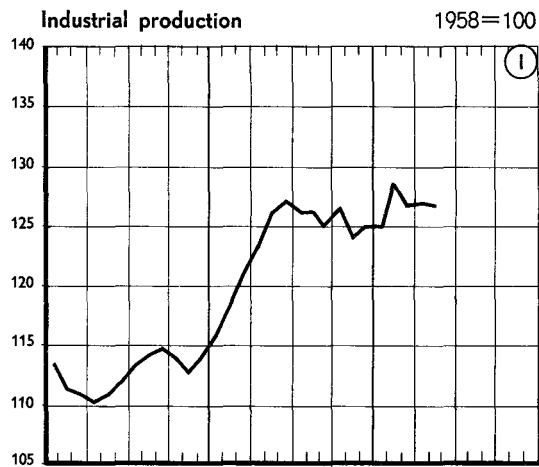
As regards private consumption, the level of employment seems likely to remain so high and the labour market so tight, that these factors alone should ensure a further expansion of wages and salaries, and consequently of spending on consumption. In addition, the sliding wage scales will doubtless make a further contribution to nominal incomes; this however also means that unit production costs and prices will once again tend to rise, although perhaps less sharply.

These prospects, coupled with the absence of any appreciable labour reserves, do not suggest that the Government's financial and budget policy should be aimed at greater expansion. In 1964 a policy was adopted which restricted the expansion of government expenditure in 1965, and this policy should be maintained in 1966. Measures to relax this restrictive policy in connection with certain private and public investments, in accordance with the Council recommendation of 8 April 1965, should be approved only as part of this overall policy. These measures should be adopted cautiously, they should be offset by restraint in other types of spending, and they should be considered only in cases where the requisite factors of production will be available.

It is doubtful whether the trend of development for 1966, suggested by the Grand Duchy's budget policy, is compatible with these requirements, in particular the objective of stabilizing unit costs and prices. When the budget is being prepared and when it finally comes up for approval, considerable efforts will still be necessary to achieve a fiscal policy that fits the current economic situation.



ECONOMIC INDICATORS



NOTES:

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

Graph 1. Index adjusted for seasonal variations. Moving averages of 3 months.

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

Graph 3. Index adjusted for seasonal variations.

Graph 4. Source: EEC business survey.

TABLE 1

	1963
Total area ('000 sq. km.)	2.6
Total population ('000)	324
Density of population per sq. km.	125
Working population ('000)	136
Working population, breakdown by main sector (%):	
— Agriculture	15
— Industry	45
— Services	40
Percentage share of gross domestic product in 1962	
— Agriculture	7.5
— Industry	53.0
— Services	39.5

TABLE 2

	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	(129)					
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				
Building (1958 = 100)	1964	48	57	83	103	106	109	110	96	98	95	73	63
	1965	48	55	82	103	110	102	105					
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)				
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			

() Provisional figures.

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 Economiques.
- 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.

