



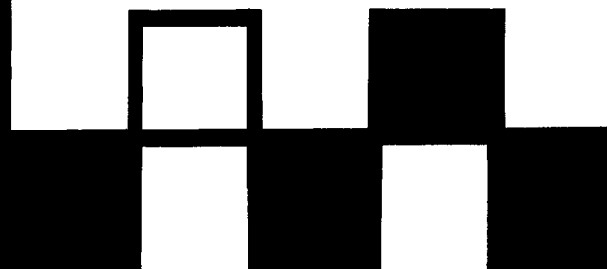
**European
Economic
Community**
Commission

**Directorate-
General
for Economic
and Financial
Affairs**

**The economic situation
in the Community**

1

1966



Quarterly survey

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

EUROPEAN ECONOMIC COMMUNITY

COMMISSION

The Economic Situation in the Community

MARCH 1966

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Note :

This Survey was completed around mid-March 1966. 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 3-1966 of the "Graphs and Notes on the Economic Situation in the Community" can usefully complete the information supplied here.

I. THE OVERALL SITUATION

Economic growth in the Community as a whole continued at a slightly faster pace in the last few months of 1965 and the first few months of 1966.

The impetus given by demand from abroad was hardly any weaker than in previous months. According to customs returns, the value of exports of goods to non-member countries in the fourth quarter was 11 % above the fairly high level of the corresponding period in 1964.

Internal demand appears to have expanded slightly faster at the end of 1965 and the beginning of 1966. The growth of gross fixed asset formation in the Community as a whole remained moderate, but investment in stocks and, above all, private consumers' expenditure expanded more vigorously than before—although in the latter case this was partly due to special factors.

Internal supply also tended to rise somewhat more rapidly. The adjusted index of the Statistical Office of the European Communities shows that industrial production went up about 1.5 % from the third to the fourth quarter—after an increase of 1 % from the second to the third. In the fourth quarter the unadjusted index was 5 % above the figure for the same quarter of 1964.

The labour markets of some member countries showed signs of easing, but only in certain areas and types of employment; in the Federal Republic of Germany and the Netherlands, however, the labour shortage remained very acute. In France and Italy unemployment began to fall slightly.

As a result of the lively expansion of internal demand, and particularly the upswing of activity in Italy and France, imports from non-member countries increased very briskly compared with previous months. In the last quarter of 1965 visible imports were 11 % higher in value than in the same period of 1964.

Intra-Community trade in goods developed even more briskly than trade with non-member countries; the value of imports from other member countries was in the fourth quarter 17 % higher than a year earlier. The decisive reason for this increase in trade was not, as previously, the expansion of imports into the Federal Republic of Germany but, rather, the revival of imports into Italy and France.

Prices in the Community went up more rapidly in the last few months of 1965 and particularly at the beginning of 1966. To a considerable extent, this was due to "autonomous" factors, such as increase in indirect taxes, rents, and charges for public utilities and transport, and to the effect of the bad weather on food prices. There was probably little change in the underlying upward movement of prices and costs.

The Community's balance of trade with non-member countries may well have deteriorated further from the third to the fourth quarter of 1965. In the fourth quarter the deficit rose to about 359 million units of account ⁽¹⁾—appreciably more than in the fourth quarter of 1964 (309 million u.a.). There may have been a slight surplus on capital transactions—in spite of some renewed outflow of short-term funds. Between the end of September and the end of December the official gold and foreign exchange reserves of the member countries went up 353 million u.a., but this was partly due to the usual seasonal deterioration in the net foreign exchange position of the commercial banks ("window dressing"). With the turn of the year this trend was reversed.

The economic developments that can be expected up to the end of 1966 suggest that expansion will continue at a somewhat faster rate than in the course of 1965.

Demand from abroad may again increase strongly—probably more rapidly than was previously supposed; in particular, demand from the United States, and no doubt purchases by the developing countries also, will stimulate the economy.

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

Internal demand should also expand faster, although only slightly faster. In spite of the further slowdown in investment that can be expected in the Federal Republic of Germany, expenditure on gross fixed asset formation in the Community as a whole can be expected to rise somewhat more rapidly owing to the recovery in Italy, France and Belgium and the faster pace of increase in the Netherlands. In addition, investment in stocks should continue to expand fairly briskly—especially in the first half of the year.

Private consumers' expenditure is also certain to show a considerable increase. In France and Italy the disposable income of households should rise even more rapidly than in the previous quarter, while in the Federal Republic of Germany and the Netherlands the pace of its growth may fall, although only slightly.

In view of the trend in demand outlined above internal supply in the Community will certainly expand quite substantially. Industrial production should continue to advance at a pace that will, as forecast at the end of 1965, ensure an increase of 6 % for the full year 1966 compared with 1965. Its rate of growth in the Federal Republic of Germany during the months ahead may indeed turn out to be somewhat lower than at first expected, but later in the year it may benefit increasingly from the continued vigorous rise in demand from abroad and the repercussions that this will have on the domestic market. In France, and possibly also in Italy, industrial production may expand somewhat faster than was predicted at the end of 1965.

The last Quarterly Survey's forecast of an increase of 4.5 % in the real gross Community product in 1966 can also certainly be maintained.

This expansion should not be hampered by serious difficulties in connection with the factors of production; in Italy and France unemployment will certainly show a tendency to fall, and in any case the shortage of manpower in the Community as a whole will tend to become if anything less acute, particularly in the Federal Republic of Germany. In the Netherlands, too, the labour market can be expected to remain as tight as before, but is unlikely to become any tighter.

The more rapid growth of overall demand in the Community will certainly be accompanied by an appreciable rise in imports from non-member countries. The Community's trade balance can therefore be expected to deteriorate further, but the deterioration should be fairly slight.

Although in the coming months a better balance between supply and demand can be expected in those member countries where there is still excess demand, cost increases will nevertheless probably continue to push prices up very appreciably in all Community countries.

Under the circumstances, and in view of the faster pace of growth in most member countries, the main purpose of short-term economic policy in the Community must still be to retard the upward movement of prices and costs. A greater effort should be made to eliminate the disequilibria that still persist in some countries, using first and foremost the instruments of budget policy but also an appropriate credit policy; in the member countries where business is now improving again (i.e. Italy, France and, to some extent, Belgium) these instruments must be used to keep the upswing well under control, so that it does not create new tensions. Lastly, everything possible should be done in the Community as a whole to reduce and eliminate the upward pressure of costs, even by direct action.

A. Recent developments

1. Demand

Overall demand continued to increase briskly at the end of 1965 and the beginning of 1966; a slight levelling-off in the growth of external demand has probably been more than offset by the more rapid rise in internal demand.

Towards the end of 1965 it became apparent that external demand (i.e. actual exports of goods and services to non-member countries) was no longer expanding quite so vigorously as in previous months. Nevertheless, in the fourth quarter of 1965 the value of visible exports (as shown by customs returns) was 11 % above the fairly high level of the corresponding period in 1964.

The Community's deliveries to the United States went up at almost the same rapid rate as in the preceding months. Above all, the reduction in the steel stocks held by American manufacturers, and the consequent drop in imports, turned out to be much less extensive and much less prolonged than could have been assumed; this was partly because of an increase in the demand for armaments, and psychological factors also played a part—because it was generally expected that steel prices would go up; there was even some tendency to replenish stocks. All the components of internal demand, except expenditure on residential construction, showed a very lively expansion, and this has been reflected in a rapid increase in imports.

In the United States industrial production quickly recovered from the setback recorded in September, and then began to mount again. The unemployment ratio fell to its lowest level for almost nine years.

Altogether the US real gross product (seasonally adjusted) went up fully 1.5 % from the third to the fourth quarter. Including statistical adjustments, this has led to a reappraisal of the GNP growth rate for the full year 1965 compared with 1964, and it is now put at 5.5 %.

At the beginning of 1966 the growth of consumption may have suffered to some extent from the increase in social security contributions, which was only partly offset by a reduction in taxes on consumption; at the same time, however, the rise in public expenditure should have more than made good any ill effects that would otherwise have hampered the growth of overall nominal demand in the United States.

In the last few months the upward trend in prices has been more pronounced than hitherto; costs also appear to have been rising more sharply.

The Community's exports to the United Kingdom, which had begun to pick up again in the third quarter, maintained their improvement in the last few months of 1965.

In view of the rather slower growth of overall demand in the United Kingdom, the expansion of imports may partly be due to the fact that the import surcharge has lost much of its effect because of persistent increases in prices and costs on the domestic market.

With regard to the development of overall demand in the United Kingdom, it appears not only that the volume of consumption has begun to rise somewhat more slowly, as a result of increased taxation and higher prices, but—even more important—that enterprises have probably been showing less propensity to invest, owing to the influence of shrinking profit margins and the restrictive credit policy. Exports, however, went up more rapidly in the fourth quarter.

In these circumstances, little if any progress in domestic production in the United Kingdom was made. In the final quarter of the year the unadjusted index of industrial production was about 2 % higher than in the same period of 1964.

In the other important industrial countries, the trend in economic activity at the end of 1965 and the beginning of 1966 did—on the whole—rather less to stimulate the Community's exports than in previous months. In the Scandinavian countries the economic upswing has clearly passed its peak, especially if measured in real terms. Except in Norway, the growth of nominal domestic demand remained, however, considerable in spite of various measures taken to curb it, once again it exceeded the growth that could be achieved in supplies from domestic sources, so that imports continued to mount. In Switzerland, where measures to slow down economic expansion had sometimes had side-effects on the trend of imports, there was at the end of 1965 and the beginning of 1966 a return to somewhat more vigorous expansion in imports from Community countries. Austria's demand for imports also quickened slightly during the period under review.

The developing countries' imports from the Community also continued to rise. The Community's exports to Latin America showed hardly any advance on previous months, but the developing countries of Asia and the associated overseas countries and territories increased their purchases quite substantially.

Nominal internal demand may have expanded somewhat faster in the last few months of 1965 and the beginning of 1966, although gross fixed asset formation in the Community as a whole still showed only a modest increase. Expenditure on plant and equipment may well have risen at about the same pace as in the third quarter. If, in France and Italy, the increasing degree of utilization of production capacities and the improvement in the general economic climate led to some recovery in purchases of plant and equipment the expansion of this element in demand weakened further in the Federal Republic of Germany.

The pace of growth in building investment appears to have become slower than in previous months, particularly in residential construction, where some slackening was

apparent throughout most of the Community. In Italy effective demand for new housing remained low, and most of the other member countries showed evidence of the effects of the financing difficulties and cost increases which had occurred during the course of 1965. In the fourth quarter this situation was reflected in a decline in the number of dwellings completed within the Community; owing to the particularly bad weather, this was about 6 % lower than the figure recorded a year earlier. Expenditure on public works in the Community as a whole continued to rise briskly, however, if allowance is made for seasonal fluctuations.

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

	1964		1965				1965 %
	million u.a. (¹)	%	1st quar- ter	2nd quar- ter	3rd quar- ter	4th quar- ter	
All non-member countries :	24 158	+ 11.5	+ 12	+ 11	+ 14	+ 11	+ 12
of which :							
Industrial countries (²)	15 621	+ 13	+ 12	+ 11	+ 15	+ 12.5	+ 12.5
including :							
United States	2 849	+ 11	+ 11.5	+ 19.5	+ 25	+ 23	+ 20
EFTA	8 832	+ 11	+ 9.5	+ 6.5	+ 11	+ 8	+ 8.5
United Kingdom	2 275	+ 15	— 5	0	+ 9	+ 12	+ 4
Developing countries (³)	6 889	+ 8.5	+ 10	+ 8.5	+ 11.5	+ 6.5	+ 9
including :							
Associated overseas countries and territories	1 652	+ 7	+ 1	+ 4	+ 8.5	+ 6	+ 5
Other (⁴)	1 649	+ 14.5	+ 23	+ 24.5	+ 15.5	+ 13.5	+ 19

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

(²) Class 1 of the standard classification of countries for the external trade of the EEC.

(³) Class 2 of the standard classification of countries for the external trade of the EEC.

(⁴) Class 3 of the standard classification of countries for the external trade of the EEC and other exports.

On the other hand, investment in stocks did more to stimulate economic activity than before. Higher prices on the world market did in fact encourage entrepreneurs to build up their stocks of raw materials and semi-finished goods. Dealers, too, appear to

have continued to increase their stocks of finished products deliberately; only in the Netherlands may there have been some decline in these stocks towards the end of the year, owing to vigorous pressure of demand, some of it speculative.

Consumption expenditure as a whole also had a greater impact than in the preceding months. Public expenditure on goods and services rose somewhat less sharply than before, mainly because wages and salaries in the public sector showed no substantial improvement in most member countries during the period; but the increase in private consumers' expenditure was—partly as a result of special factors—noticeably more rapid in the Community as a whole in the fourth quarter; for example, the increase in indirect taxes announced in the Netherlands and Belgium for 1 January 1966 added very greatly to the pressure of demand for a time, and this was partly financed by a reduction in the proportion of disposable incomes saved by households. But in the other member countries, too, the trend was still appreciably upward, perhaps more so than before.

The growth of private consumers' expenditure was strongly sustained by the steady expansion in *per capita* incomes from wages and salaries in the Community generally. The rise in the total number of hours worked, provided an increasing stimulus to this element of expenditure, especially in Italy and France. Lastly, transfer incomes were again raised appreciably, the increase being very substantial in Italy and the Netherlands.

In the Netherlands and Belgium the pattern of private consumers' expenditure was largely influenced by the tax increase mentioned above. In those countries the pressure of consumer demand at the end of 1965, and its easing at the beginning of 1966, mainly affected purchases of consumer durables. In the fourth quarter of 1965 the number of passenger and estate cars sold was some 128 % higher in the Netherlands, and about 31 % higher in Belgium, than in the same period of 1964. In the Federal Republic of Germany and France, domestic sales of passenger and estate cars also showed a marked increase towards the end of the year, compared with the previous quarter. In Italy, on the other hand, where the abolition of a special tax had released a wave of purchases that had been postponed because of the tax, the car market showed some signs of slackening, but this will probably prove to be only temporary.

2. Production

Internal supply in the Community rose slightly more rapidly at the end of 1965 and the beginning of 1966.

The increase in the rate of growth was most striking in the case of industrial production. At all events, the adjusted Index of the Statistical Office of the European

Communities (excluding construction and food, beverages and tobacco) went up by about 1.5 % from the third to the fourth quarter of 1965—following an increase of 1 % in the previous quarter. In the fourth quarter the unadjusted index was 5 % higher than the figure for the same period of 1964.

The faster rate at which industrial production grew in the Community was mainly due to the vigour of expansion in the consumer goods industries. Output in the textile industry, which has been picking up for some time now, again exceeded the results achieved in the same period of the previous year; even more substantial increases, however, were recorded in consumer durables, particularly the automobile industry. In the fourth quarter the number of passenger and estate cars produced in the Community was 12 % higher than in the same period of 1964, and in December alone as much as 21 % higher. This was the first time that such a high year-to-year growth rate had been achieved since the first quarter of 1964.

The production of capital goods in the Community as a whole gathered momentum appreciably, although the trend has for some time been rather sluggish in the Federal Republic of Germany. In electrical engineering, output again increased particularly rapidly, and in mechanical engineering it continued to rise, although the advance was in general a modest one. In the latter sector, as also in the case of commercial vehicles, there have of late been clear signs that in France and Italy production was rising.

In the mining industry, on the other hand, and in several basic materials industries, aggregate output in the Community declined from the third quarter to the fourth; the slackening was particularly marked in coal-mining. With building and construction slowing down, output also fell in certain industries which produce building materials. Iron and steel production was lower in the fourth quarter of 1965 than in the same period of 1964; since December there has been a recovery in the flow of orders received, but at the beginning of the year this had had little effect on output. Most branches of the chemical industry, however, continued to expand as fast as before.

In the services sector, there was hardly any change in the underlying trends for the Community as a whole. In several member countries there may indeed have been a slight increase in activity in certain branches close to the consumer level, but certain others were still feeling the effects of the sluggish trend in production in some basic materials industries.

Seasonally adjusted, the increase in the number of persons in paid employment in the Community at the turn of the year is likely to be very slight. In the member countries that have passed through a phase of slacker economic activity, advances in output were at first mainly due to rising productivity, and it is only recently that a slight tendency for the numbers in paid employment to rise has become apparent. In the other member countries the upward trend in the total number of wage and salary

earners remained quite weak. In the Federal Republic of Germany—in certain industries—this was because of the reduced pace at which production was growing, but some branches began to hoard a certain amount of labour which was not really needed in view of the level of output.

At the end of 1965 and the beginning of 1966 there may have been a slight drop in the seasonally adjusted figure for unemployment in the Community as a whole. This is due to the developments recorded in Italy and France, while in most of the other member countries there were indications that—at least in certain areas and types of employment—labour markets were slightly less tight.

In the Netherlands and the Federal Republic of Germany, however, the situation can still only be described as one of over-employment; the number of unfilled vacancies was again several times larger than the number of persons unemployed.

3. The balance of the markets

During the last few months of 1965 the growth of imports into the Community, which was already brisk in the summer, continued at quite a rapid rate. From the third quarter to the fourth the value of visible imports from non-member countries shown by customs returns gives, after seasonal adjustment, an increase of about 5 %. In the last three months of the year these imports were 11 % higher than in the same period of 1964.

Owing, above all, to a vigorous expansion of demand for raw materials in several member countries and to the rise in demand for certain agricultural products, purchases from the developing countries went up considerably; the increase in the value of such imports was further intensified by the higher prices recorded on world markets since the autumn. It was in particular imports from the associated overseas countries and territories, which, after having shown no advance since the end of 1964, picked up appreciably. Imports from the United States were also stimulated by the factors mentioned above, and continued to mount. In addition, the faster growth of consumer demand in some member countries was reflected in a more expansionary trend in imports from the EFTA countries. The Community countries' purchases from the United Kingdom, for example, showed an appreciable increase in the last quarter of 1965, although in the first nine months of the year they had been lower than in the same period of 1964.

Although the expectation of fresh reductions in intra-Community customs duties may towards the end of 1965 have had a rather inhibiting effect, merchandise trade between the member countries rose more rapidly in the final quarter. Customs returns for imports show that the value of intra-Community trade (after seasonal adjustment)

increased by 7 % from the third quarter to the fourth, after a rise of 3.3 % from the second to the third. The figures for the fourth quarter were at least 17 % higher than those for the last three months of 1964.

Visible imports from non-member countries

(% change in values on preceding year)

Import from	1964		1965				1965 %
	million u.a. (¹)	%	1st quar- ter	2nd quar- ter	3rd quar- ter	4th quar- ter	
Total non-member countries	26 826	+ 8.5	+ 0.5	+ 3	+ 11.5	+ 11	+ 6.5
of which :							
Industrial countries (²)	15 451	+ 7.5	- 2	+ 3.5	+ 8.5	+ 10	+ 5
including :							
United States	5 430	+ 7.5	- 8	+ 8	+ 9	+ 10.5	+ 4.5
EFTA	6 588	+ 7	+ 4	+ 1	+ 6.5	+ 7.5	+ 4.5
United Kingdom	2 585	+ 5.5	- 1.5	- 5.5	+ 1.5	+ 9	+ 1
Developing countries (³)	9 831	+ 11.5	+ 3.5	+ 1	+ 14	+ 10.5	+ 7
including :							
Associated overseas countries and territories	2 054	+ 8	- 4	- 3.5	+ 0.5	+ 5.5	- 0.5
Central and South America	2 459	+ 8.5	0	0	+ 23	+ 5	+ 6.5
Others (⁴)	1 544	+ 2	+ 19	+ 13	+ 22.5	+ 26	+ 18

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

(²) Class 1 of the standard classification of countries for the external trade of the EEC.

(³) Class 2 of the standard classification of countries for the external trade of the EEC.

(⁴) Class 3 of the standard classification of countries for the external trade of the EEC and other imports.

In contrast to the development observed at the end of 1964, the expansion of intra-Community trade was no longer due mainly to the quantities purchased by the Federal Republic of Germany from other member countries; these have in fact been rising noticeably more slowly, while the increase in purchases by other member countries was considerably more lively. France's imports, for example, went up very rapidly as a result of the upswing in that country's economic activity; in the fourth quarter their

year-to-year growth rate reached about 13 % in value. The same trend was shown in Italy, where a markedly more expansionary development in the last few months of 1965 led to some recovery in import demand—though this was at first rather hesitant. The Benelux countries' imports from the rest of the Community also went up considerably faster, but here the trend was partly due to purchases made in anticipation of the higher indirect taxes which came into force on 1 January 1966.

On the export side of intra-Community trade, deliveries from France and Italy again went up appreciably in the fourth quarter of 1965 despite the recovery in the growth of domestic demand in both countries; the fresh upward movement in their mutual exports played an important part in this development. In addition, the expansionary internal economic situation in France and Italy, coupled with the pressure of demand from the Netherlands and Belgium—some of it speculative—caused a marked revival in the growth of exports from the Federal Republic of Germany.

This development in intra-Community imports and exports led to changes in the corresponding trade balances of individual member countries, and helped to restore a more "normal" pattern. Thus, for example, the balance in the Federal Republic of Germany again showed a marked improvement, while both in France and in Italy it tended to deteriorate further. The Netherlands' deficit, however, increased again—partly owing to the particularly large imports towards the end of the year. The balance of the Belgo-Luxembourg Economic Union was the only one to show no substantial change.

In the last few months of 1965 and especially at the beginning of 1966, prices went up more rapidly than before. In January the increases in the cost-of-living or retail price indices, compared with a year before, were as follows : about 7 % in the Netherlands, 4.2 % in Belgium and the Federal Republic of Germany, 4.1 % in Luxembourg, 3.1 % in Italy, and 2.6 % in France.

The faster rise in prices was partly due to "autonomous" factors, i.e. higher charges for public utilities and transport, increases in controlled rents and, particularly in Belgium and the Netherlands, in indirect taxes. In assessing the "autonomous" character of these increases one must, however, bear in mind that they are not, strictly speaking, inherent in the present economic situation but are in most cases the result of earlier, inflationary economic developments and of the resultant higher costs.

In addition, the seasonal rise in the cost of food was generally steeper than usual, partly owing to the exceptionally bad weather. Crop products rose particularly sharply; the longer term upward movement in beef prices appears, on the other hand, to have ceased or at least to have flattened out, and at the beginning of 1966 pigmeat prices were also tending to become steadier.

In the Federal Republic of Germany, the Netherlands and Belgium, prices for finished industrial products continued to show increases due in particular to increased costs. Even the slowdown in expansion in the German capital goods industries has so far hardly caused any abatement of the upward trend shown by prices in this sector. In Italy, on the other hand, where the pressure of unit costs has been slackening for some time (because wage increases have been relatively limited and production has been rising more rapidly as business activity picks up), there was only a slight increase in industrial producer prices. The same is true of France, although here too a slightly faster pace of increase has been apparent in recent months. One reason for this may have been that—as in the rest of the Community—import prices caused costs to rise in France. The tendency towards higher world market prices has in fact already begun to have a distinct influence on the prices being paid for imported raw materials and semi-finished goods.

Lastly, the prices of services in the Community as a whole went up at much the same rapid rate as before.

The Community's trade balance with non-member countries may well have deteriorated further between the third quarter and the fourth. The new deficit, at about 359 million u.a., was also appreciably heavier than in the same period of 1964 (309 million u.a.). The full current account may nevertheless have closed once again with a surplus, however moderate. Precise information regarding the capital account is not yet available, but it would seem that there was some drain of short-term funds. If the gross gold and foreign currency reserves of the monetary authorities rose by 353 million u.a. between the end of September and the end of December 1965, this increase is doubtless largely the result of a mere transfer within the overall reserves: the net foreign exchange position of the commercial banks deteriorated in favour of the official reserves, as is usual at the end of the year (owing to "window dressing").

In the fourth quarter the development of internal liquidity was again influenced by the balance of payments, but in different ways in different member countries: in Italy, liquidity again expanded quite vigorously; similarly, in Belgium there was a net increase in liquidity caused by transactions with abroad; in France, the contribution made by the balance of payments decreased. In the Netherlands, the balance of actual payments will probably even have resulted in a tightening of liquidity; in the Federal Republic of Germany, internal liquidities were probably no longer adversely influenced by developments in the balance of payments.

In several countries the cash transactions of the public authorities had the effect of increasing liquidity, partly owing to seasonal factors. This was most particularly the case in Italy. In the last few months of 1965 these transactions may, however, have tended to reduce liquidity in France.

As a result of these factors, and because in some member countries the amount of notes and coin in circulation was going up less rapidly, bank liquidity—in national cur-

rency—was either less tight than in the summer and autumn months (as in the Federal Republic of Germany), or even tended to expand (in Italy and Belgium). Rates on the money markets therefore remained relatively stable in most member countries; in France and the Federal Republic of Germany this was helped by the decision of the monetary authorities to offset the seasonal tightening of the money market by temporarily reducing the minimum reserves.

The development of bank credit quickened in several member countries in the fourth quarter, and thus also helped, sometimes considerably, to increase the internal liquidity of business. In Belgium especially, credit should have been expanding more strongly. The trend appears to have been similar in France, where the recovery in economic expansion was coupled with an increased demand for credit on the part of enterprises. Lastly, in the Federal Republic of Germany, the increase in advances to business and private customers towards the end of 1965 was perceptibly greater than usual for the time of year. In the Netherlands there was no substantial change in the general trend, and in Italy the upward movement in credit was again no more than moderate.

In the fourth quarter stock markets were at first exceptionally weak in almost all member countries. Only in Italy has there been any very marked increase in share prices since November. In the other Community countries it was not until the end of the year that certain signs of recovery became apparent, and this trend continued in some countries in January 1966. In France the development of share prices appears to reflect the revival in economic activity that has followed the removal of various uncertainties; at any rate they tended, after having been in the doldrums for over three years, to move up again during January in response to extensive purchases by private investors. In the Netherlands the temporary recovery in share prices was due to the fact that American selling of shares dried up. In Belgium the stock market was influenced by developments in the other member countries—and also in some important non-member countries. These factors rather than the growth and profit expectations of German companies were also not without their effect on the stock market in the Federal Republic, where after a pause of many months prices began to creep up at the beginning of 1966, as investors at home and abroad placed their money in shares.

In the fourth quarter of 1965 the markets for fixed interest securities mostly remained tight, generally because of the heavy demand for capital on the part of the public authorities—with the local authorities prominent among them—and also on the part of enterprises, where the margins available for self-financing are now smaller. The fact that facilities for borrowing from the banks were limited increased the demand for capital on the bond market. Interest rates continued to rise. The experience of the Netherlands was typical in this respect. Certain difficulties were encountered in placing a number of public loans; in December, however, there was some recovery in the quotations for State loans. In the Federal Republic of Germany investors were still rather

reticent; this tendency was reinforced by the announcement of several public loans within a short space of time, and it only began to become less marked in January, since when prices have become more stable. In France, where not only a State loan but also quite a considerable number of new company issues were floated in the fourth quarter, interest rates showed a slight temporary increase. In Italy, on the other hand, the ability of the bond market to raise funds remained very great even in the final quarter of the year, and interest rates tended to fall slightly.

Community product and expenditure

	1963 ⁽¹⁾	1964		1965 ⁽³⁾		1966 ⁽⁴⁾
	At current prices (in '000 million u.a. ⁽⁶⁾)	% change on preceding year ⁽²⁾				
		Volume	Value	Volume	Value	Volume
Gross Community product	249.9	+ 5.6	+ 9.8	+ 4	+ 7.5	+ 4.5
Private consumption	153.0	+ 4.4	+ 8.2	+ 4	+ 8	+ 4.5
Public current expenditure	37.2	+ 1.7	+ 7.8	+ 4	+ 11	+ 4
Gross fixed asset formation	57.1	+ 7.3	+ 11.9	+ 3	+ 6	+ 4.5
Balance exports ⁽⁵⁾ less imports ⁽⁵⁾ (in '000 million u.a. current prices)	+ 0.6		+ 1.4		+ 2.7	+ 2.2

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

⁽²⁾ Community aggregates based on official exchange parities.

⁽³⁾ Commission estimates.

⁽⁴⁾ Commission forecasts.

⁽⁵⁾ Goods, services and factor income.

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

Note:

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

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

B. Outlook

For the Community as a whole, the outlook for the rest of 1966 indicates no important change from that described in the last Quarterly Survey (4/1965). The expansion of overall money demand could, however, prove yet a little more lively than predicted.

It is true that exports of goods and services will grow less vigorously than in the greater part of 1965; but this slowdown of expansion could well turn out to be less substantial than has so far been assumed, since the deeper American military commitment in Vietnam could have a sharper impact on economic activity in the United States itself and indirectly on the rest of the world, provided, of course, that no solution to the conflict is found in 1966.

Domestic demand in the United States should expand appreciably. Admittedly, in view of the rising cost of US defence operations, the expansion of public disbursements for civil purposes must be expected to slow down a little; total public expenditure will, however, increase appreciably, and this will certainly spur on the economic expansion of most of the other components of domestic demand, even if the growth of tax revenue gathers momentum as a result of the cancellation of an intended reduction in indirect taxes and of the plans to collect taxes more rapidly.

In particular, the fairly steep upward movement of fixed investment by enterprises, confirmed by the business surveys of November/December 1965, will probably continue for some time yet. True, the cost of borrowing has risen, and the scope for self-financing will be somewhat limited by the measures to speed up the collection of direct taxes (corporation tax); moreover, in addition, the rapid rise in this backlog of orders is tending to put too great a strain on the resources of certain capital goods industries, and this almost certainly means longer delivery dates and higher prices for plant and equipment. But there still appear to be ample resources of liquidity in the American economy, so that unless additional measures to throttle back economic activity are taken fairly soon, the expansion of investment is unlikely to slow down before the end of the year.

It would also seem that, despite the increase in social security contributions, the growth of private consumers' expenditure will remain fairly brisk, all the more since the rate of growth of wage incomes is benefiting somewhat from the labour market situation. But domestic supply in the United States could now prove a little less elastic than has been suggested—a large number of industries are already running above optimum capacity and some bottlenecks are hampering supplies—and, in view of the further contraction of manpower reserves and of rising world commodity prices, the slight tendency for prices to rise, due to the play of market forces, could well be reinforced by costs.

In coming months, therefore, imports—including imports from the Community—are likely to go on growing substantially, perhaps even faster than before.

In the United Kingdom a number of measures have been taken which may well strengthen the tendency for growth to lose pace—a tendency outlined in the last Quarterly Survey. The authorities are apparently maintaining a somewhat restrictive policy with regard to public expenditure. A more restrictive attitude on the expansion of bank advances and a tightening of hire purchase controls early in 1966 are mainly designed to slow down further the expansion of private consumers' expenditure. Narrower profit margins and the reticent credit policy will, however, also slow down industrial investment once again; and while, in the face of all this, reform of official investment incentives (with grants instead of tax allowances and the establishment of an Industrial Reorganization Corporation) may or may not on balance lead to expansion—a matter which it is difficult to assess, it is at all events unlikely to do so before the end of 1966.

Consequently, neither domestic production nor imports of manufactures in the United Kingdom are likely to increase appreciably this year; on the other hand there should be a lasting recovery in purchase of raw materials and semi-manufactures to replenish stocks, sharply depleted for a time in 1965.

The development prospects for the other EFTA countries depend to some extent on the way Governments react to the results of their stabilization drives—results which so far have for the most part proved unsatisfactory. The public authorities have themselves sometimes contributed in no small measure to the maintenance of the unduly steep rise in expenditure; this is partly the reason why the disequilibrium—persisting in most of these countries—between the expansion of money demand and that of domestic production, which is stretched to capacity, is due to too sharp an increase in disposable incomes. The demand for imports will remain considerable; however, in view of the tendency for the payments position of a number of the countries to deteriorate, it could impel the authorities to impose further measures of restriction.

The demand in the industrial countries for raw materials and semi-manufactures from the developing countries is vigorous and in some of them has recovered momentum. In view of this and of shortages of certain raw materials due to special factors such as the Vietnam conflict, other international crises and local strikes, it now seems that world market prices will probably rise for quite some time. For the developing countries, in general, this may well mean an improvement in their terms of trade and an increase in foreign exchange earnings, giving them later in the year more scope from the payments angle for imports from the industrial countries. Another point is that their drawing facilities with the International Monetary Fund were also increased on the entry into force in February 1966 of the new arrangements for higher quotas, with a new scale re-weighted in their favour.

In view of the foregoing, the vigorous development of Community exports to the non-member countries can be expected to continue in 1966. The growth rate indi-

cated in the previous Quarterly Survey (for the full year 1966 compared with 1965) of 8 % (value) should now be regarded as a lower limit of possible growth.

During the rest of the year internal demand in the Community may be expected to expand at a slightly faster rate than before.

This is certainly true in respect of the development of expenditure on gross fixed asset formation. The point where the growth rate for the Community as a whole is most likely to show some increase in coming months is that of investment in plant and equipment : in most of the member countries the likelihood of an expansion in overall demand, the reduction in the reserves of production capacity, and, in some cases, a modest improvement in profits should engender a more rapid development of investment demand. In addition to this there will, in France and in Italy, be the impact of new tax rules designed to spur on productive investment. Germany is the only country in which the flow of domestic orders to the capital goods industries suggests that investment in plant and equipment will slow down.

In comparison with investment in plant and equipment, investment in building and construction will probably make only moderate progress. In fact, in residential construction, where the rate of completions was already tending to decline at the end of 1965, the figures for building permits issued in the second half of 1965 indicate a relatively low level of starts in the following months. On the other hand, the expected recovery of industrial investment in a number of Member States is very likely to lend increased vigour to spending on industrial and commercial building. It is probable that expenditure on public works will in general increase once again; however, except in Belgium and Luxembourg, where a previous decline has given way to a recovery which is maintained, and marked expansion is to be expected, its year-to-year growth rate is likely to be smaller than in 1965.

Again, in view of the fairly rapid growth of Community production and of world price trends for raw materials and semi-manufactures, investment in stocks will probably gather a little momentum, particularly during the first half of the year.

It is estimated that the upward movement of public current expenditure on goods and services in the Community as a whole will tend to slow down slightly, although the expansion of this demand component in Italy and the Benelux countries should remain fairly rapid; in Germany the rate of progress will probably be more moderate than in the previous year, and in France it is likely to remain within reasonable bounds, even if a little faster.

In the coming months, the expansion of private consumers' expenditure will probably be brisk. In France and in Italy, the adjusted growth rates for disposable incomes of private households should increase, while expansion is likely to be a little slower than before in Germany.

In general, however, some uncertainty still subsists with regard to the extent of forthcoming wage increases and it is thought that in the event they might once again prove more vigorous than forecast. For the Netherlands, estimates currently available point to a year-to-year increase of 11.5 % in the total wages and salaries bill for 1966; in the other member countries the upward movement is expected to be a little weaker.

In most member countries the growth of transfer incomes should be a little less lively than in 1965. If the predictions prove correct that the increase in the consumer price level in the Community as a whole will be slightly less than in 1965, the increase in the volume growth rate of private consumers' expenditure will be rather higher than the increase of this demand component at current prices.

The prospects for the development of overall demand and the estimated degree of production elasticity suggest a slight increase in the growth rate of the Community's internal supplies.

In the field of agricultural production the cold weather does not seem to have affected sowings to any appreciable extent; with normal weather in the coming months crop production will show an appreciable increase over the 1965 level. Internal supply of livestock products as well should grow more briskly than in 1965.

It looks as if the 6 % growth rate for industrial production ⁽¹⁾ forecast in the last Quarterly Survey will prove correct. It is true that growth in France will perhaps be more rapid than first assumed; on the other hand, expansion in Germany must be expected to be a little slower.

As for the trends by sector, activity in the consumer goods industries appears to be remaining fairly dynamic. For example, the year-to-year growth rate for textile production in 1966 is estimated at a minimum of 5 %. The growth of the production of passenger and estate cars is at present put at about 7 % (there was no growth at all in 1965). In the capital goods industries, the total growth of Community production—based mainly on the recovery in France and in Italy—is likely to be curtailed by the loss of momentum in Germany. On the other hand, production of chemicals and oil will probably continue to forge ahead. In the iron and steel industry as well, the order trend now holds out prospects of renewed and appreciable expansion.

On the other hand, since the latest trends in the demand for building indicate that, even with favourable weather conditions, activity in this sector can expand only moderately in 1966, it will be advisable to maintain the estimate for the growth of overall gross Community product for 1966 (4.5 %) published in the last Quarterly Survey, at least for the time being.

⁽¹⁾ As defined for the Index of the Statistical Office of the European Communities, i.e. excluding building and food, beverages and tobacco.

In view of the foregoing, the current disequilibria on the labour markets may be expected, if anything, to ease slightly in coming months. For one thing, unemployment will doubtless tend to contract in those member countries in which it increased—to a greater or lesser extent—in 1965, but this will not mean any danger of considerable strains for the immediate future, in France for example. Secondly, in those countries where labour shortages have so far been particularly marked, the slightly easier trends are likely to continue.

Given the faster growth of demand in the Community as a whole, and assuming that commodity prices remain firm, the Community's imports from non-member countries should again rise appreciably—more rapidly than previously estimated and probably faster than the corresponding exports. The balance of trade, calculated on the basis of customs returns, will therefore probably tend to deteriorate a little further in the course of the year; for the full year 1966 it could well close with a somewhat heavier deficit than in the previous year.

Price trends in the Community as a whole will continue upward. This will apply even for those member countries—Italy and France—whose economies are enjoying a recovery after a period of weakness and where, if demand expands in the normal way, firms will still be running below capacity. In these countries it is true that the rapid productivity gains which go with the expansion of output in this phase of the business cycle are tending to hold unit costs down. As against this, the more rapid development of demand is offering more opportunities than hitherto of passing on higher costs—even those incurred at an earlier stage—in the shape of higher prices. Nor can it be ruled out that the changed economic climate may once again engender stronger cost pressure. In this connection it is significant that in Italy wage negotiations are now under way or imminent for 4 million workers, a figure which compares with only 600 000 in 1965. Whether and to what extent prices and costs will actually rise faster will depend essentially on the rate of expansion of overall demand. But further “autonomous” price increases, such as higher fares and freight rates for public transport and distribution undertakings must, in any case, be reckoned with.

In Germany and the Netherlands price increases in the consumer field, at any rate, will again depend to a considerable extent on demand or will be fostered by the development of demand. But the outlook in Germany in particular suggests that this factor will decline in importance. On the other hand, “cost push” is generally gaining in importance in this phase of the business cycle; wage expansion should, it is true, slow down a little, but productivity gains—except in the Netherlands—are declining faster. In the Belgo-Luxembourg Economic Union rising price trends will depend to quite a large extent on the cost push factor.

Appreciable increases in charges for public utilities—made necessary by previous cost increases—will also help to force price indices to a higher level in these countries.

Whether food prices will play a stabilizing role in the Community is still uncertain. Assuming average weather conditions, this should normally be the case in most member countries for many crop products whose prices soared in 1965. But experience shows that at consumer level average reductions in food prices following on increases are always relatively small. Another point is that in some member countries, notably France, the farm-gate prices of a number of products could be increased for agricultural policy reasons.

At all events, prices in the Community as a whole (after adjustment for variations) will in general tend upwards. True, the actual price increment in Germany and the Netherlands could well be a little smaller than in 1965. As against this, no loss of upward momentum is to be expected in Belgium, and in Italy and France there is actually a danger that the underlying upward movement, which has so far remained relatively slow, may again gather speed.

As it has already made clear in the address by one of its Vice-Presidents, M. Marjolin, to the European Parliament on 18 January, and in its last Quarterly Survey (4/65), the Commission believes that in these circumstances stable prices and costs must remain the principal economic goal of the six Governments, Parliaments and banks of issue and of the Community Institutions.

That the Short-term Economic Policy Committee shares this view, may be seen from its Opinion of 7 March concerning the complete economic budgets for 1966. This Opinion is given as an Annex to the present Survey.

In the following chapters, which are devoted to the economic situation in the various member countries, the Commission again suggests the guiding lines of economic policy it believes appropriate in each country in the interests both of the co-ordination of short-term economic policy at Community level and in the best interests of the countries themselves.

In Germany and in the Netherlands, the main task is still further to damp down the expansionary effect of budgetary policy by measures going beyond the considerable efforts already made, notably in Germany in respect of the Federal budget, and to pursue, at least for the time being, the restrictive monetary and credit policy.

In Belgium, the expansion of public spending (including that of semi-public institutions) and notably the growth in public expenditure on consumption, subsidies and other transfers stimulating consumption should be cut back enough to reduce the still too high overall deficit of the public authorities to a figure which can be financed from domestic savings without undue reduction in the funds available for the outside financing of investments by enterprises. The expansion of credit in Belgium is again beginning to gather momentum, and this trend must also be curbed.

In France, the measures so far taken to encourage directly productive investment by private industrial enterprises have certainly been most opportune; but the authorities must continue to show extreme caution in respect of all measures likely to stimulate expansion. The present upswing is already quite rapid; and any further acceleration could entail the risk of fresh inflationary strain.

These considerations apply also, and perhaps even more, to Italy, where it would seem that the time has come to apply the brake to the expansion of public consumption and transfer expenditure if the authorities wish to avoid a repetition of developments in 1963 and early 1964. Stimulants to domestic demand through "deficit spending" should now be very carefully regulated and concentrated on investment demand.

All the Community countries face the problem of the pressure of costs on prices, albeit in varying degrees. It has become clear that a slowdown in the expansion of demand and of economic growth to the extent achieved in 1964-65 is not sufficient to bring the upward movement of unit costs to a quick halt.

One conclusion which must be drawn from all the above is that an effective incomes policy is needed in the member countries. In this respect, it should be clear that in the present phase of the business cycle, when the profit trend, possibilities of self-financing and investment by industry are not major price policy problems in any member country, the stabilization of wage costs per unit of output must be the essential objective of incomes policy. If stabilization is not achieved, a situation can be foreseen in which the authorities would finally have to make such drastic use of the "classical" instruments of short-term economic policy that economic growth and employment would suffer severely; or there would be more or less open inflation, which would ultimately also lead to prolonged stagnation or recession.

At present, it is indeed of capital importance for the Community countries that they eliminate inflation—both demand and cost inflation. The economic integration of the member countries is becoming increasingly close, and it is sufficient for one or two major member countries merely to tolerate the pressure of domestic inflation for all the others to be drawn in sooner or later. There is always a time-lag, and the inflation may have disappeared in the "sick" countries before the others have been contaminated. Whereupon the contaminated member countries re-export the disease to the countries where it began, and as soon as the recovery of demand has gathered full momentum there the process begins over again.

True, there are certain advantages in the business cycles in the various Community countries being out of phase. It was for this reason, for example, that the 1965 price increases in certain member countries, notably Germany, were smaller than they would otherwise have been. This difference in phase also prevented the slowdown of economic

activity in Italy and France from degenerating into a real recession and then made a vital contribution to the business recovery in these countries.

But the time-lag seems to have become narrower of late, mainly because of the advance of economic integration and because of the efforts of the Governments to maintain full employment. It no longer leaves enough time for stabilizing forces to exert their full impact on prices and costs in a given member country: the economic situation in the partner countries is now apt to force a faster pace on the first country too soon, i.e. while the upward cost and price movement is still too appreciable.

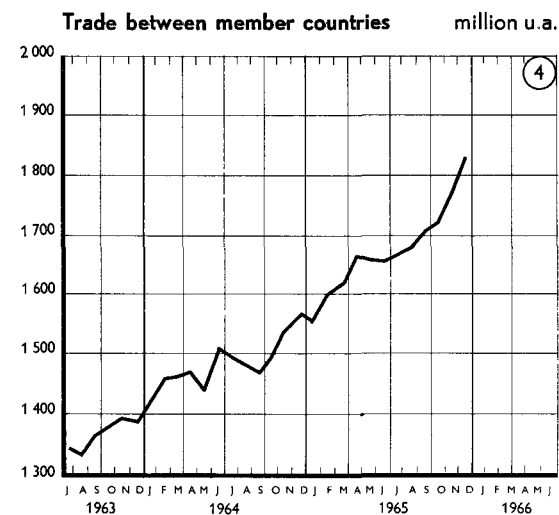
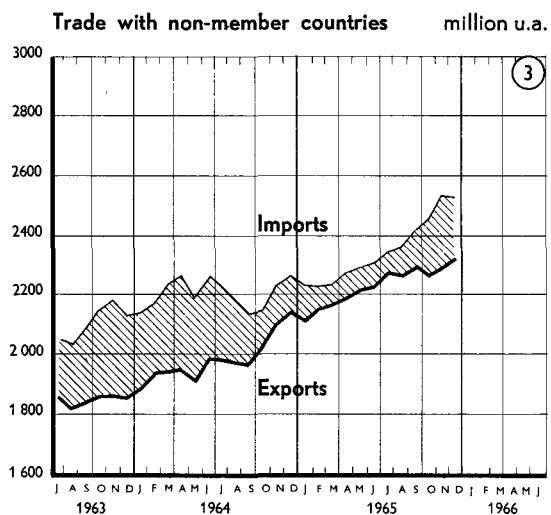
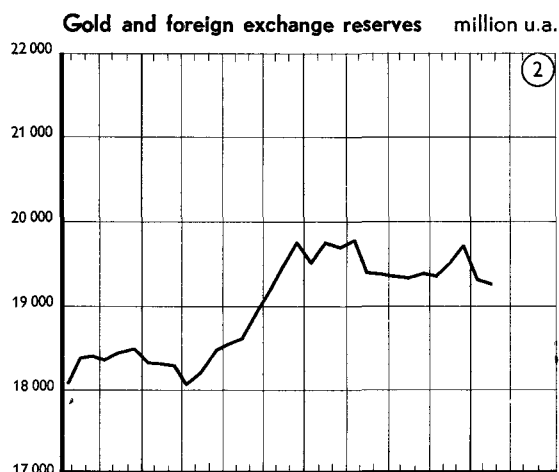
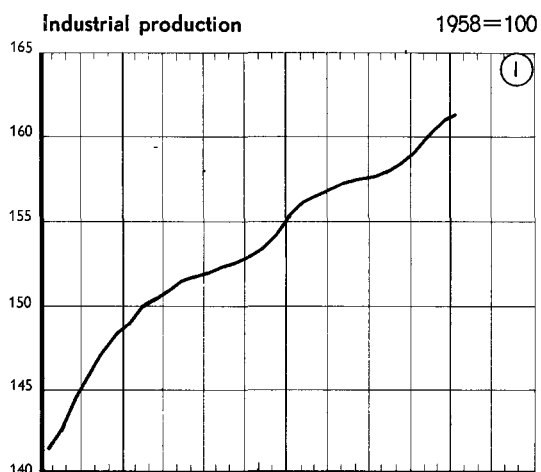
This is the danger which the Community might well face relatively soon, i.e. towards the end of 1966 or in 1967, if the authorities do not succeed in keeping a rein on the economic upswing in Italy and in France and in damping down quite soon the upward movement of costs and prices in the other member countries.

This danger is all the greater since it looks as if once again factors outside the Community must be expected to work rather against than for stabilization, at least in the immediate future.

This would mean a cost-price spiral within the Community, a chain reaction from country to country, which could well lead eventually to general inflation, followed by a recession.

On the other hand, if success is achieved in the near future in eliminating internal imbalances and in stabilizing costs and prices, there is no doubt that the Community can look forward in the longer term to a period of vigorous—but balanced—expansion.

ECONOMIC INDICATORS



NOTES:

Source: Statistical Office of the European Communities.

Graph 1. Trend curve; estimation established on the basis of indices adjusted by the SOEC for seasonal and fortuitous variations (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 imports.

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

EEC

TABLE 1: Basic data (1964)

Total area ('000 sq. km.)	1 167.5
Total population ('000)	179 243
Density of population per sq. km.	153
Working population ('000)	73 964
Working population, breakdown by main sector (%)	
— Agriculture	18
— Industry	44
— Services	38

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

	% change by volume on preceding year						Volume indices (1958 = 100)	Contri- bution (in %) to 1964 GNP
	1959	1960	1961	1962	1963	1964		
Gross Community product	5.2	7.8	5.4	5.5	4.2	5.5	139	—
Industrial production	6.3	11.9	6.9	5.8	5.2	7.1	152	—
Visible imports	5.1	20.5	6.0	11.3	10.2	6.9	176	—
Private consumers' expenditure	3.7	6.3	6.3	6.4	5.7	4.4	138	60
Gross fixed asset formation	8.2	10.7	10.2	6.8	4.9	7.3	158	23
Visible exports	12.5	11.1	3.0	1.0	3.8	9.3	148	—
Intra-Community visible trade	24.2	22.0	15.0	13.9	16.0	13.2	259	—
Gross product per capita	4.2	6.9	4.4	4.3	3.0	4.4	131	—

TABLE 3 : Basic monthly indicators

	Year	Jan.	Feb.	Mar.	Apr.	May	June	July	Aug.	Sept.	Oct.	Nov.	Dec.
Industrial production (1958 = 100)	1964	147	152	156	156	159	155	143	121	154	159	164	157
	1965	154	159	157	163	164	164	147	128	162	166	171	165
Imports from non-member countries (cif, million u.a.)	1964	2 288	2 186	2 237	2 381	2 192	2 320	2 254	1 886	2 085	2 270	2 238	2 460
	1965	2 243	2 090	2 420	2 368	2 380	2 352	2 404	2 156	2 386	2 443	2 558	2 754
Exports to non-member countries (fob, million u.a.)	1964	1 891	1 878	1 959	2 038	1 866	2 036	2 053	1 731	2 030	2 252	2 113	2 291
	1965	1 936	2 068	2 413	2 172	2 249	2 192	2 348	1 997	2 239	2 380	2 367	2 649
Balance of trade (million u.a.)	1964	- 397	- 308	- 278	- 342	- 326	- 288	- 201	- 155	- 55	- 18	- 125	- 169
	1965	- 307	- 22	- 7	- 196	- 131	- 160	- 56	- 159	- 97	- 63	- 191	- 105
Intra-Community trade (million u.a.)	1964	1 436	1 452	1 496	1 577	1 415	1 576	1 532	1 243	1 512	1 654	1 510	1 623
	1965	1 442	1 573	1 796	1 680	1 661	1 691	1 735	1 437	1 734	1 871	1 812	1 933

NOTES

Source : Statistical Office of the European Communities.

Table 1

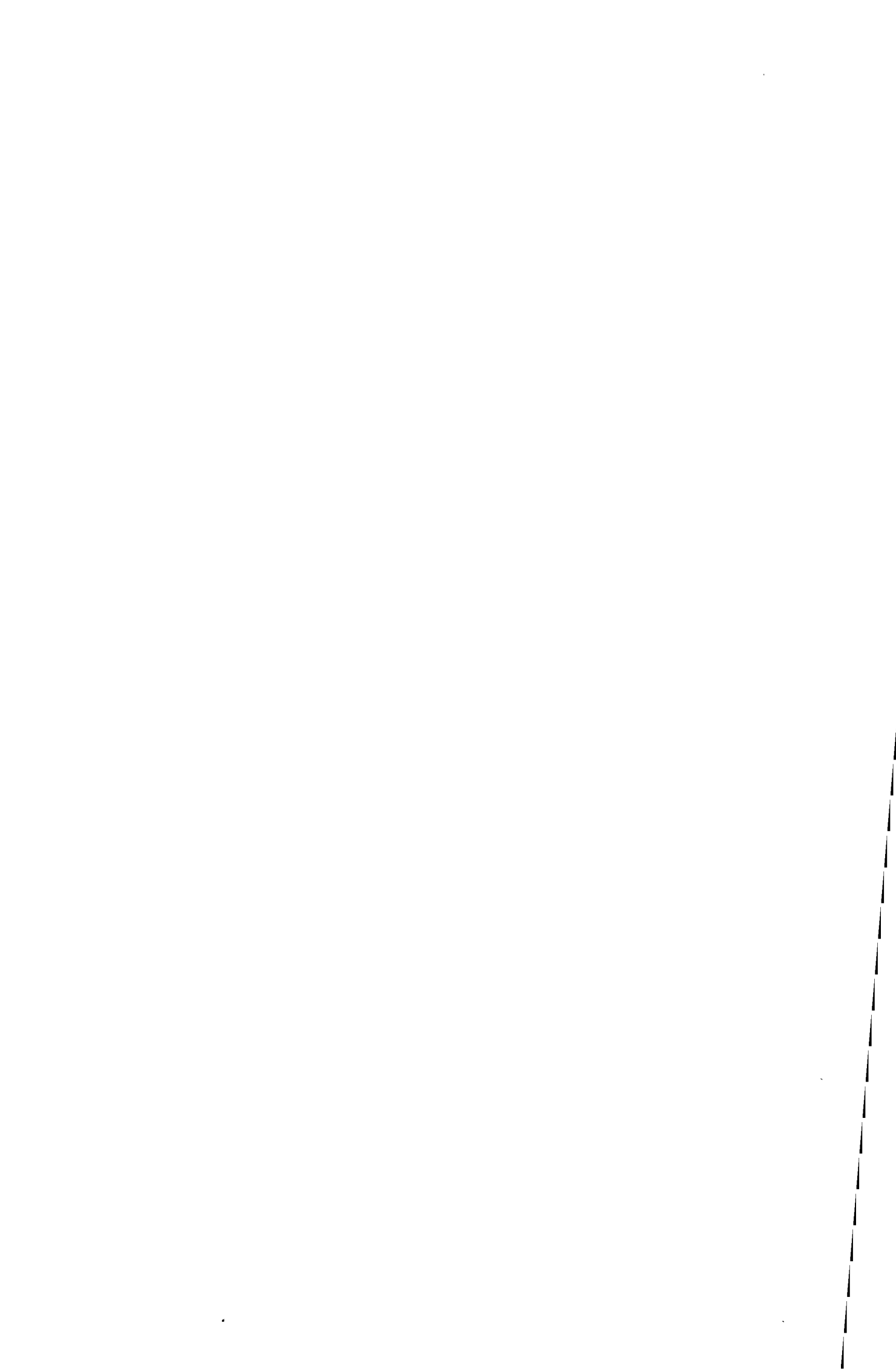
- Total population at mid-year.
- Population in employment at mid-year. Netherlands: 1961.

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

The tendency for economic activity to slow down, already discernible in the Federal Republic at the beginning of the autumn, intensified in the last few months of 1965 and the first few months of 1966. The expansion of overall demand remained at a very high level but became less boisterous, with greater variety in individual trends.

The change in the economic climate is most apparent in the slower increase of gross fixed asset formation, while private consumers' expenditure continued to rise very briskly—probably even faster than before. The slackening in the growth of domestic demand, the upsurge of business activity in Italy and France, and the pressure of demand from some non-member countries, especially the United States, all led to a quickening of exports.

The slowdown in overall demand, coupled with the persistent shortage of manpower, caused the growth of production to fall off further; the expansion of industrial production, particularly, tended to decline perceptibly. Imports also went up less briskly than before.

On the labour market as a whole demand remained excessive. However, there were indications that the manpower situation was beginning to ease in some respects.

The quickening of exports and the slowdown in imports brought the current account back into surplus. In spite of the underlying tendency for the situation to ease in some branches, price increases continued unabated, especially at consumer level.

Altogether, there are clearer signs than before that the economy should regain its equilibrium in the coming months. The slowdown in the growth of expenditure on fixed assets will very probably be further intensified—at least for a while. There may however well be a further appreciable rise in consumer demand. With incomes rising further, the increase in private consumers' expenditure will be lively, though perhaps somewhat less lively than in the last few months of 1965. Towards the end of the year, too, the recovery of exports might sustain or even increase expenditure on investment.

In the next few months the advance in production will certainly remain relatively weak. In some branches of industry and in certain parts of the services sector it will still be limited by physical factors, particularly the manpower shortage,

but in a growing number of branches it will also reflect the slowness with which demand is expanding.

Consumer prices might tend to mount again quite appreciably, owing to the influence of excess demand on consumer markets and to the increasing pressure of costs.

In view of these prospects, the chief need is still the maintenance of a coherent anti-inflationary short-term economic policy.

1. Recent developments

Exports of goods and services, which had accelerated from the second to the third quarter of 1965, continued to rise rapidly. The foreign trade returns show that visible exports in the fourth quarter were 11.1 % higher in value, and 9.8 % greater in volume, than a year before. In January the year-to-year growth rate was 9.4 % (in value).

A particularly marked increase in the pace of growth was shown in the adjusted figures for exports to other EEC countries, particularly Italy. Exports to the United States continued to rise very vigorously. On the other hand, deliveries to the EFTA countries, especially Switzerland, contributed less to the expansion of activity.

In domestic demand, which had on the whole continued to increase very strongly until the third quarter of 1965, the trend was definitely reversed in the autumn months owing to a decline in the propensity to invest. The growth of gross fixed asset formation was in fact appreciably less marked than in the preceding months. In November-December 1965 capital expenditure on building even fell below the level of the corresponding period of the previous year. Although this was mainly the result of a particularly strong seasonal decline caused by the early winter, a weakening in demand was a factor that also played an increasing part. Expenditure on plant and equipment appears to have risen but little in recent months; in the mechanical engineering industry, at least, the expansion of domestic sales was smaller in the fourth quarter than in the third.

The trend in stocks largely reflected the decline in the investment boom. The latest results of the EEC business survey confirm the impression that an involuntary increase in stocks took place as a result of slacker demand in the capital goods industry and, above all, in its primary branches, the basic materials and producer goods industries.

Towards the end of 1965 public current expenditure on goods and services rose rather more slowly; the pace of growth slackened because, unlike the year before, there were no substantial increases in wages and salaries in the public sector during the final quarter.

Private consumers' expenditure, on the other hand, has in the last few months been growing with undiminished vigour—probably even more quickly than in the immediately preceding months. In the fourth quarter of 1965 the index of retail sales was at least 10.4 % higher by value (6.4 % higher by volume) than in the same period of the previous year.

The rising trend in consumption is mainly due to the substantial wage increases. In industry gross wages and salaries per head in the fourth quarter were 7.5 % up on the corresponding period of 1964. Allowing for the increases in wages and salaries in other sectors, together with the growth of numbers in paid employment and of income transfers, mass incomes were 10.3 % higher than in the fourth quarter of 1964. In contrast to this, the amounts withdrawn from their businesses by self-employed persons appear to have risen more slowly, influenced by the less favourable trend in profits. All in all, the disposable incomes of households should have risen rather less than their expenditure on consumption; this would make the savings ratio lower than in the third quarter, when it was, however, exceptionally high owing to the issue of VEBA people's shares.

Initially the principal result of the slacker trend in economic activity caused by the weakening of demand was that the labour market did not tighten further. Only in a few cases were there signs that the situation was easing; some enterprises in the iron and steel industry, for instance, went over to short-time working, and the number of unfilled vacancies, which from the middle of 1963 till the middle of 1965 had been rising, went up somewhat less rapidly. By and large, however, the labour market remained under great pressure. At the end of February the number of unemployed, at about 236 000, was almost 55 000 less than a year before.

In the last few months the growth of production has increasingly adapted itself to the slower pace of final demand; in a few sectors it was still limited by the manpower shortages or insufficient capacity. Industrial production in the fourth quarter of 1965, as shown in the Federal Statistical Office's index of production per working day, was now only 3.4 % higher than in the same period of 1964. In January 1966 the year-to-year growth rate was even down to 0.7 %. The slackening was very striking in the capital goods industry. In the consumer goods industry, on the other hand, production achieved further substantial advances.

Imports of goods and services, too, probably lost momentum again, compared with the preceding months. This applies, in any case, to imports of goods; customs

returns show that in the fourth quarter their volume was 10.7 % and their value 14.4 % higher than in the fourth quarter of 1964. In January 1966 the year-to-year growth rate amounted to 8.6 % by value. Imports of raw materials and semi-finished goods slackened particularly. Purchases of finished goods, however, showed another substantial increase, due mainly to the continued pressure of rising consumption.

Although overall demand has been expanding less rapidly, it certainly cannot yet be said that excess demand has been satisfactorily eliminated; in private consumption, at any rate, the increase in prices—which has been even more rapid than before at this level—is still due mainly to demand; where pressure from this factor has eased, prices have been bedevilled by the persistent pressure of costs. These affect industrial producer prices, where the upward movement has so far shown only a slight tendency to slacken.

Consumer prices have, however, been affected by special factors in addition to the excessive pressure of demand and increased costs; owing to the bad weather, there were unusually steep increases in food prices. The general cost-of-living index for December and January was 4.2 % up on the same period of the preceding year, in which there had also been considerable price increases.

As exports quickened sharply and the growth of imports slackened, the trade account again showed a surplus in the fourth quarter; on the basis of customs returns the surplus was DM 605 million. The current account which, in addition to the items included in the trade and services balances, also covers transfer payments, closed with a greatly reduced deficit of DM 566 million, as against a deficit of DM 2 700 million in the previous quarter. The deficit on the overall balance of payments, on the other hand, was only DM 356 million less than in the third quarter, because there was a relatively sharp deterioration in a few items which are particularly sensitive to seasonal factors and figure in the capital balance (including items that can only be included under errors and omissions, but not including changes in the foreign exchange position of the commercial banks).

As the balance of payments has lately been tending to improve and the amount of notes and coin in circulation has been increasing more slowly, bank liquidity tended to become somewhat less tight in the last few months of 1965, although the cash transactions of the public authorities, which usually contribute to an expansion of bank liquidity at that time of year, exerted less influence than a year before. In the fourth quarter the liquid resources freely available to the credit institutions were up for the first time in many months.

Basically, however, bank liquidity remained tight. In order to avoid an excessive shortage at the end of the year and so to reduce the need for extensive repatriation of funds, the Bundesbank temporarily reduced minimum reserves for the month of Decem-

ber. The expansion of bank advances to business and private customers, which had been very moderate in October and November, did not speed up significantly in the December-January period.

National product and expenditure

	1963 ⁽²⁾	1964 ⁽²⁾		1965 ⁽²⁾		1966 ⁽³⁾
	At current prices (in DM '000 million)	% change on preceding year				
		Volume	Value	Volume	Value	Volume
Gross national product	377.6	+ 6.6	+ 9.6	+ 4.4	+ 8.4	+ 3.5
Imports ⁽¹⁾	70.0	+ 10.9	+ 11.8	+ 14.2	+ 17.1	+ 8.5
Private consumption	215.9	+ 5.4	+ 7.8	+ 6.2	+ 9.8	+ 4.5
Public current expenditure	59.2	— 0.6	+ 4.5	+ 5.7	+ 11.9	+ 3.5
Gross fixed asset formation	95.3	+ 11.9	+ 14.5	+ 6.6	+ 8.8	+ 3.0
Exports ⁽¹⁾	75.0	+ 10.3	+ 11.4	+ 7.1	+ 9.1	+ 9.0

⁽¹⁾ Goods, services and factor income.

⁽²⁾ Federal Statistical Office, "Wirtschaft und Statistik", No. 1/1966.

⁽³⁾ Commission estimates and forecasts.

Note :

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

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

2. Outlook

The prospects for the further development of the economy in 1966 now suggest that, at least in the first half of the year, the trend in the development of the individual components of overall demand will be rather more varied than could be foreseen when the outlook was last considered (see Quarterly Survey No. 4/1965).

The impetus given by demand from abroad should turn out to be a little stronger than seemed likely towards the end of 1965; demand from the other EEC countries in

particular has been rising very briskly of late. In addition, sales possibilities should be increased by the general trend towards greater expansion throughout the world and especially in the United States. Lastly, as a result of the slower growth of domestic demand, many enterprises now find themselves able, or obliged, to export more. In the fourth quarter of 1965 the flow of industrial orders from abroad was 7.8 % higher than in the same period of 1964.

At the same time, the growth of total gross fixed asset formation will perhaps flatten out rather more noticeably in the coming months, because enterprises may well increase their capital expenditure more slowly than was at first to be supposed. This is partly due to declining profit margins and the tightness of the capital and money markets. In December the flow of domestic orders in the capital goods industry simply remained at the same very high level as in the corresponding period of 1964 and, since then, the backlog of orders has decreased. The probable slowdown in capital expenditure should, however, not be overestimated. The EEC investment survey made at the end of 1965 shows that industry was then still expecting capital expenditure to rise by 5 % in 1966.

With building investment, too, the tendency for growth to be slower might also continue. In the fourth quarter the number of permits issued for new buildings rose only very slightly. Projects for industrial and commercial building were down considerably. While in housing the figures still point to a significant reserve of demand, as the backlog of unfinished dwellings amounted to 780 000 units at the beginning of 1966, the inhibiting influence exerted on plans for new building by the difficulty of finding finance may well become even stronger.

In view of the decision to cut the Federal budget, the increase in public current expenditure will tend to be rather less than was at first expected.

Private consumption will in the months ahead continue to be the mainspring of economic activity. The real increase of 5 % predicted for 1966 in the last Quarterly Survey (No. 4/1965) should now, however, be regarded as a maximum. The progressive slackening of demand in certain sectors of the economy might slightly reduce the growth rate of actual earnings. The collective wage agreements in the metal industry suggest that enterprises will be less willing than before to concede wage increases, owing to the pressure of developments in sales and profits.

Production will be affected by the slower growth of overall demand and also by physical factors which are still exerting a restraining influence (such as the shortage of manpower). The increase in industrial production is likely to be no more than slight, at least until the middle of the year. To judge by the results of the EEC business survey, the tendency for output to weaken will be most marked in the industries producing plant and equipment; in the consumer goods industries, however, it still seems probable that output will rise.

Imports, too, should only expand relatively slowly compared with previous months. The growth rate will, however, still be substantial, mainly because imports of finished goods will continue to rise.

Although demand should no longer be expanding as sharply as in the previous quarter, there will still be considerable upward pressure on prices. In the first place, the pressure of costs caused by excess demand persists for a time even after the pressure of demand has eased. In addition, those cost increases that have occurred will eventually be passed on to prices. Evidence of this is to be found not least in the forthcoming increases—some of them very considerable—in charges for public transport and utilities and in public fees. Lastly, the tendency towards higher prices in the private consumption sector will certainly still be sustained by demand.

The trade balance should continue to improve, though the current account will probably close with a deficit—at least for the first half of the year.

Altogether, these prospects are fully in line with the forecasts that were given for the full year 1966 in the last Quarterly Survey, but the changes may all turn out to be somewhat more pronounced than expected. It therefore seems reasonable to put the figure for the real growth of the gross national product somewhat lower—about 3.5 % instead of 4 %.

With economic forces as they are at present, the main task of short-term economic policy must be to encourage the underlying tendency towards an easing of tension, and to improve the conditions on the basis of which there could later be faster but more balanced growth.

For this purpose, it will be necessary effectively to limit the expansion of cash expenditure to the lower rate that has been achieved, with a considerable effort, in the Federal budget. In particular, the powers granted to the Federal Government itself by the Finance Act should be used to achieve further economies, so that the 5 % limit on the increase in actual expenditure for 1965 is not overstepped when the 1966 budget, which involves an increase of around 5 %, is put into effect.

Unfortunately, if the budget policy of the Federal Government promises to be more on line with the requirements of the present economic situation, the same cannot yet be said of budget policy in the Länder. From what is already known of their forthcoming budgets, it appears likely that the increase in their overall expenditure will again be too steep. In view of the situation on the capital market, it will of course be very difficult to finance the quite extensive gaps in some of the Länder budgets; the difficulty of finding funds should therefore exert some pressure in favour of greater restraint where expenditure is concerned. But recent experience justifies the fear that the credits needed by the Länder may be provided in part from other sources, perhaps

even by monetary means. It thus appears necessary that the Federal Government, in view of its powers and responsibility in the field of short-term economic policy, should try once again, as part of a special campaign, to get the Länder to bring their budget policies more into line with the exigencies of short-term economic policy.

Monetary and credit policy must for the time being continue to follow a restrictive line—at least until a public budget policy better suited to the present economic situation is assured, and as long as excessive price and cost increases persist. As the current account is now tending to come back into surplus, one element which was formerly a considerable factor in the tightness of liquidity is no longer present; indeed current payments may later in the year even become a factor making a positive contribution to the liquid resources of banks and business. If monetary and credit policy were relaxed, this would increase the risk that the tendency towards a better balance between overall supply and demand, which could later help to stabilize prices and unit costs, might not develop sufficiently to have the requisite effect.

In February the Bundesbank confirmed that it is still thinking of continuing its restrictive policy. It announced that the second half of the reduction in rediscount quotas, which had already been decided upon but was postponed in August 1965, would come into force on 1 May 1966.

In the phase of the economic cycle through which the Federal Republic of Germany is now going, it would seem especially important to ensure that the growth of cost incomes is slowed down considerably. Direct action in the field of incomes policy would, if successful, help to ensure that the other, more important restrictive instruments of short-term economic policy need not be used so long or so intensively as to have a very substantial effect on real economic growth for a lengthy period. In particular, a more moderate trend in wages could also make a direct contribution to price stabilization.

3. The economic situation in West Berlin

In 1965 West Berlin experienced very considerable economic growth. Real gross product went up 6.5 %, and for the first time since 1960 the rate of expansion was higher than in the Federal Republic.

Vigorous expansion continued in the fourth quarter of 1965; there were signs here and there that expansion was moderating, but they were less pronounced than in the Federal Republic.

Exports of goods continued to rise quite sharply; in the fourth quarter the value was 13.7 % higher than a year earlier. It was again possible to raise deliveries to the

Federal Republic quite substantially; in value these were 10.6 % up on the same period of 1964.

In the last few months of 1965, gross fixed asset formation increased rather less rapidly than before, especially in construction which, after expanding particularly strongly at first, was not quite so brisk towards the end of the year. Private consumers' expenditure, on the other hand, rose if anything a little faster, to judge by the retail turnover figures.

At the end of 1965 the number of persons in employment was about as high as a year before. The decrease in the number of wage and salary earners caused by natural population movements was almost completely offset by net immigration; fewer workers came in from West Germany but more from abroad. All in all, industry's demand for manpower does not appear to have abated.

The labour market remained very tight. In the last three months of 1965 the number of unemployed was about one third lower than in the same period of 1964, while the number of unfilled vacancies went up by almost a quarter during the same period.

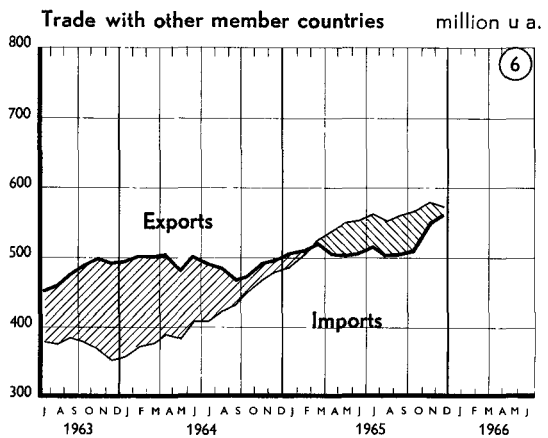
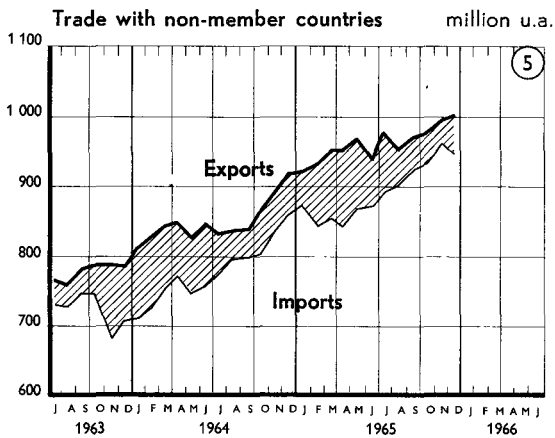
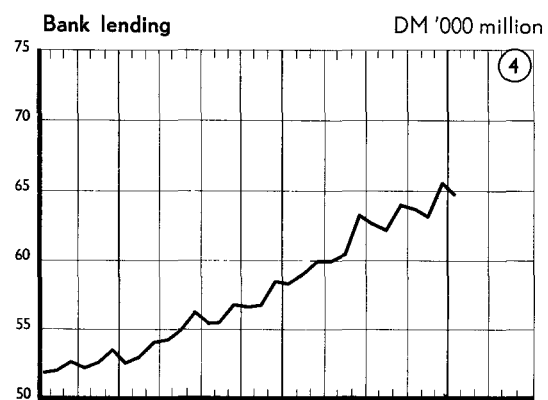
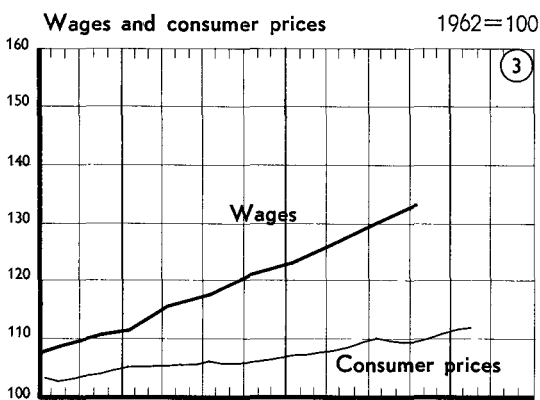
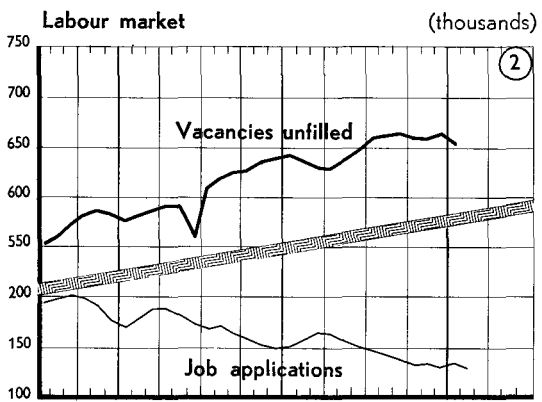
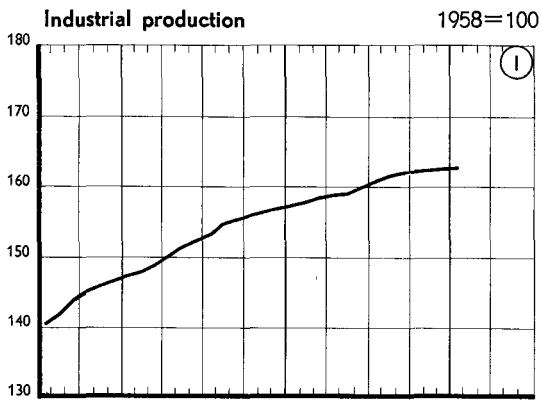
Industrial production increased slightly more slowly in the fourth quarter than in the third. However, production was almost 10 % up on the same period of the previous year, the rate of growth being more than double that recorded in the Federal Republic. In particular, output in the producer goods industry was just on 5 % higher than in the corresponding period of 1964, while expansion quickened in the consumer goods sector, where the year-to-year growth rate for production was over 16 %.

Purchases from the Federal area have risen somewhat more slowly; in spite of this, however, visible trade with the Federal area showed a deficit of DM 133 million in the fourth quarter. This was about as heavy as in the corresponding period of 1964.

Up till very recently there has been no stop in the upward movement of consumer prices. In January 1966 the cost-of-living index was 5.9 % up on a year before.

The outlook for the rest of the year is one of continued lively expansion. New orders in industry have been coming in rather hesitantly of late, but they have been appreciably higher than sales during the same period, so that the backlog of orders increased again. In the coming months investment, in which Berlin experiences comparatively little difficulty with regard to financing, may therefore rise much more than in the Federal Republic.

ECONOMIC INDICATORS



NOTES:

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

Graph 1. Trend curve; estimation established on the basis of indices adjusted by the SOEC for seasonal and fortuitous variations (excluding construction, food, beverages and tobacco).

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

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

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

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

Federal Republic of Germany

TABLE 1: Basic data (1965)

Total area ('000 sq. km.)	248.5
Total population ('000)	59 041
Density of population per sq. km.	238
Working population ('000)	27 153
Working population, breakdown by main sector (%)	
— Agriculture	10.9
— Industry	48.7
of which : Construction	.
— Services	40.4
Percentage share of gross domestic product	
— Agriculture	4.5
— Industry	52.7
of which: Construction	.
— Services	42.8
Gross product per capita (DM)	7 598

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

	% change by volume on preceding year						Volume indices (1958 = 100)	Contri- bution (in %) to 1964 GNP
	1960	1961	1962	1963	1964	1965		
Gross national product	8.8	5.4	4.1	3.5	6.6	4.4	159	—
Industrial production	10.7	6.3	4.4	2.9	8.5	5.4	168	—
Total imports	16.9	7.7	11.4	8.3	10.9	14.2	198	28.4
Private consumers' expenditure	6.9	6.9	6.0	3.0	5.4	6.2	162	61.8
Public current expenditure on goods and services	7.6	8.2	12.1	8.3	- 0.6	5.7	174	14.1
Gross fixed asset formation	11.3	9.4	5.8	2.8	11.9	6.6	176	26.4
Total exports	13.0	3.3	4.3	9.6	10.3	7.1	173	28.3
Gross national product per capita	7.7	5.5	4.1	3.2	6.5	.	.	—
Gross national product per person gainfully employed	6.8	4.1	3.4	3.1	6.3	3.8	.	—

Federal Republic of Germany

TABLE 3: Foreign trade (at current prices)

	% change on preceding year							Indices 1958 = 100	Million u.a.	% of the total
	1959	1960	1961	1962	1963	1964	1965			
Visible exports										
Total	11.3	16.4	11.1	4.5	10.2	10.9	10.5	203	17 911	100
Intra-EEC	13.5	23.3	19.6	20.9	20.8	8.4	6.7	262	6 305	35.2
To non-EEC countries	10.5	13.8	7.6	1.0	4.7	12.5	12.6	181	11 606	64.8
Exports of food, beverages and tobacco										
Total	11.2	9.3	4.3	7.3	16.0	20.5	25.1	238	435	2.4
Intra-EEC	13.7	10.2	1.0	8.1	23.9	22.1	22.6	254	166	0.9
To non-EEC countries	9.8	8.8	6.3	6.9	11.5	19.5	26.6	229	269	1.5
Exports of raw materials and manufactures										
Total	11.3	16.6	11.3	4.5	10.1	10.8	10.1	203	17 476	97.6
Intra-EEC	13.5	23.6	20.1	12.2	20.8	8.1	6.3	262	6 139	34.3
To non-EEC countries	10.5	13.9	7.6	0.9	4.6	12.3	12.3	180	11 337	63.3
Visible imports										
Total	15.2	19.2	8.3	12.2	6.0	12.2	20.0	238	17 486	100
Intra-EEC	29.8	22.9	13.3	16.6	8.7	17.4	30.7	351	6 661	38.1
From non-EEC countries	10.1	17.7	6.1	10.3	4.7	9.7	13.8	198	10 825	61.9
Imports of food, beverages and tobacco										
Total	15.2	4.1	7.9	20.1	- 8.3	8.3	21.6	188	3 651	20.9
Intra-EEC	25.2	13.9	15.8	15.9	0.0	9.3	23.0	268	1 349	7.7
From non-EEC countries	11.7	0.3	4.4	22.2	-12.2	7.8	18.1	160	2 302	13.2
Imports of raw materials and manufactures										
Total	15.1	24.6	8.4	9.9	10.7	13.3	19.1	258	13 835	79.1
Intra-EEC	31.4	26.0	12.5	16.8	11.5	19.7	31.4	382	5 312	30.4
From non-EEC countries	9.5	24.0	6.7	6.8	10.3	10.2	12.6	212	7 523	48.7

TABLE 4: Basic monthly indicators

	Year	Jan.	Feb.	Mar.	Apr.	May	June	July	Aug.	Sept.	Oct.	Nov.	Dec.
Industrial production (1958 = 100)	1964	134	141	148	148	158	151	142	137	153	159	166	155
	1965	150	152	152	163	163	162	147	143	161	167	171	158
Total orders received (1958 = 100)	1964	160	164	171	185	165	178	177	154	181	192	185	179
	1965	166	173	193	190	183	182	180	165	197	199	195	187
of which:													
home orders	1964	153	158	163	182	163	174	177	154	179	190	181	172
	1965	161	167	193	188	185	178	176	165	197	198	192	177
foreign orders	1964	190	193	187	200	176	193	178	156	190	203	203	206
	1965	187	195	222	199	201	200	193	173	205	209	213	234
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	2.63	2.61	3.25	3.61	4.04	3.85	4.45	4.39	4.27	4.17	3.81	3.75
Private consumers' expenditure: Retail turnover (1958 = 100)	1964	126	122	143	147	142	137	149	131	139	167	168	223
	1965	134	129	154	170	156	150	167	143	155	178	195	241
Total visible imports (million u.a.)	1964	1 078	1 058	1 158	1 231	1 097	1 233	1 311	1 141	1 246	1 370	1 368	1 419
	1965	1 331	1 247	1 492	1 396	1 479	1 484	1 523	1 375	1 542	1 566	1 584	1 606
Total visible exports (million u.a.)	1964	1 240	1 289	1 362	1 423	1 281	1 350	1 363	1 172	1 329	1 487	1 390	1 538
	1965	1 364	1 353	1 626	1 396	1 543	1 407	1 554	1 299	1 480	1 583	1 557	1 767
Balance of trade (million u.a.)	1964	+ 162	+ 231	+ 204	+ 192	+ 184	+ 117	+ 57	+ 31	+ 83	+ 118	+ 22	+ 118
	1965	+ 32	+ 106	+ 135	+ 1	+ 65	- 77	+ 31	- 76	- 63	+ 17	- 27	+ 161
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	6 325	6 436	6 393	6 295	6 211	6 303	6 335	6 354	6 352
Money supply (DM '000 million)	1964	63.5	64.2	64.3	65.3	66.7	67.7	67.8	68.7	68.4	69.0	71.5	72.9
	1965	69.4	70.4	70.1	71.4	73.3	74.0	74.1	74.2	74.2	75.1	77.5	78.4

Federal Republic of Germany

NOTES

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

Table 1

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

Table 2

- Source : Statistisches Bundesamt. Wirtschaft und Statistik.
- ENP in 1954 prices.
- Industrial production : value added at market prices.
- Total exports and imports : goods, services and factor income.

Table 3

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

Table 4

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

B. France

By the turn of the year the economic upswing in France was once again very vigorous.

Exports of goods and services, notably to the other EEC countries, continued to develop very briskly. Even more important, however, has been the additional vigour with which domestic demand has been expanding in recent months. Not only are there further signs of some revival in gross fixed asset formation by private industry, while the growth of expenditure on construction and on plant and equipment throughout the public sector continues to make a fairly dynamic contribution to business activity, but in addition the expansion of private consumers' expenditure has—as a result of a steeper upward trend in incomes and contraction of the propensity to save—evidently been gathering momentum.

Supply has kept abreast of demand. The increase in industrial production from September to December was, apart from seasonal variations, 2.5 %. This means that the record level reached in April 1964 has already, according to the seasonally adjusted INSEE index, been exceeded by 4.3 %. Merchandise imports have also risen sharply : in the fourth quarter, the year-to-year growth rate in real terms was almost 8 %.

While there was consequently some tendency for external surpluses to decline, the price trend remained very calm. The somewhat more vigorous increase that has recently occurred in the consumer price level has been due in the main to seasonal and special factors.

The outlook for the rest of the year now seems even more buoyant than could previously be foreseen — especially since the Government introduced its supplementary economic and social programme in the middle of February. The upswing in domestic demand may in fact turn out to be very sharp. Managements are almost certain to revise upwards their investment plans, which in any case made provision for some measure of increase in expenditure over that of 1965. Private consumers' expenditure may well expand more rapidly. Moreover it is perhaps to be expected that the budget transactions of the public authorities will also contribute more than previously to the growth of demand. Lastly, the outlook for the continued upward movement of demand from abroad remains very favourable.

Although reserves of technical production capacity and of manpower would seem adequate to satisfy the expansion of demand for the time being—the estimated year-to-year increase in industrial production is about 6.5 % to 7 %—and although

imports will contribute to the expansion of supply, a re-emergence of certain wage and price strains later in the year cannot be completely ruled out. Since, in addition, a number of "autonomous" price increases (public transport fares and freight rates) have been decided on and the "adjustment" of various farm prices has been announced, the upward movement in the level of consumer prices could well gather some fresh momentum.

There are, therefore, undoubtedly good grounds for maintaining great caution over any economic policy that stimulates the expansion of demand. When, in a period of full economic revival steps are taken to encourage productive investment—such steps would certainly appear to be justified by the hesitant trend of productive investment over recent years—and also social measures, especially measures to assist those with small incomes, it is particularly necessary for the authorities to show corresponding restraint in dealing with the other components of domestic demand. The economy might otherwise become generally overheated, perhaps not in 1966, but certainly in 1967, and this would be a renewed threat to the necessary work of stabilizing prices and costs.

1. Developments in recent months

Exports of goods and services continued their brisk expansion in the last weeks of 1965 and into the New Year. Customs returns showed that in terms of value the year-to-year growth of merchandise exports was 14.4 % in the fourth quarter and 13.4 % in January. Sales to other member countries, in particular, again expanded rapidly. On the other hand, exports to non-member countries suffered at times from the impact of inhibiting factors, with steel exports to the United States declining and sales to the franc area and to the South American developing countries marking time.

In recent months the expansion of domestic demand has obviously gained further strength.

Gross fixed asset formation in the private sector is now showing more numerous signs of revival. The INSEE survey for November suggests that private industry, encouraged by the improving outlook for sales and profit, has begun, albeit somewhat hesitantly for the moment, to increase its spending on investment. The trends in domestic production and in imports of plant and equipment point in the same direction. For the public authorities and the other sectors of economic activity, the rate of growth of fixed investment has probably not varied appreciably in recent months: it has remained particularly vigorous throughout the public sector (including public undertakings) and distinctly sluggish in residential construction.

In recent months investment in stocks has continued to grow. In particular, it looks as if the progressive improvement of production and sales expectations has further encouraged managements to replenish depleted stocks of raw materials.

About the turn of the year expenditure on consumption expanded with particular vigour. While no noteworthy change was recorded in the growth rate of public expenditure, the growth of private consumers' expenditure, previously confined to a small number of industries (notably textiles and motors), has evidently gathered momentum and spread to almost all goods and services.

The vigour with which private consumers' expenditure has been rising is partly due to the income trend : wage incomes in particular have been mounting more steeply because of the growth in the volume of employment and of a further improvement in hourly wage rates (1.4 % between 1 October 1965 and 1 January 1966 in the private sector). In view of the general expansion of business activity, the amounts withdrawn from their businesses by self-employed persons are also likely to have grown faster than before. Lastly, for technical fiscal reasons and because of tax reductions granted for 1965, the tax burden borne by households has been appreciably lighter. Another factor in the recent expansion of consumption seems, however, to have been a change in the way incomes are used : a smaller part has apparently been devoted to saving (notably to covering the cost of building houses) and a correspondingly larger share to consumption.

In line with the development of demand, supply has been growing at a remarkably rapid rate in recent months.

The seasonally adjusted INSEE index ⁽¹⁾ shows that industrial production rose from September to December by 2.5 %, after an advance of 1.8 % in the previous three months, and so now stands 4.3 % above the record achieved in April 1964. According to the seasonally unadjusted index ⁽²⁾ the year-to-year growth rate for December was 6.9 %.

The revival of production, which had so far been confined in the main to the textile and motor industry, has now spread to virtually all industries at or near the consumer stage; moreover, the trend in a number of capital goods industries has improved favourably. In the basic materials sector output trends have continued to vary from industry to industry : the oil refineries have stepped up production sharply, chemicals have made more moderate progress, but the metal-manufacturing and building-materials industries have been in the doldrums.

In contrast with industrial production, growth in the building industry—particularly in respect of main structural work—slowed down distinctly in the fourth quarter.

⁽¹⁾ Excluding building and construction; the method of seasonal adjustment used is a new one and takes account of the fourth paid holiday week.

⁽²⁾ Excluding building and construction; corrections are made to account for any differences in the number of working days in the month.

The relative elasticity of supply from domestic production was due in the main to the improvements achieved in productivity per hour worked; in the last few months, however, the total number of hours worked has also been picking up again : the average working week has been extended again, and the numbers in employment have begun to rise. The changed trend in the manpower situation has been reflected on the labour market in a decline in the numbers seeking employment and a larger number of unfilled vacancies.

Imports of goods and services have expanded in recent months even more vigorously than domestic production. The growth in demand for imported goods has spread beyond consumer goods and has now reached the capital goods sector. Imports of raw materials and semi-manufactures have also tended to rise sharply, but food imports have shown practically no change. All in all, the volume of merchandise imports—calculated from customs returns—was in the fourth quarter of 1965 almost 8 % and in January 1966 about 9 % higher than a year earlier.

Since overall supply developed along lines closely parallel to those of overall demand, and since no additional upward pressure was exerted by costs, prices—apart from normal variations—have remained relatively settled in recent months. For example, the retail prices of manufactures have hardly risen at all; the INSEE retail index shows that at the beginning of 1966 they were only 1.1 % above the corresponding 1965 figure. Nor, except for certain autonomous increases, have the prices of services risen more rapidly. But seasonal and special factors (including shortages due to the cold spell in January) engendered an appreciable increase in food prices, with the result that the general cost of living rose more sharply between September 1965 and January 1966 (1.1 % according to the INSEE index, which covers 259 articles) than in the corresponding months a year before (0.8 %). The year-to-year increase in January 1966 was 2.6 %.

The sharp upswing of imports brought to an end the tendency for the trade balance to improve; since the autumn a slight deterioration has been apparent, particularly in merchandise trade with non-member countries. This means that the surpluses on current account have probably also tended to contract. Since, in addition, net imports of long-term capital have probably declined fairly appreciably and since there have at times been outflows of short-term capital, the surplus on the overall balance of payments will probably have been smaller than before. At any rate the growth of gross official gold and foreign exchange reserves has slowed down very substantially : in the fourth quarter of 1965 the rise was only FF 384 million and in January FF 43 million, compared with FF 1 526 million in the corresponding four months of 1964/65. The net foreign exchange position of the commercial banks has probably also improved only slightly of late.

The appreciable expansion of domestic liquidity that accompanied the faster recovery of demand was therefore due less to the development of the balance of payments than to a sharp increase in advances by banks and other financial institutions.

This increase was FF 9 900 million in the fourth quarter of 1965, compared with FF 7 300 million for the corresponding period of 1964. Expansion was sharpest in bills of exchange and in connection with hire purchase operations. Towards the end of 1965, the cash transactions of the public authorities, on the other hand, tended, if anything, to reduce liquidity.

The money market was under strain for a time and interest rates rose appreciably, although the monetary authorities lowered minimum reserve rates temporarily and used open market operations to channel considerable sums into the banks. On the capital market, the demand for funds by private industry has remained heavy; in the middle of October, too, the Government issued a loan of FF 1 000 million, the yield of which is available to certain firms for the financing of their investments. Capital market interest rates have also shown a slight tendency to rise.

National product and expenditure

	1963 ⁽²⁾	1964 ⁽²⁾		1965 ⁽³⁾		1966 ⁽⁴⁾
	At current prices (in FF. '000 million)	% change on preceding year				
		Volume	Value	Volume	Value	Volume
Gross national product	395.6	+ 5.5	+ 9.2	+ 3	+ 6	+ 5.5
Imports ⁽¹⁾	55.0	+ 11.9	+ 14.6	+ 2	+ 3.5	+ 11
Private consumption	256.8	+ 4.2	+ 7.9	+ 3	+ 5.5	+ 5
Public current expenditure	53.7	+ 3.0	+ 7.1	+ 3	+ 7	+ 4.5
Gross fixed asset formation	79.1	+ 10.2	+ 14.3	+ 5	+ 9	+ 6
Exports ⁽¹⁾	56.7	+ 7.5	+ 10.5	+ 9.5	+ 10	+ 9.5

⁽¹⁾ Goods, services and factor income.

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

⁽³⁾ Commission estimates.

⁽⁴⁾ Commission forecasts.

Note :

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

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

2. Outlook

The outlook for the rest of the year is that of a rather more expansionary economic climate than was predicted in the last Quarterly Survey (4/65). One of the reasons for this is that the Government has since decided on a supplementary economic and social programme, which—apart from changes in the price control system, the reduction of the statutory maximum working week from 60 to 54 hours and steps to improve agrarian structure—contains a number of concrete measures to stimulate demand.

Some of these measures are designed to stimulate more directly the propensity to invest of managements: there is to be a “tax credit certificate” representing 10 % of the depreciation value of plant and equipment delivered or ordered between 15 February 1966 and 31 December 1966, borrowing facilities for companies that specialize in leasing equipment to industry are to be improved, and minimum interest rates charged to borrowers by the commercial banks are to be abolished—a measure which could ultimately lead to cheaper credit, notably for big firms.

A group of measures has also been adopted in the social field; these are mainly designed to improve the lot of the poor and of families; they will at the same time stimulate consumption, albeit to a limited extent. The guaranteed minimum wage in agriculture (SMAG) was raised by 2.98 %, that in industry (SMIG) by 2.12 % on 1 March 1966. At the same time the number of “provincial de-weighting”⁽¹⁾ regions was reduced and minimum wages were tied to the general retail price index (259 articles). Minimum old-age pensions are to be raised on 1 July instead of on 1 October as originally planned. There is to be an increase in family allowances of 4.5 % from 1 August 1966 onwards, with a reduction in the number of provincial de-weighting regions and in the de-weighting percentage.

Lastly, increases in farm-gate prices for certain agricultural products have been decided on, mainly as a means of improving farmers’ incomes.

Consequently, it can be assumed that the expansion of domestic demand in 1966 will be yet a little more vigorous than was predicted.

The prospects for the development of external demand have remained very favourable. It is true that in Germany, which is far and away France’s best customer, the slowdown in economic activity has of late become more pronounced; but in the other member countries—notably in Italy—conditions remain fairly expansive, and this should enable France to step up sales on these markets sharply. Nor can it be ruled

⁽¹⁾ Instead of a basic rate with additions payable in areas with high cost of living (positive “weighting”), France fixes a rate for the high-cost area and there are deductions in other areas (“de-weighting”).

out that demand from non-member countries—including those in the franc area—will recover strength again in the months ahead.

The gross fixed asset formation of enterprises could well develop into a fairly dynamic component of domestic demand in the coming months. It was expected to recover a little in any case, given the state of the markets (rising sales, production capacity contracting, improved profit expectations) and as a result of the measures taken last year to facilitate financing (new tax rules concerning investment income, facilities in connection with the turnover tax, Government loans, etc.). According to an INSEE survey carried out last November, private industry—a sector in which investment had been very sluggish for the last three years—was already planning to spend in 1966 4 % more than it spent last year on building and plant and equipment. It is quite possible that these plans will be revised appreciably upwards. The expansion of investment by public undertakings and by general government will in any case remain fairly vigorous. Accordingly, even if the expansion of expenditure on residential construction should at first lose still further momentum—and the temporarily rather weak trend of building authorizations and starts in 1965 seems to suggest that this will be the case—a speed-up can be expected in the growth of overall expenditure on gross fixed asset formation.

In addition, the trend of investment in stocks may be expected to make an increased contribution to production, employment and imports.

The prospects with regard to consumption are also more expansionary. Public current expenditure on goods and services could well grow faster than was proposed in the Finance Law for 1966, particularly if there should be some further rise in wages and salaries in the course of the year.

Private consumers' expenditure is bound to be stimulated by a more rapid development of incomes : wages and salaries in the public sector may grow somewhat faster, but of much greater importance is a steeper rise in the total wages bill that is expected to occur in private industry as a result of the increasingly vigorous upswing in general economic activity. In view of the improvement of certain social benefits, too, transfer incomes will grow faster than could so far have been foreseen. Lastly, a further increase in the amounts withdrawn from their businesses by the self-employed, particularly farmers, is to be expected.

It should be possible, at any rate until the autumn, to meet the consequent fairly rapid expansion of overall demand without placing any significant overstrain on technical capacities. However, the backlog of orders in industry (which is now growing again) and the rising production expectations of businessmen suggest that firms will be running appreciably nearer capacity, first in industries at or near the consumer stage, but later in the capital goods sector as well.

It is estimated in general that the year-to-year increase in industrial production for 1966 will be about 6.5 % to 7 %. Taking growth in the other sectors of the economy into account, the real increase in the gross national product may be put at nearly 5.5 %, compared with the 4.5 % predicted in Quarterly Survey 4/65.

The expansion in production is unlikely to be achieved through improvements in productivity alone, and employers will presumably be making heavier demands on existing manpower reserves. At the moment an unusually large number of young people are beginning their working lives, so that the labour supply would seem elastic enough for the time being, but it should be remembered that the training of the available reserves frequently falls short of the requirements of commerce and industry. The reappearance of certain strains on the labour market later in the year is consequently not to be ruled out, and this could affect the trend of wages.

A further sharp expansion in imports of goods and services may help to swell supply and thus postpone the danger of further strain. The surplus on external trade in goods and services should tend to contract.

The prospects for the maintenance of stable prices—at least in relative terms—are none the less not quite as good as they were. At any rate, there is just a possibility that their upward movement may regain a little momentum. The pressure exerted, not only by demand, but also by unit costs, might well tend to grow. A significant fact in this connection is that, as the economic surveys of the INSEE institute reveal, both industry and dealers have for some time been expecting prices to start rising again appreciably. The authorities have not yet lifted the price controls on manufactures at producer level, a measure which in itself would be desirable in the interests of the restoration of the proper functioning of the price system and of “true” prices, and have accepted no more than a slight modification of the controls through an official proposal for the conclusion of “programme contracts” with enterprises concerned. But in the final analysis partial controls scarcely constitute an absolute bar to the upward movement of the consumer price level as a whole, for they in very large measure simply serve to divert upward pressure to other areas—in this case mainly towards the services sector.

Here, a number of adjustments to higher costs have in any case already been officially announced (fares and freight rates). Again, the re-adjustment to be made in various farm prices is unlikely to leave the cost of living unaffected.

It would, then, definitely not be sound to neglect the objective—not yet fully achieved—of the stabilization of prices and costs for the sake of economic growth, all the more since production has in any case already been expanding fairly rapidly for some months. Further measures to stimulate demand might bring with them the danger of general overheating of the economy—if not in 1966 then certainly in 1967.

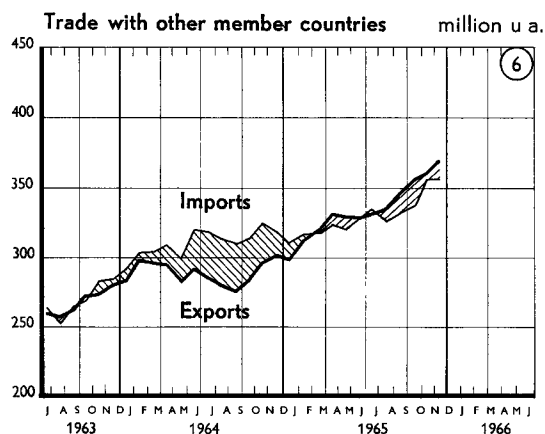
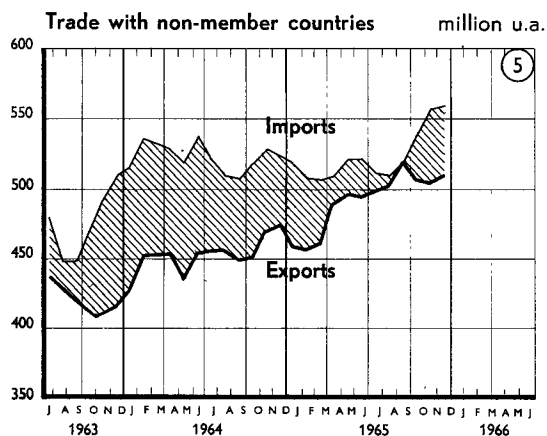
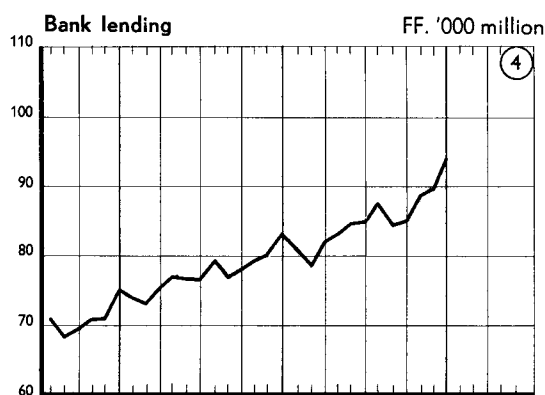
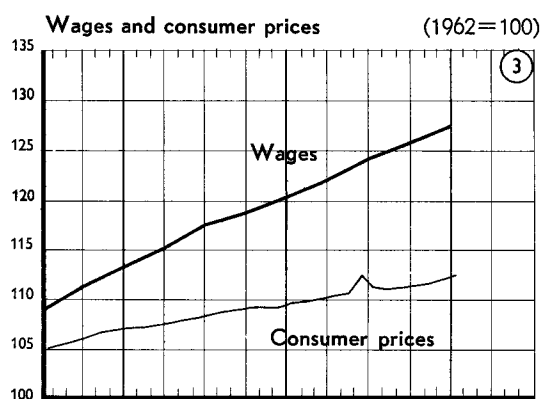
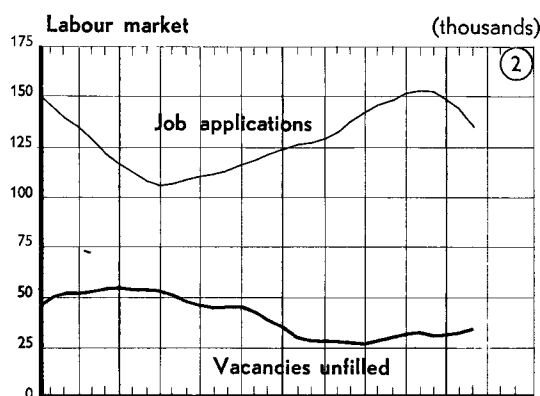
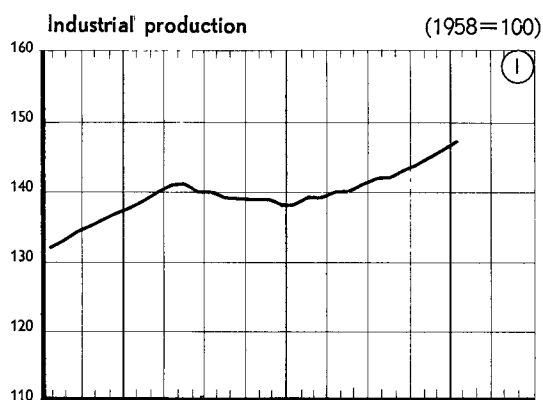
To a large extent the French authorities' new economic and social programme takes these considerations into account and there are many points in its favour. For example, the Commission and the Short-term Economic Policy Committee had already raised the question many months ago whether there was not a case for measures that would encourage the propensity to invest of private industry. Many such measures—particularly with regard to financing—were in fact adopted last year, and about the middle of February further tax reliefs were added. In addition, a number of decisions based on social considerations have been taken, and these should serve to stimulate consumption, albeit to a limited extent.

In general it is true that the formal equilibrium of the Government budget does not seem to be endangered by these measures, since it is fairly certain that, in view of the expansionary economic trends now foreseen, actual tax yields will be higher than the estimates. But the question does arise whether, in this phase of upswing, the budget should not gradually but increasingly be used as a stabilizer, i.e. as an anti-cyclical weapon. At all events, the greatest moderation must once again be recommended in those fields of expenditure for which priority has not been renewed. In this respect it would be particularly useful if steps could be taken with a minimum of delay to limit the burden placed on the Treasury by the growing social security deficits. There may also be a case at the present time for increasing the charges for public services other than transport. These increases could properly be considered as reduced expenditure or increased income—as defined in point 5 of the Council's economic policy recommendation of 15 April 1964.

The monetary authorities must also guard against any undue development of domestic liquidity. If the rapid expansion of short-term credit in recent months were to continue or even gather momentum, it might be wise to regard this as a signal that the authorities should gradually put the brakes on the expansion of liquidity again.

However, the sooner an effective incomes policy is brought to bear this year, the longer the delay permissible before restrictive measures need be taken; in other words, the new phase of economic expansion would then be all the more fruitful and could be maintained for a longer period without increasing the threat to equilibrium. The prospects of success with regard to the incomes policy, however, will remain relatively favourable only as long as the labour markets are not bedevilled by further extensive strains. Lastly, there are strong arguments for a further and (particularly for the broad mass of those in receipt of incomes) easily understandable and attractive extension of the system of incentives to saving introduced last year. A measure along these lines might supplement the incomes policy and would help not only to curb expenditure on consumption but could play a major role in the financing of the fresh productive investment needed if harmonious and lasting growth is to be achieved.

ECONOMIC INDICATORS



NOTES:

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

Graph 1. Trend curve; estimation established on the basis of indices adjusted by the SOEC for seasonal and fortuitous variations (excluding construction, food, beverages and tobacco).

Graph 2. Source: INSEE. Series seasonally adjusted. Moving averages of 3 months. End-of-month figures.

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

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

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

u.a.: one unit of account = 0.888761 gm of fine gold = US \$1 at the official rate of exchange.

France

TABLE 1: Basic data (1964)

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

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

	% change by volume on preceding year						Volume indices (1958 = 100)	Contri- bution (in %) to 1964 GNP
	1959	1960	1961	1962	1963	1964		
Gross national product	+ 3.0	+ 7.4	+ 4.4	+ 7.1	+ 4.7	+ 5.5	137	—
Industrial production	+ 3.1	+ 7.6	+ 5.5	+ 6.7	+ 5.7	+ 6.4	140	—
Total imports	— 1.6	+16.5	+ 7.0	+ 8.7	+12.7	+11.9	168	15
Private consumers' expenditure	+ 1.9	+ 5.6	+ 5.9	+ 6.9	+ 6.6	+ 4.2	135	64
Public current expenditure on goods and services	+ 6.5	+ 2.7	+ 3.4	+ 4.3	+ 2.7	+ 3.0	125	13
Gross fixed asset formation	+ 2.3	+ 6.8	+10.5	+ 7.9	+ 6.8	+10.2	153	21
Total exports	+12.4	+17.2	+ 5.5	+ 3.1	+ 8.5	+ 7.5	167	14.5
Gross national product per capita	+ 2.0	+ 6.3	+ 3.3	+ 5.1	+ 2.9	+ 4.2	126.5	—
Gross national product per person gainfully employed	+ 4.0	+ 7.3	+ 4.4	+ 6.8	+ 3.6	+ 4.7	135	—

France

TABLE 3 : Foreign trade (at current prices)

	% change on preceding year							Indices 1958 = 100	Million u.a.	% of the total
	1959	1960	1961	1962	1963	1964	1965	1965	1965	1965
Visible exports										
Total	+ 9.4	+22.5	+ 5.2	+ 2.0	+ 9.8	+11.3	+11.8	196	10 050	100
Intra-EEC	+33.7	+33.9	+18.8	+11.9	+14.2	+12.8	+18.0	362	4 116	41.0
To non-EEC countries	+ 2.4	+18.2	- 0.5	- 3.0	+ 7.2	+10.3	+ 7.8	149	5 934	59.0
Exports of food, beverages and tobacco										
Total	- 0.8	+36.3	+17.4	- 2.9	+22.0	+14.4	+11.5	241	1 601	15.9
Intra-EEC	+47.2	+54.6	+26.2	+ 1.4	+34.5	+16.6	+26.5	577	704	7.0
To non-EEC countries	-11.0	+29.3	+13.6	- 5.1	+15.4	+13.0	+ 2.0	165	897	8.9
Exports of raw materials and manufactures										
Total	+11.0	+20.2	+ 3.3	+ 3.0	+ 7.8	+10.7	+11.8	190	8 449	84.1
Intra-EEC	+32.6	+31.1	+17.5	+13.9	+10.9	+12.1	+16.4	336	3 411	34.0
To non-EEC countries	+ 4.8	+16.2	- 2.7	- 2.6	+ 6.0	+ 9.8	+ 9.0	146	5 038	50.1
Visible imports										
Total	- 9.2	+23.3	+ 6.3	+12.8	+15.9	+15.4	+ 2.7	184	10 338	100
Intra-EEC	+10.8	+36.3	+13.6	+20.0	+24.3	+20.3	+ 6.7	327	4 015	38.8
From non-EEC countries	-15.1	+19.0	+ 3.3	+ 9.2	+12.3	+12.4	+ 0.3	144	6 323	61.2
Imports of food, beverages and tobacco										
Total	-15.9	+ 6.2	- 2.3	+19.8	+ 5.1	+14.9	- 0.6	126	1 772	17.1
Intra-EEC	+54.3	+16.7	-12.3	+37.6	+37.4	+26.2	+ 8.9	410	378	3.6
From non-EEC countries	-20.8	+ 4.7	- 0.8	+17.4	0	+12.5	- 2.8	106	1 394	13.5
Imports of raw materials and manufactures										
Total	- 7.1	+28.7	+ 8.5	+10.9	+18.8	+15.5	+ 3.4	204	8 566	82.9
Intra-EEC	+ 7.5	+37.9	+16.3	+18.7	+22.7	+19.8	+ 3.5	321	3 638	35.2
From non-EEC countries	-12.5	+24.5	+ 4.5	+ 6.6	+16.3	+12.6	+ 1.2	161	4 928	47.7

TABLE 4 : Basic monthly indicators

	Year	Jan.	Feb.	Mar.	Apr.	May	June	July	Aug.	Sept.	Oct.	Nov.	Dec.
Industrial production (1958 = 100)	1964	143	146	145	150	149	149	129	84	139	146	151	148
	1965	141	145	144	146	146	150	129	92	142	151	156	158
	1966	150											
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	44.7	45.9	43.8	44.6	50.5	41.8	44.4	49.6	53.2	56.5	
	1966												
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	204	228	219	223	232	199	258	244	236	352
	1966	216											
Total visible imports (million u.a.)	1964	861	846	883	930	841	896	814	630	783	840	827	917
	1965	816	799	934	900	872	866	827	679	813	890	926	1 023
	1966	899	936										
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	877	651	826	916	904	998
	1966	780	877										
Balance of trade (million u.a.)	1964	- 130	- 95	- 114	- 159	- 136	- 99	- 60	- 76	- 86	- 6	- 21	- 94
	1965	- 123	- 17	- 38	- 61	- 19	- 43	+ 50	- 28	+ 13	+ 26	- 22	- 25
	1966	- 119	- 59										
Official gold and foreign exchanges reserves (gross, million u.a.)	1964	4 481	4 494	4 477	4 533	4 680	4 737	4 813	4 827	4 863	4 902	4 999	5 105
	1965	5 172	5 254	5 316	5 367	5 341	5 350	5 336	5 346	5 381	5 381	5 449	5 459
	1966	5 468	5 503										
Money supply (FF '000 million)	1964	147.7	146.6	148.5	148.6	149.0	152.0	156.3	154.8	155.2	155.7	154.5	162.0
	1965	159.3	157.9	159.9	161.9	162.6	166.1	170.1	169.2	170.0	171.2	179.9	177.2
	1966	174.9											

France

NOTES

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

Table 1

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

Table 2

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

Table 3

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

Table 4

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

C. Italy

Economic expansion continued apace during the fourth quarter of 1965, in response to vigorous impulses from both foreign and domestic demand.

Merchandise exports resumed their rapid advance after the third quarter's pause, and in terms of value were about 20 % higher than in the fourth quarter of 1964.

In the aggregate expenditure for gross fixed capital formation also increased, but entirely owing to the further growth of investment in plant and equipment. In construction, investment still seemed to be declining on balance, though perhaps less sharply. Private consumers' expenditure continued to grow, and apparently at a quicker pace.

This pattern of demand called forth an appreciable increase in industrial production and caused the recovery to spread more evenly throughout the various branches. In the fourth quarter the Central Statistical Institute's (ISTAT) index of industrial production stood 8.4 % above its level for the same period of the previous year. Merchandise imports expanded even faster and were more than 17 % higher in value than in the last quarter of 1964.

Prices continued to rise, slowly but unmistakably, even though on the whole supply adjusted flexibly to demand. In January, wholesale prices were 2.3 % and consumer prices 3.1 % higher than a year before.

The balance of payments deteriorated partly for seasonal, and partly also for cyclical reasons, but still registered a comfortable surplus. The monetary authorities' gold and foreign exchange reserves rose by only Lit. 152 000 million between end-September and end-December, in spite of the commercial banks' imports of short-term capital for the habitual window-dressing operations at the end of the year.

The outlook for the Italian economy up to the end of 1966 is distinctly expansionary.

Although foreign demand is likely to expand somewhat less vigorously than in 1965, it is nevertheless expected to remain buoyant. But strong growth may be predicted especially for domestic demand. This certainly applies to investment expen-

diture as a whole, though weakness in building investment may have a dampening effect for some time yet; it also applies to consumption expenditure, which ought once more to expand considerably.

In these circumstances industrial production and especially imports must be expected to grow vigorously. Unemployment should tend to fall slightly.

The elasticity of supply will no doubt remain high for some time to come, but prices must nevertheless be expected to move distinctly upward again. Rapidly growing demand will enable earlier cost increases to be passed on more easily, costs will no doubt rise further and, lastly, major price-raising factors of a structural nature will still be in evidence.

The balance of payments is likely to deteriorate steadily throughout 1966, but not, for the time being, so much as to give cause for worry.

Given this outlook for the year, there certainly is a clear case for keeping up the policy of stimulating investment, especially for directly productive purposes. In general, however, the achievement and maintenance of internal and external equilibrium will be served best if short-term policy proceeds with increasing caution in introducing additional direct stimulants for domestic demand.

1. Recent developments

Exports of goods and services rose briskly during the fourth quarter of 1965. A point worth stressing is that merchandise exports resumed their rapid advance after the slower pace of the third quarter; during the fourth quarter their value was some 20 % higher than during the corresponding period of 1964. Merchandise exports to non-member countries expanded particularly sharply. Exports of services also continued to grow.

At the same time domestic demand increased markedly, and this applies both to gross fixed capital formation and to consumer spending. Investment in plant and equipment, which had spurted in the third quarter, almost certainly went ahead further during the fourth quarter, though a little more slowly. In construction, on the other hand, it seems that investment was still declining on balance, though the partial indicators available at present on employment in the building industry suggest some attenuation of the downward tendency. In housing, investment certainly still declined,

but there were some signs of revival in the number of new projects started both in residential and in business and industrial building. In addition, public works expenditure was still on the increase.

All in all, according to ISCO estimates, the volume of gross fixed investment in seasonally adjusted figures should have risen by some 2.5 % between the third and the fourth quarter of last year.

Investment in stocks probably also rose, mainly because producers' stocks of raw materials and producer goods were building up more rapidly.

While there was probably no change in the rate of increase in public current expenditure on goods and services during the fourth quarter, private consumers' expenditure seems to have expanded at a faster pace, at least to judge by the growth of disposable incomes. The total number of hours worked seems to have grown more satisfactorily than during the early quarters of 1965, as will be shown in more detail below; in addition, hourly wages definitely increased again; minimum contractual wages (excluding family allowances) throughout most of the economy ⁽¹⁾ went up by almost 1.5 % between the third and the fourth quarter, thus slightly exceeding the previous quarterly rise of 1.2 %, while effective wage rates increased even more rapidly.

Once again during the period under review, the index-tied cost-of-living bonuses in agriculture, industry and trade contributed not a little to the rise in wages. From 1 January 1966 the bonus was, incidentally, raised also for workers in the public sector and for bank employees.

Transfer incomes, in their turn, rose appreciably, thanks to the increase in social insurance benefits in October. Last but not least, there was probably another increase in the incomes of independent farmers.

As a whole, according to ISCO, the volume of consumption expenditure, seasonally adjusted, probably rose by some 2.5 % from the third to the fourth quarter.

On the supply side, industrial production again expanded considerably during the fourth quarter of 1965. Seasonally adjusted ISCO figures based on the index of the Italian Central Statistical Institute (ISTAT) put the quarter's increase around 2.5 % which means a level 8.2 % above that for the fourth quarter of 1964 and 4 % above that achieved prior to the slight recession of 1964. The advance was led once more by the base industries and electricity, but recovery spread increasingly also to other branches, including especially those in the capital goods sector. Among consumer goods industries,

⁽¹⁾ Agriculture, industry, public sector, trade and transport.

textile production recovered further and indeed expanded vigorously. Production of passenger cars, on the other hand, still declined, no doubt under the influence of transitory special factors, such as the trough after the wave of buying due to the large pent-up demand in the first half of 1965, and postponement of purchases in the expectation of price reductions and new models; at the beginning of 1966 production seems to have started expanding again. In building, however, production probably declined further.

For the first time in two years the numbers in paid employment—after adjustment—suggested an increase over the preceding quarter: the Central Statistical Institute's sample survey seems to point to a seasonally adjusted rise of 0.2 % between July and October 1965. It would also seem that the return flow of manpower from industry and the services back into agriculture, which had been set in motion by the recession, not only came to a halt but began to move once again in the normal direction. Working hours per person employed increased; at any rate last October, for the first time in a fairly long while, the number of workers on short time was considerably lower than 12 months earlier (according to ISTAT 23.4 % lower), and claims on the wage equalization fund by short-term workers in industry (including construction) fell off towards the end of the year.

These developments led to a slight decline in the number of unemployed (according to ISTAT, 27 000 or 4 % between July and October) and the unemployed ratio ⁽¹⁾ in turn fell slightly—to 3.4 %.

Imports of goods and services again expanded rapidly during the fourth quarter, when the value of merchandise imports was over 17 % higher than in the corresponding period of 1964. To judge from the latest statistics on imports by classes of goods, those of November 1965, particularly rapid increases were registered by imports of raw materials, food and other consumer goods. Imports of services, too, seem to have risen appreciably.

Although by and large supply adjusted flexibly to demand, prices continued to rise during the last months of 1965, though generally at a reduced pace. Certain food shortages due to the weather did, however, push up both wholesale and retail prices quite sharply. Auxiliary materials for industry and services also displayed an upward price trend. All in all wholesale prices rose between September 1965 and January 1966 by 1.2 %, and consumer prices by 1.1 %; in January the respective price indices were 2.3 % and 3.1 % above their level twelve months earlier.

The trade balance showed a slight tendency to deteriorate during the fourth quarter, inasmuch as imports grew faster than exports, and closed with a deficit of about

⁽¹⁾ Defined by ISTAT as the percentage of unemployed in the total labour force.

Lit. 35 000 million. In addition, there was a seasonal decline in net earnings on services as well as a new outflow of capital; nevertheless the global balance of payments still showed the considerable surplus of about Lit. 180 000 million. In spite of the commercial banks' imports of short-term funds for window-dressing purposes at the end of the year, official gold and foreign exchange reserves increased by only Lit. 152 000 million (to a net total of Lit. 2 854 000 million) or rather less than the surplus on the balance of payments. The reason is that the monetary authorities acquired some US Treasury Bonds. In January 1966 official gold and foreign exchange reserves seem to have diminished, mainly on seasonal grounds.

National product and expenditure

	1963	1964 ⁽²⁾		1965 ⁽²⁾		1966 ⁽³⁾
	At current prices (in Lit. '000 million)	% change on preceding year				
		Volume	Value	Volume	Value	Volume
Gross national product	30 193	+ 2.7	+ 9.7	+ 3.4	+ 7.1	+ 4.5
Imports ⁽¹⁾	5 438	- 5.1	- 2.7	+ 0.9	+ 2.1	+ 16.0
Private consumption	19 281	+ 2.3	+ 8.1	+ 2.1	+ 6.0	+ 5.0
Public current expenditure	4 101	+ 4.0	+ 13.1	+ 3.7	+ 11.6	+ 5.0
Gross fixed asset formation	7 150	- 6.5	- 0.7	- 8.2	- 6.8	+ 6.0
Exports ⁽¹⁾	4 753	+ 11.6	+ 15.4	+ 19.9	+ 20.1	+ 9.0

⁽¹⁾ Goods, services and factor income.

⁽²⁾ Relazione generale sulla situazione economica del paese (1965).

⁽³⁾ Commission forecasts.

Note :

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

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

The balance of payments thus had again an expansionary effect on domestic liquidity during the fourth quarter (+ Lit. 262 000 million). But the Treasury's cash transactions created liquidity on an even larger scale (some Lit. 590 000 million). Bank

liquidity again expanded sharply, in spite of a strong increase both in the banks' compulsory reserves, as a consequence of rapidly growing deposits, and in monetary circulation: demand for bank credit went up no more than moderately, and in consequence the banks' loan/deposit ratio dropped again, from 70.5 % in September to 69.8 % in December. The banks continued to use a major part of their liquid resources to purchase securities.

The securities market was extremely buoyant during the last months of 1965 and the early months of this year, and developments on the equities market were for the first time in a long while even more lively. This trend was in part due to the improved economic climate, which was undoubtedly the decisive factor; but the Montecatini-Edison merger decision also had a very stimulating effect on the market. Equity prices rose on average by 20 % between November 1965 and January 1966, and in the weeks that followed these gains were consolidated. Bond prices, too, continued to rise, so that there was a further marked fall in yields.

2. Outlook

The outlook for the rest of the current year is still distinctly expansionary ⁽¹⁾.

Exports of goods and services are expected to make further good progress, though perhaps at a somewhat more moderate pace than last year. Business conditions in countries which are major customers of Italy suggest that demand from this quarter will remain buoyant. Italy's own competitive position is still strong, especially as regards delivery dates, and in relation to some countries it may even have improved lately as regards prices. In addition, it is the declared intention of the Italian Government to take additional steps to encourage exports. Finally, the 10 % reduction in the Community's internal tariffs on 1 January 1966 is bound to make room for more Italian exports to other Member States. On the other hand, further expansion of domestic demand will no doubt have some dampening effect on the growth of exports. All in all, however, export prospects look distinctly bright in the light of the answers given in the EEC business survey on the state of order books in export industries, and of the "Forum" survey carried out by *Mondo Economico* at the beginning of January.

Domestic demand, too, is likely to expand in the course of the year.

The value of gross fixed asset formation is likely to grow in 1966 for a number of reasons: prospects for foreign and consumer demand are favourable; the reduction of duties on intra-Community trade will make it even more urgent to proceed to rationali-

⁽¹⁾ See detailed discussion in the last Quarterly Report, pp. 102-105.

zation investment with a view to maintaining and improving competitive strength; investment activity can be expected to receive stronger direct and indirect impulses from the public sector; and finally there is an ample supply of credit at falling rates of interest. There are, however, factors which still tend to hold back investment expenditure. In the building sector these include the long technical and administrative delays that occur before any project can start, and certain political and psychological obstacles, of which not the least is the continued uncertainty about the future course of rent policy. On a more general plane there are also the problems caused by the reserves of capacity still waiting to be utilized, and the squeeze on profits. As regards the last-named two factors, some improvement may already be under way.

All in all, there seem to be good grounds for assuming that gross fixed asset formation will display a marked upward trend in 1966. This assumption is confirmed by the results of some recent inquiries. The EEC business surveys show that in the capital goods industry the number of managements which consider their backlog of domestic orders to be below normal fell during the fourth quarter of last year and again in January. Another survey, which ISCO conducted last autumn in mining and in the manufacturing industry, suggests that investment will resume its upward movement in both these sectors in 1966. An optimistic picture also emerges from the replies to the "Forum" survey of *Mondo Economico*, which for the first time in a long while show a clear majority of businessmen expecting an increase in demand for capital goods.

Stocks are likely to go up sharply, especially those of raw materials and primary products, and retail trade stocks.

In its turn, consumption expenditure is expected to grow appreciably. This certainly applies to public consumption, to judge by the rather expansionary estimates for the relevant items in the 1966 budget. The expectation of a strong expansion in private consumers' expenditure rests on several reasons. One is the probability that the volume of employment will go up more sharply, in spite of the considerable margins of unutilized capacity which no doubt still exist. Secondly, hourly wage rates are likely to rise appreciably, for the current year, unlike 1965, is one when wage contracts are due for renegotiation in many major branches of industry. Finally, the relaxation at the end of last year in hire-purchase regulations governing payments terms for durable consumer goods ought to give a certain boost to private consumer spending. This assessment of the prospects for private consumption is likewise confirmed by the results of the "Forum" survey.

This outlook justifies the expectation that industrial production will expand vigorously, and also more evenly throughout the various sectors, than in 1965. In the building materials industry, production may be slack for some time yet, but ought to pick up later in the year when, as can be expected to occur in the foreseeable future, growth tendencies gradually come to the fore in the construction sector.

The numbers in paid employment might and the working hours per person may well increase further. A decreasing tendency may be predicted for the number of unemployed is likely to decline although the reduction will probably be no more than slight.

Imports will certainly expand more vigorously than production, and a rapid increase is expected in foreign supplies not only of raw materials, but also of finished products.

Prices will undergo conflicting influences in the course of the year. The present high elasticity of production and large reserves of capacity will inevitably exert a restraining influence on prices as output rises. On the other hand, there are definite signs of factors that will tend to raise prices. The expected vigorous expansion of demand will make it easier to pass on to prices part of the earlier considerable cost increases which are still squeezing company profits, while the pending wage negotiations, which according to reports are likely to involve some 4 000 000 workers in 1966 as against 600 000 in 1965, may well lead to further and by no means negligible cost increases. Structural cost-raising factors, especially in the distribution sector, will work in the same direction. All in all, it seems that prices could rise again quite appreciably, especially in the field of private consumption.

The adverse tendency which has been in evidence for some time in the trade balance will no doubt become stronger, but the current account may none the less continue to show surpluses.

This outline of probable developments is essentially the same as that contained in the preceding Quarterly Report. But, taking the year as a whole, it is probably right to make an upward adjustment in the forecasts for growth rates, especially as regards private consumption and imports.

Given these prospects, it will be incumbent upon those responsible for short-term economic policy to give continued, but cautious and selective, support to expansion and at the same time to counteract the upward pressure on unit costs and prices more energetically.

These purposes can be achieved in part by direct measures to encourage productive investment, and these have the additional advantage of improving growth prospects in the longer run. This last point is of particular importance because of the sharp contraction of productive investment during the last two years.

In the case of all other measures which stimulate additional demand, it would now seem wise to proceed with more caution than hitherto, because their impact could be too sharp and they could thus lead to a revival of the upward pressure on prices. This danger may at first sight seem remote, given the high elasticity of production at the

moment; but a closer analysis of likely developments in the situation, not the least of which is the persistence of the "post-inflationary" cost push, makes it clear that in the longer run the threat cannot just be ignored.

For budgetary policy, which has so far played a major part in overcoming the weakness of the business situation, the implication is that investment-oriented expenditure ought to be stepped up, while the expansion of all other public expenditure should be contained. This would not only increase the possibilities of using budgetary policy as a brake on the economy—and this will no doubt prove necessary again sooner or later—but it may at the same time achieve the highly desirable purpose of reducing the budget deficit in conditions of cyclical upswing and hence of relatively buoyant revenues. This would make it easier to rely less on the increasingly doubtful method of financing part of the deficit by monetary means, and might also reduce the Treasury's demands on the capital market.

The availability of adequate resources on the capital market is indeed an essential condition for lasting investment growth. Hence all measures are to be welcomed which promote saving and help to channel savings to the capital market by the shortest route.

In addition, such measures would diminish the risks which are always inherent in an expansionary monetary policy (the creation of an inflationary potential of credit expansion). Given the large increase in bank liquidity and in the supply of money, the question may in any event arise soon enough whether first steps should not be taken to prepare, if need be, for a timely and effective containment of an unduly rapid acceleration in the expansion of credit and in the velocity of circulation.

Not the least of the efforts required is to pursue—and with especial vigour at this juncture—an incomes policy designed to slow down the rise in unit costs. If no progress can be made in this direction in the present situation of the labour market, there will be little chance later, when the upswing has gathered force, to avoid excessive rises in wage costs without reintroducing sharp countercyclical restrictions.

As soon as economic growth is sufficiently consolidated, it will be time to consider the voluntary reduction or suspension of duties, in order to raise the supply of goods through additional imports and so to counteract the price rise. From the point of view of the balance of payments there would be no difficulty about such measures. Admittedly, their price-reducing effect depends also upon the efficiency of the distribution sector. For this reason the efforts to rationalize the trade channels, which have so far had little effect, need to be intensified.

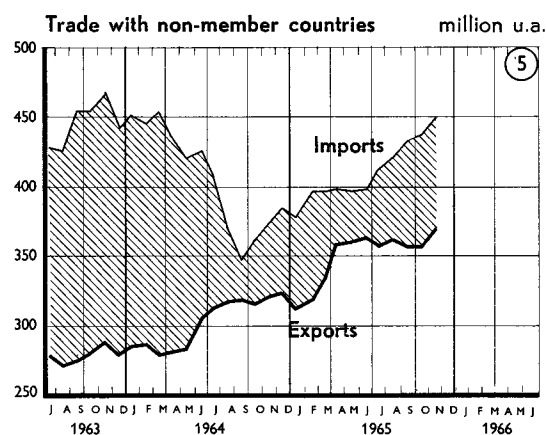
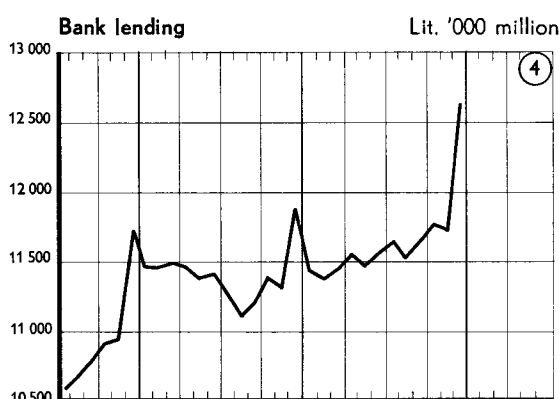
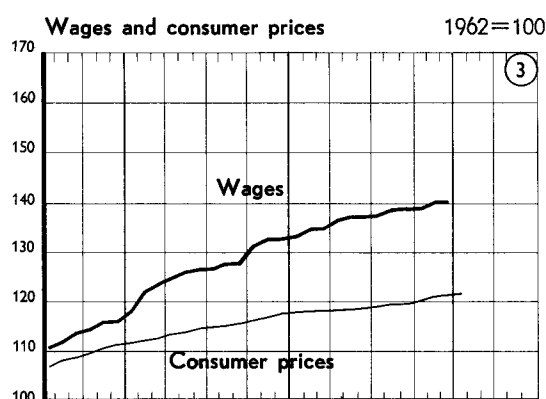
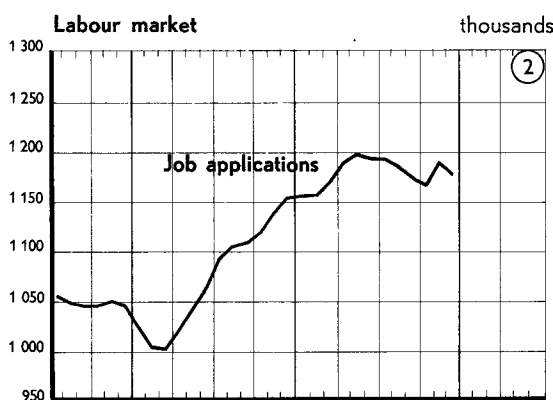
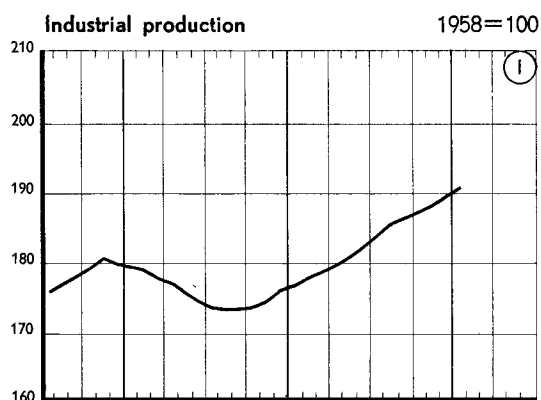
In part, the Italian authorities' short-term economic policy answers these requirements. The existing depreciation allowances were slightly raised at the beginning of 1966, and additional facilities were introduced. The so-called fiscalization of social

charges, which was introduced in August 1964 and later broadened, and by which the Government took over part of the social contributions payable by employers, has been extended to the end of 1966.

Furthermore, the Government at the beginning of the year introduced two bills providing for an increase in indirect taxes (on domestic power consumption and on certain beverages). The resulting increment in tax revenue, which is estimated at some Lit. 50 000 million, is to be used to finance public investment programmes in agriculture and in the school system. This step, too, is quite in line with current requirements, inasmuch as it is intended to reduce the proportion of government demands on the capital market.

By contrast, the general tendencies of budgetary policy as a whole, as exemplified in the budget and supplementary estimates, appear less correct from the point of view of short-term economic policy. Relatively too much is being spent where it will stimulate the expansion of private consumption, and not enough where it will promote direct or indirect investment; the deficit seems at this stage to be rather too large, even though the cyclical upswing is already fairly vigorous; and finally, as mentioned before, a very considerable part of the deficit is still to be financed, directly or indirectly, by monetary means.

ECONOMIC INDICATORS



NOTES:

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

Graph 1. Trend curve; estimation established on the basis of indices adjusted by the SOEC for seasonal and fortuitous variations (excluding construction, food, beverages and tobacco).

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

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

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

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

Italy

TABLE 1: Basic data (1964)

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

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

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

TABLE 3 : Foreign trade (at current prices)

	% change on preceding year						Indices (1958 = 100)	Million u.a.	% of the total
	1959	1960	1961	1962	1963	1964	1964	1964	1964
Visible exports									
Total	14.1	26.1	14.7	11.4	8.2	18.0	234.9	5 956.3	100
Intra-EEC	30.7	36.0	21.8	23.7	10.3	26.4	373.6	2 265.9	38.0
To non-EEC countries	8.9	22.3	11.8	5.8	7.0	13.4	191.2	3 690.4	62.0
Exports of food, beverages and tobacco									
Total	4.4	5.6	10.6	14.5	- 3.4	2.4	138.2	705.1	11.8
Intra-EEC	18.1	12.5	14.7	23.4	- 8.7	8.8	187.0	354.3	5.9
To non-EEC countries	- 3.7	0.4	7.4	6.5	2.1	- 3.3	109.3	350.8	5.9
Exports of raw materials and manufactures									
Total	16.6	30.7	15.5	10.9	10.2	20.5	259.2	5 251.2	88.2
Intra-EEC	36.3	45.4	23.9	23.9	15.6	30.4	458.2	1 911.6	32.1
To non-EEC countries	11.5	26.0	13.7	4.5	7.7	15.5	207.6	3 339.6	56.1
Visible imports									
Total	6.2	41.0	10.6	15.9	24.5	- 4.1	229.3	7 231.3	100
Intra-EEC	31.5	45.7	17.2	22.9	31.1	- 4.5	345.9	2 364.6	32.7
From non-EEC countries	- 0.8	38.4	8.1	13.0	21.5	- 3.9	197.0	4 866.7	67.3
Imports of food, beverages and tobacco									
Total	2.0	33.5	5.3	7.3	57.5	2.4	243.1	1 355.1	18.7
Intra-EEC	15.3	42.6	- 1.3	10.0	73.1	15.7	357.5	278.1	3.8
From non-EEC countries	- 0.2	31.8	6.6	6.8	54.4	- 0.6	229.9	1 077.0	14.9
Imports of raw materials and manufactures									
Total	7.1	42.4	11.6	17.5	19.2	- 5.5	225.3	5 876.9	81.3
Intra-EEC	33.6	46.0	19.2	24.1	27.8	- 6.6	344.5	2 086.5	28.9
From non-EEC countries	- 0.9	41.0	8.4	14.4	14.8	- 4.8	189.3	3 789.7	52.4

TABLE 4 : Basic monthly indicators

	Year	Jan.	Feb.	Mar.	Apr.	May	June	July	Aug.	Sept.	Oct.	Nov.	Dec.
Industrial production (1958 = 100)	1964	177.9	171.7	178.2	178.4	169.5	167.7	179.8	128.7	175.8	181.5	173.8	171.9
	1965	167.4	166.9	181.7	178.4	181.3	175.2	191.1	140.0	187.6	190.9	189.3	(190.9)
Building : domestic turnover of building materials (1958 = 100)	1964	178.5	169.8	188.3	183.6	195.3	195.3	193.3	181.7	197.6	182.9	156.4	169.2
	1965	160.8	136.8	173.8	160.8	166.7	196.3	192.3	183.4	184.7	185.6	185.5	180.2
Private consumers' expenditure : turnover of department stores (1958 = 100)	1964	254	210	255	246	277	300	280	232	290	355	289	513
	1965	270	215	249	303	284	318	296	241	330	354	319	(530)
Total visible imports (million u.a.)	1964	715.3	696.0	667.7	650.1	633.4	635.6	543.5	448.4	539.0	590.9	510.4	597.6
	1965	545.6	591.9	630.3	595.3	615.2	573.9	629.5	561.9	614.7	641.0	679.4	(672.0)
Total visible exports (million u.a.)	1964	419.4	449.7	452.7	489.7	458.7	505.8	575.4	436.8	530.6	567.4	504.7	540.0
	1965	460.7	559.9	643.4	588.8	571.4	611.4	627.4	552.6	615.8	637.8	651.0	(646.4)
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	- 84.9	- 32.0	+ 13.1	- 6.5	- 43.8	+ 37.5	- 2.1	- 9.3	- 1.1	- 3.2	- 23.4	(-25.6)
Official gold and foreign exchange reserves (net, million u.a.)	1965	3 154.1	2 958.7	2 748.3	2 728.9	2 761.2	2 826.2	2 898.2	3 071.0	3 257.1	3 432.1	3 615.2	3 756.3
	1966	3 797.8	3 873.9	3 755.3	3 811.5	3 895.5	4 032.3	4 250.4	4 390.7	4 323.0	4 270.2	4 303.4	4 566.2
Money supply (Lit. '000 million)	1964	11 058	10 961	11 096	10 953	11 118	11 264	11 308	11 239	11 379	11 434	11 702	12 465
	1965	11 984	11 861	12 077	12 225	12 522	12 687	12 885	12 808	13 103	13 227	13 420	

() Provisional figures.

Italy

NOTES

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

Table 1

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

Table 2

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

Table 3

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

Table 4

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

D. The Netherlands

The economic growth of the Netherlands continued during the final months of 1965 and on into 1966.

Demand from abroad continued to rise, and in the fourth quarter of 1965 the value of goods exported was 10.5 % higher than a year earlier. At the same time there was a steep rise in domestic demand: gross fixed asset formation advanced appreciably, with investment by enterprises and the public sector presumably rather brisker than before; investment in stocks of raw materials and semi-finished goods appears to have made a greater contribution than previously, and the still vigorous—at times even accelerated—rise in private consumers' expenditure was even more striking. The disposable incomes of households had in fact been rising somewhat more rapidly, and the propensity to save weakened temporarily as certain purchases were brought forward in anticipation of heavier indirect taxes. After the turn of the year the pace at which private consumers' expenditure had been rising calmed down once more.

Overall supply also rose rather more vigorously than in the preceding months. According to the CBS index, industrial output in the final quarter of 1965 was 6.1 % higher than a year earlier. As the advance in productivity was considerable, the strain on the labour market did not grow worse, though it was still acute. Imports also rose more rapidly than before, with the value of visible imports in the fourth quarter of 1965 no less than 14.6 % up on the corresponding figure for the previous year.

The resultant deterioration in the trade balance led to a distinct drop in the surplus on current account; on a transactions basis this amounted to Fl 12 million in the fourth quarter. For the same period the overall balance of payments closed with a deficit of some Fl 230 million.

The trend of prices in the last few months has once again been very definitely upward, and at the beginning of the year the level of retail prices was 7 % higher than a twelvemonth previously. Much of the rise has been due not just to the factors of demand and costs, but also to the upward adjustment of indirect taxes, of the tariffs charged by public utilities and of controlled rents, and to higher prices for imported raw materials and for farm produce.

The outlook for the business situation in the months ahead is still one of quite rapidly expanding demand.

Exports may go up at much the same pace as in 1965. In this connection it would seem that the rising level of costs in the Netherlands may for some while yet affect the trend of exports less than the increased productive capacity that is becoming available as a result of some easing in the pace at which real private consumers' expenditure is expanding.

The disposable incomes of households may advance rather more slowly than before, though they—and total wage and transfer incomes in particular—will still be rising decidedly faster than production. The growth of total investments is expected to be appreciably more rapid than in 1965: not only is investment in stocks expected to increase far more vigorously, but probably the expansion of fixed investment by enterprises and the public authorities will also gain in speed.

Supply may well expand briskly, and in the course of the year there should be a quite rapid advance in the pace of industrial production. Imports, too, are likely to go up more rapidly than before.

The likelihood of any reduction of strains seems none the less to be still decidedly small. On the labour market there is unlikely to be any very appreciable easing of the situation, although there could be a very slight increase in reserves of manpower. Upward pressures on prices due to the business situation will indeed be less vigorous than last year, but still quite considerable. The upward movement of domestic prices is on the whole likely to lose little of its momentum in the course of the year, especially as in this sphere the trend of world market prices will probably not be a factor contributing to stability. Finally, there is also little prospect that the current external account will improve on its recent performance.

It would seem, then, that the inflationary trend is still present, even if it is for the moment less pronounced than it was last year. The instruments of short-term economic policy ought therefore to be used even more vigorously than before in order to slow down the expansion of domestic demand in money terms and to curb the rise in prices.

1. Recent developments

Exports of goods and services, which had already been expanding slightly faster in the third quarter of 1965, continued to rise in the last few months of the year. Foreign trade statistics show that the value of goods exported in the fourth quarter was 10.5 % higher than a year earlier.

For the first time since the beginning of 1965, exports to non-member countries expanded more vigorously, compared with the preceding months, than those to member countries, in spite of the weakening in demand from the United Kingdom. The growth of overall exports was mainly due to increased exports of finished industrial products, especially textiles and chemicals, and less to increased agricultural exports.

Gross fixed asset formation showed quite a strong upward movement. Expenditure by enterprises, particularly on plant and equipment, may even have risen somewhat faster—to judge by the partial figures at present available—after having still shown a certain tendency to remain stationary during the first half of the year. Investment in housing construction continued to expand quite considerably; in the fourth quarter of 1965, 36 000 dwellings were completed, as against 35 000 in the same period of 1964; here it should be observed that the weather at that time was better than towards the end of 1965. Public capital expenditure also showed a more rapid increase.

Investment in stocks probably also had a stronger impact in the fourth quarter than in the preceding months, as far as the accumulation of stocks of raw materials and semi-finished goods is concerned. In the case of finished goods, however, there may even have been a slight decrease in stocks held by industry and trade, in view of the upsurge of demand towards the end of the year.

Public current expenditure may have risen more rapidly in the last few months of 1965, owing to fresh adjustments of wages and salaries in the public services and perhaps also to increased spending on defence equipment.

Towards the end of 1965 the growth of private consumption also became more rapid owing to the influence of certain factors of a speculative nature (purchases brought forward in anticipation of heavier indirect taxes). There was a particularly vigorous increase in expenditure on cars and other consumer durables. Altogether, private consumption in the fourth quarter went up by over 14 % in value and 10.5 % in volume. At the beginning of 1966, when the effect of the special factors mentioned above had worn off, consumption slackened accordingly for a time; nevertheless the underlying upward trend appears to have persisted.

The growth of private consumers' expenditure in the fourth quarter of 1965 was partly due to a decline in the savings ratio; another factor that helped to make it possible, however, was a continued and very pronounced rise in the disposable incomes of households. Wage and salary incomes did in fact go up as result of a fresh increase in the total number of hours worked and because of the bonuses that were paid in the autumn (a second instalment equal to 1 % of the annual wage in the private sector, and a bonus of 2 % in the public sector). In addition, there was a marked advance in transfer incomes; unemployment benefit was raised in October and old age pensions went up by 2 % in December. Lastly, the income tax reduction which took place in the middle of 1965 again caused disposable incomes to rise even faster than gross incomes.

Even after the new year, incomes continued to show a pronounced upward trend. Minimum wage rates were again raised substantially; in addition, there were general wage increases to offset increases in controlled rents. When new collective wage and salary agreements were concluded in January and February 1966, it was agreed that considerable payments should be made on account—until such time as the approval of the competent authorities had been obtained. In January wages and salaries in the public services went up by 5 %.

The faster expansion of overall demand led, in the fourth quarter, to a more rapid expansion both of internal and external supply.

According to the seasonally adjusted index, industrial production may well have gone up by over 2 % in the last quarter, though after the new year there may again have been some slackening in the pace of growth. Building output (seasonally adjusted) also showed a considerable advance.

The fairly high degree of elasticity in domestic supply was certainly due in part to the increase in directly productive investment which has occurred in the last few years; it was, however, also partly bound up with the fact that the increase in demand was concentrated on precisely those goods—especially consumer durables—for which certain reserves of productive capacity were available.

As the more rapid rise in production was coupled with great advances in productivity, the strains on the labour market did not become more acute. In the fourth quarter of 1965 and at the beginning of 1966 the seasonally adjusted number of unemployed remained at about the same level as the monthly average for the full year 1965 (about 35 000). The seasonally adjusted unemployment ratio (number of unemployed expressed as a percentage of the total labour force) was running at about 0.8 % in January 1966. The number of unfilled vacancies was no higher than in the autumn of 1965; it was, however, 3.6 times as great as the number of persons seeking employment.

Imports of goods and services continued to expand at the faster pace observed since the summer months. According to customs returns the value of goods imported in the fourth quarter of 1965 was 14.6 % higher than in the same period of 1964. This high rate of growth is, however, partly due to exceptional factors (purchases brought forward in anticipation of heavier indirect taxes, and purchases of aircraft). Imports from member countries tended to rise more vigorously than those from non-member countries.

The upward movement of prices, which had slowed down during the summer months, was again quite pronounced in the fourth quarter of 1965 and especially in January 1966. The index of retail prices was 5.2 % higher in the fourth quarter than in the same period of 1964, and in January even as much as 6.9 % higher. Increases in the prices of imported raw materials and consumer goods contributed to this develop-

ment in the fourth quarter. Another important factor was a further rise in food prices. In addition, the persistent advance in wage costs per unit of production helped to push prices up.

“Autonomous” factors—increases in charges for public services, in indirect taxes and in rents—did much to bring about the new rise in prices that has taken place since the beginning of 1966.

National product and expenditure

	1963 ⁽²⁾	1964 ⁽³⁾		1965 ⁽³⁾		1966 ⁽⁴⁾
	At current prices (in Fl. '000 million)	% change on preceding year				
		Volume	Value	Volume	Value	Volume
Gross national product	52.34	+ 8.2	+ 16.2	+ 5	+ 11	+ 5.5
Imports ⁽¹⁾	26.09	+ 15.0	+ 18.1	+ 6	+ 7.5	+ 9.5
Private consumption	31.10	+ 5.7	+ 12.6	+ 7	+ 12	+ 4.5
Public current expenditure	7.90	+ 1.6	+ 16.8	+ 1.5	+ 13	+ 2.5
Gross fixed asset formation	12.37	+ 16.5	+ 23.6	+ 6	+ 10	+ 8
Exports ⁽¹⁾	26.36	+ 11.9	+ 14.4	+ 8.5	+ 10.5	+ 8.5

⁽¹⁾ Goods, services and factor income.

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

⁽³⁾ Commission estimates.

⁽⁴⁾ Commission forecasts.

Note

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

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

As imports tended to expand faster than exports, there was a marked deterioration in the trade balance. In the fourth quarter of 1965 the current account showed a surplus of only Fl. 12 million, compared with surpluses of Fl. 442 million in the third quarter of 1965 and Fl. 338 million in the fourth quarter of 1964.

In addition, the balance of private capital movements closed with a deficit. In the last three months of 1965 the overall payments balance therefore showed a deficit of about Fl. 230 million. As the net gold and foreign exchange reserves held by the Central Bank fell by only Fl. 8 million, the net foreign exchange position of the commercial banks deteriorated so much more.

The trend in the balance of payments, and the State's revenue surpluses, had the effect of reducing internal liquidity in the fourth quarter of 1965. On the other hand, bank lending to business and private customers continued to expand briskly; moreover, the demand for credit on the part of local authorities was temporarily met by monetary measures. The capital market became noticeably tighter; interest rates continued to rise, and certain difficulties were encountered in the placing of several loans.

2. Outlook

In the coming months exports should continue to expand at about the pace recorded since the beginning of 1965. No doubt the growth of demand in some important purchasing countries will slacken a little, but industry, with its present pattern of exports, should nevertheless be able to increase its share on these markets. The fact that certain reserves of productive capacity are available for exports should more than offset the effects of persistent increases in costs and declining competitiveness. At any rate in the last few months the flow of orders from abroad has expanded, particularly in the chemical industry and in mechanical engineering.

Where deliveries to the EEC member countries are concerned, the reduction of internal tariffs from 1 January 1966 should have a beneficial effect, as should also the stronger upswing of economic activity in Italy and France. Prospects for the development of exports to non-member countries are also satisfactory, as exports to the United States, in particular, should continue to expand quite vigorously.

In contrast to demand from abroad, domestic demand may well increase slightly faster in the coming months. Although it is probable that the expansion of expenditure on consumption by households will slow down to some extent, a greater stimulus will, however, be provided by the development of total gross investment, which showed only a small increase in value in 1965 compared with the previous year, and even declined slightly in volume.

In the first place, gross fixed asset formation on the part of enterprises will certainly rise somewhat more rapidly than before. In particular, expenditure on means of transport can be expected to show a vigorous increase owing to special purchases of ships and aircraft. But expenditure on plant and equipment and on building should

also rise because enterprises in which the State has an interest are proposing to expand their investment programmes.

In addition to factors that encourage investment—expectation of rising demand, persistent labour shortage and sharp increases in production costs—there are, however, others that have the effect of retarding it: reduced possibilities for self-financing, partly owing to the heavier burden of direct taxation and particularly of corporation tax; difficulties in obtaining funds from outside sources, direct restrictions imposed by the authorities where building permits and prices are concerned. All in all, one cannot rule out the possibility that the underlying expansion of investment by enterprises may even fall off again towards the end of 1966—especially if conditions on the money and capital market prove even more unfavourable than in 1965. For small and medium-sized enterprises, particularly, the situation will remain rather unsatisfactory.

Secondly, the expansionary trend in capital expenditure by local authorities will certainly cause public investment to rise at approximately the faster pace observed since the end of 1965. In addition, investment in housing construction should increase further, although somewhat less strongly than in the course of 1965. It appears in fact that the need for housing is no longer quite as acute as before in certain parts of the country; very steep increases in building costs and high interest rates are also having a damping effect on demand for private house-building.

Lastly, the trend in investment in stocks, which has again been tending to rise since the middle of 1965, can be expected to quicken particularly strongly.

In contrast to capital expenditure, the rapid rise in expenditure on consumption may well slow down in the coming months. To judge by the budget estimates, this applies in the first place to public current expenditure, but there should also be a somewhat slower advance in private consumers' expenditure. The disposable incomes of households will certainly not go up quite as fast as before. The numbers in paid employment may well rise about as much as in 1965, but wages and salaries per worker may increase somewhat less during the course of the year—as no new general bonus payments are envisaged for this autumn. Moreover, no further general reductions in wages tax and income tax can be expected before the beginning of 1967; as 1966 goes on, the progressive rates of taxation will therefore curb the growth of disposable incomes slightly—in sharp contrast to 1965.

There is, however, some uncertainty with regard to the strength of the actual upward pressure of wages; even if the new collective wage and salary agreements do not generally overstep the limit beyond which the authorities regard increases as “dangerous”—and this in itself is by no means sure—the possibility of a further and more pronounced wage drift certainly cannot be entirely ruled out.

Moreover, transfer incomes will rise sharply, as a result of the increase in old age pensions which was decided upon in the spring and backdated to 1 January 1966. On the other hand, with regard to the development of disposable incomes from entrepreneurship and property, it must be remembered that they are subject to considerable pressure from costs.

With this increase in overall demand, production is likely to rise further in the coming months. The persistent shortage of manpower will, of course, continue to slow down growth to some extent, especially in industry and building. However, the supply of labour may well become somewhat more elastic—not least because of the difficulties some enterprises are experiencing owing to the changing pattern of demand and insufficient adaptability. As regards capacity, too, conditions may be quite favourable to growth; in addition, fairly rapid expansion and rationalization of the production apparatus can be expected in view of the pace of investment.

Imports of goods and services should continue to show a marked upward trend. Above all, imports of raw materials, semi-finished goods and capital goods (especially means of transport) can be expected to increase considerably. Imports of consumer goods may go up somewhat more slowly.

In view of the probable development of imports and exports, it is hardly likely that the balance of current transactions will improve in 1966 compared with 1965—leaving aside the effects of imports brought forward in anticipation of tax increases, which weighed upon the figures for 1965 and may therefore benefit those for 1966 accordingly. On corrected figures some deterioration does in fact seem possible, especially if the terms of trade do not improve.

By and large, the prospects for economic activity in the coming months are still in line with the forecasts that were made in the last Quarterly Survey (No. 4/1965) with regard to possible changes in the most important real aggregates of demand and of the gross national product for the whole of 1966 compared with 1965.

But it would seem that prices are also continuing to rise very sharply. The current increase in wage costs per unit of production may well be less strong than the year before, but it still appears very substantial. In addition, import prices will probably exert some upward pressure on prices, and the recent increases in indirect taxes and in the charges of public undertakings will have their repercussions. As the expansion of nominal demand should remain lively, it will also be possible, for that reason alone, to pass on cost increases.

In view of these prospects, no important changes need be made in the remarks concerning short-term economic policy made in the last Quarterly Survey (No. 4/1965).

At most they have become more pertinent. The present tendency for prices and unit costs to steady is still not strong enough for a policy of stabilization to be dispensed with.

As before, public budget policy must take pride of place. In this field care should be taken to limit the growth of expenditure more strictly, particularly expenditure which serves or encourages consumption either directly or indirectly. The net impact of the national budget on economic activity appears to remain too strong—although it is only about half as strong as last year—to be compatible with the aim of stabilizing prices and costs sufficiently rapidly. Furthermore, local authorities' budgets will doubtless be substantially more expansive in effect—although certain problems exist with regard to financing.

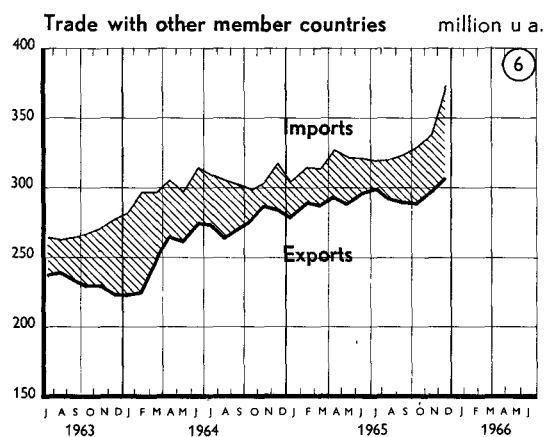
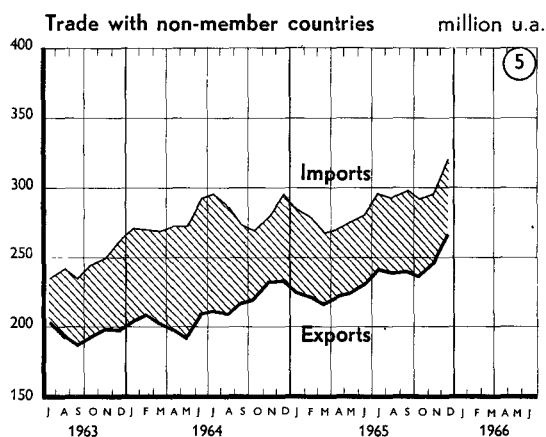
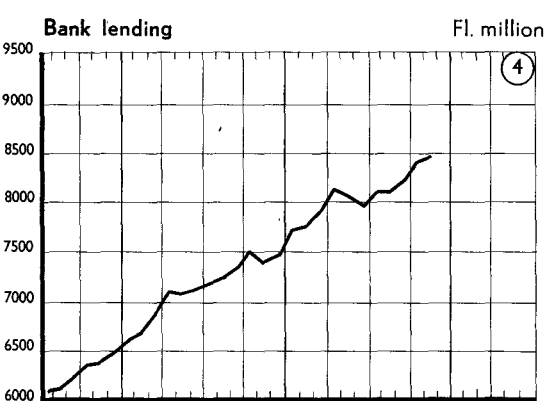
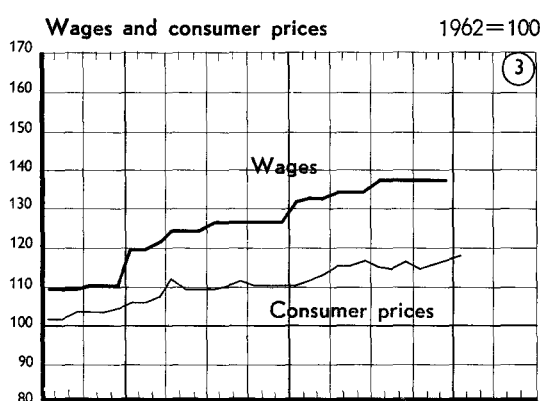
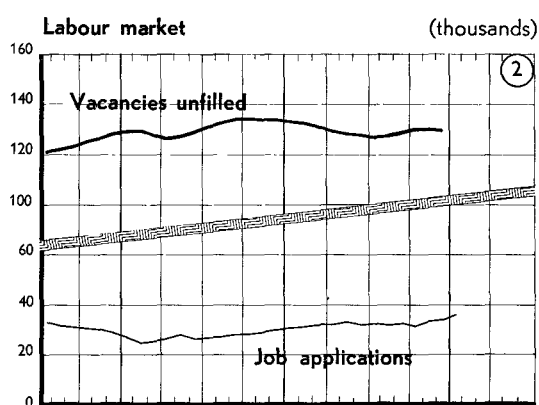
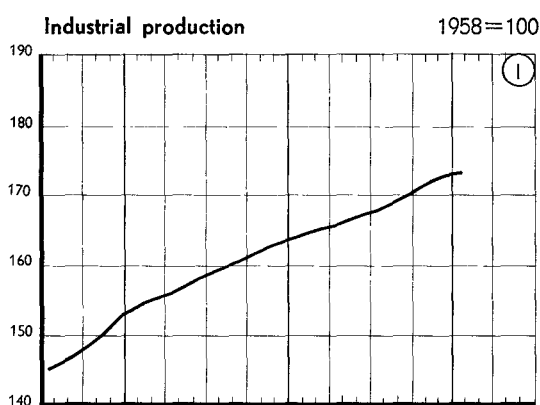
In so far as it does not prove possible to manage public budgets in a way that will better fulfil the requirements of short-term economic policy and stabilization policy, other instruments of short-term economic policy will have to be applied more vigorously. It would be highly beneficial if the growth of consumption and of money incomes affecting costs could be adequately curbed by means of an incomes policy. On this point it should be noted that the tendency to conclude new collective wage and salary agreements for several years at a time is combined with a certain moderation of the annual wage increases involved. But these agreements contain price index clauses of various kinds, and above all the annual wage increases are still far higher than the rate of increase in productivity that can be expected in the economy as a whole in the medium term. Thus the upward pressure of wage costs per unit of production may possibly be mitigated to some extent; but with this aim it will be fixed for years to come—and without any coherent ideas on medium-term economic development or any corresponding economic policy having been worked out by the authorities.

It would be preferable to agree on wage increases that keep in the short term within the bounds set by the development of productivity in the economy as a whole, as the EEC Council of Ministers recommended in its stabilization programme. This would promote the stabilization of costs and prices that is necessary at present, and would also allow time for reflection and decision on a medium-term economic policy and an incomes policy which in certain circumstances would not have to make wage increases in the medium term conditional on advances in productivity, for example if other suitable steps could be taken (e.g. in the field of workers' savings).

But a short-term incomes policy aimed at stabilizing costs and prices will scarcely work at all while labour markets remain too tight. Then it would be better to resort to the conventional instruments of short-term economic policy—because these alone, rightly applied, can mitigate these strains sufficiently. If this is not done through instruments of budget policy, there will be no choice but to apply monetary and credit policies

more stringently than would otherwise be necessary—possibly after first sharpening up the weapons of those policies. If this were to have an adverse effect on economic growth, that would be the price that would have to be paid for a budget policy not consonant with the needs of the economic situation. It must be realized that economic growth will in any case one day be seriously threatened if the inflationary trend in prices and costs is not brought under more effective control.

ECONOMIC INDICATORS



NOTES:

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

Graph 1. Trend curve; estimation established on the basis of indices adjusted by the SOEC for seasonal and fortuitous variations (excluding construction, food, beverages and tobacco).

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

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

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

Graphs 5 and 6. Series adjusted for seasonal and accidental variations (moving averages of 3 months). Exports fob, imports cif. Conversion at official exchange rates. 1 unit of account = 0,888671 gm of fine gold = UC \$ 1 at the official rate of exchange.

Netherlands

TABLE 1: Basic data (1964)

Total area ('000 sq. km.)	33.5
Total population ('000)	12 124
Density of population per sq. km.	362
Working population in 1961 ('000)	4 289
Working population, breakdown by main sector in 1961 (%):	
— Agriculture	10
— Industry	42
of which: Construction	10
— Services	48
Percentage share of gross domestic product:	
— Agriculture	9.3
— Industry	40.9
of which: Construction	(7)
— Services	49.8
Gross product per capita (Fl.)	5 014

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

	% change by volume on preceding year						Volume indices (1958 = 100)	Contri- bution (in %) to 1964 GNP
	1959	1960	1961	1962	1963	1964		
Gross national product	+ 5.2	+ 8.9	+ 3.5	+ 3.8	+ 3.1	+ 8.2	137	—
Industrial production	+ 9.0	+10.1	+ 4.2	+ 4.8	+ 4.6	+ 9.5	150	—
Total imports	+13.8	+17.3	+ 5.8	+ 7.5	+ 9.1	+15.0	190	51
Private consumers' expenditure	+ 4.6	+ 6.4	+ 5.8	+ 6.5	+ 6.6	+ 5.7	141	58
Public current expenditure on goods and services	- 1.2	+ 6.6	+ 4.4	+ 5.1	+ 4.7	+ 1.6	123	15
Gross fixed asset formation	+12.0	+11.6	+ 6.7	+ 4.4	+ 2.0	+16.5	166	25
Total exports	+11.5	+13.3	+ 3.0	+ 6.2	+ 5.9	+11.9	164	50
Gross national product per capita	+ 3.7	+ 7.6	+ 2.2	+ 2.4	+ 1.7	+ 6.8	127	—
Gross national product per person gainfully employed	+ 4.0	+ 6.7	+ 1.8	(+ 0.9)	(+ 1.8)	(+ 6.0)	(123)	—

() Provisional figures.

TABLE 3: Foreign trade (at current prices)

	% change on preceding year							Indices 1958 = 100	Million u.a.	% of the total
	1959	1960	1961	1962	1963	1964	1965	1965	1965	1965
Visible exports										
Total	+12.1	+11.7	+ 6.9	+ 6.5	+ 8.2	+17.0	+10.1	199	6 396	100
Intra-EEC	+19.4	+15.8	+10.9	+10.0	+17.3	+22.1	+10.2	267	3 564	55.7
To non-EEC countries	+ 6.9	+ 8.4	+ 3.6	+ 3.2	- 0.6	+11.2	+10.0	151	2 332	44.3
Exports of food, beverages and tobacco										
Total	+14.4	+ 5.3	+ 0.8	+ 6.9	+ 9.3	+ 9.5	+13.0	176	1 568	24.5
Intra-EEC	+26.9	+ 6.1	+ 3.1	+10.0	+12.1	+12.8	+19.7	231	972	15.2
To non-EEC countries	+ 3.4	+ 4.4	- 1.8	+ 3.3	+ 5.8	+ 5.1	+ 3.6	126	596	9.3
Exports of raw materials and manufactures										
Total	+11.2	+14.2	+ 9.2	+ 6.3	+ 7.9	+19.6	+ 9.2	208	4 828	75.5
Intra-EEC	+16.1	+20.7	+14.3	+10.0	+19.4	+25.6	+ 7.1	283	2 592	40.5
To non-EEC countries	+ 8.1	+ 9.6	+ 5.2	+ 3.2	- 2.4	+13.1	+11.9	159	2 236	35.0
Visible imports										
Total	+ 8.7	+15.0	+12.8	+ 4.6	+11.6	+18.2	+ 5.9	206	7 471	100
Intra-EEC	+15.3	+18.6	+21.1	+ 6.7	+14.9	+19.0	+ 8.7	263	3 987	53.4
From non-EEC countries	+ 3.9	+12.2	+ 5.3	+ 2.5	+ 8.3	+17.4	+ 2.9	165	3 484	46.6
Imports of food, beverages and tobacco										
Total	+ 9.4	+ 3.4	+ 5.9	+ 6.3	+15.5	+16.2	+ 3.5	177	988	13.2
Intra-EEC	+ 9.5	+16.4	+41.5	- 7.0	+11.8	+22.0	+13.1	282	225	3.0
From non-EEC countries	+ 9.3	+ 1.2	- 1.0	+10.0	+16.3	+14.9	- 1.2	159	763	10.2
Imports of raw materials and manufactures										
Total	+ 8.5	+17.2	+14.0	+ 4.3	+11.0	+18.6	+ 6.3	211	6 483	86.8
Intra-EEC	+15.6	+18.8	+20.0	+ 7.6	+15.0	+19.0	+ 7.8	262	3 762	50.4
From non-EEC countries	+ 2.3	+15.6	+ 7.7	+ 0.7	+ 6.1	+18.0	+ 4.2	167	2 721	36.4

TABLE 4: Basic monthly indicators

	Year	Jan.	Feb.	Mar.	Apr.	May	June	July	Aug.	Sept.	Oct.	Nov.	Dec.
Industrial production (1958 = 100)	1964	143	145	150	150	155	150	136	138	151	165	167	163
	1965	154	157	157	160	164	163	145	147	163	176	178	171
Investment (Fl. million)	1964			3 295			4 017			3 899			4 078
	1965			3 787			4 301			4 222			
Building (Fl. million)	1964			1 362			1 682			1 783			1 613
	1965			1 545			1 814			1 993			1 854
Private consumers' expenditure (1958 = 100)	1964	157	146	159	153	173	160	181	161	166	182	173	193
	1965	175	157	173	184	187	180	204	174	185	199	201	227
Total visible imports (million u.a.)	1964	539	569	549	640	562	628	636	499	559	628	567	630
	1965	554	564	631	614	577	617	665	537	620	676	625	793
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	488	596	594	557	611
Balance of trade (million u.a.)	1964	- 137	- 123	- 109	- 161	- 107	- 137	- 152	- 94	+ 2	- 76	- 62	- 92
	1965	- 77	- 75	- 99	- 103	- 76	- 63	- 121	- 98	- 24	- 82	- 68	- 182
Official gold and foreign exchanges reserves (million u.a.)	1964	1 860	1 841	1 833	1 802	1 817	1 736	1 869	1 879	1 960	1 965	2 069	2 034
	1965	2 075	2 094	2 069	2 033	2 036	2 010	2 042	2 053	2 065	2 038	2 120	2 058
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	16.31	17.01	17.04	16.89	16.89	16.97	17.15

Netherlands

NOTES

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

Table 1

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

Table 2

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

Table 3

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

Table 4

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

E. B.L.E.U.

Belgium

The expansion of overall demand speeded up towards the end of 1965. Since this was partly due to speculation on the increase in indirect taxes announced for 1 January 1966, there was a slackening-off for a time after the beginning of the year. Nevertheless, there is an impression that the underlying basic trend has tended upwards rather more strongly for some months past than it did in the first six months of 1965.

Exports made a strong contribution to expansion: in the fourth quarter merchandise exports, according to external trade statistics, were some 15 % up in value on the corresponding figure for the previous year.

However, domestic demand has now also gathered momentum, notably as regards overall industrial investment. It is true that no real change took place in the very moderate tendency for expenditure on buildings and plant and equipment to rise; but investments in stocks of raw materials and semi-manufactures perceptibly increased. Furthermore, public investment increased more definitely than before, and the slight falling-off in expenditure on residential construction has come to a halt. Above all, however, there has been a speed-up—which was very pronounced in the last months of 1965—in the growth of private consumers' expenditure.

Production has also risen more quickly—at any rate in industry, where it was higher by some 2 % in the fourth quarter and by some 4.5 % in January than it was at the corresponding times a year before. In spite of this more dynamic development, conditions on the labour market continued to ease very slightly.

Imports likewise increased more rapidly. Merchandise imports in the fourth quarter were up by about 13 % (value) on the figure for the fourth quarter of 1964. The balance of trade did not further improve, but the balance of payments remained conspicuously favourable.

The upward pressure on prices was intensified, not only by factors forming part of the current trend, such as the continuing increases in costs but also, and more particularly, by the increases in indirect taxes which made themselves felt from the beginning of the year onwards. In February the retail price index was 4.3 % higher than a year previously.

The trend in the coming months promises to be fairly expansive. For one thing, the increase in exports may well remain at a very high level. Again, gross fixed asset formation—particularly public investment—will no doubt show a rather more dynamic underlying trend. Investment in stocks will also make a heavier contribution to overall demand. Finally, the underlying upward tendency of private consumers' expenditure may be expected to continue at about the same rate as in the previous months.

Given these prospects for demand, production—especially industrial production—should continue to rise fairly quickly. Imports will undoubtedly also show considerable vigour.

The persisting rise in costs—rendered possible by the high demand—will exert further upward pressure on the price level. At the moment, it does not look as though consumer prices will rise more slowly than in 1965.

Accordingly, increased efforts towards stabilization are necessary in Belgium too, particularly in the fields of budgetary policy and incomes policy. But the present attitude of caution in the fields of monetary and credit policy might also have to be intensified, if the expansion of credit, which has recently gathered momentum, does not slow down again soon.

1. Recent developments

The high elasticity of supply in some sections of industry and the heavy demand from Belgium's leading customers have probably led to a further rapid increase in exports of goods and services in the last months. This is certainly true of merchandise exports, which, according to customs returns, rose again, and considerably, from the third to the fourth quarter of 1965. The year-to-year increase for this demand component in the fourth quarter was some 15 % (value).

The strongest contribution to demand came from the member countries, while exports to the non-member countries slackened off slightly, owing, in particular, to the weak development of sales to all the EFTA countries except the United Kingdom.

The expansion of domestic demand has speeded up, and in respect of certain demand components the increase in momentum has been quite marked.

Thus, trends in the field of gross fixed asset formation may well have improved slightly. Apart from seasonal variations, etc., expenditure by enterprises (not including

residential construction) seems to have continued its slow expansion, notably owing to rising investment in building and construction; in residential construction, the tendency to decline, at any rate in volume, may well have come to a halt. Public investment, which had touched a low point in the spring of 1965, has continued growing and the actual growth rate increased.

A change has also occurred in investment in stocks. The data available on the development of imports of raw materials and semi-manufactures, taken with the results of recent business surveys, suggest that stocks in these categories are now tending to increase again after a period of contraction.

However, it is primarily in the field of consumption expenditure that expansion has speeded up very sharply. Public consumption expenditure increased, largely because of additional disbursements carried over from the 1965 budget. But private consumers' expenditure also rose substantially towards the end of 1965, mainly owing to a rush to buy goods which were expected to be subject to increased taxes with effect from 1 January 1966. For example, over 30 % more new private cars were bought in the fourth quarter of 1965 than in the fourth quarter of 1964.

But it is not impossible that factors directly related to the economic trend have also prompted a recovery in the growth of private consumers' expenditure. A relevant point here is that some industries—especially textiles and construction—rose above the low point of the first half of 1965: the wage and salary bill paid in these industries, which had previously declined, has now expanded again appreciably.

In addition, the rising trend in the average income of persons in paid employment has probably slowed down only a little. It is true that a tendency for the upward pressure on wage rates to ease is discernible in the recent collective agreements; but the additional increases linked to the sliding wage scales continued unabated.

Moreover, at the beginning of 1966, implementation of the Government's social programme caused a further considerable increase in transfer incomes (especially for increased pensions and family allowances).

Finally, the propensity to consume, which had distinctly declined for a time, probably gained strength as the general business climate improved.

None the less, the increase in private consumers' expenditure may well, in general, have slowed down somewhat in the first months of 1966—simply because the anticipatory purchases towards the end of 1965 led to a corresponding decline thereafter. Even so, there is an impression that the trend in private consumers' expenditure, adjusted for fortuitous and seasonal variations, has remained rather more strongly upwards-directed than in 1965.

Supply met the more vigorous expansion of demand by an increase in domestic production and in imports.

According to the INS Index, adjusted for seasonal and fortuitous variations, industrial production grew vigorously in the fourth quarter of the year. However, the level in the previous quarter was relatively low, partly owing to losses of production connected with the lengthening of paid holidays, and hence the annual growth rate of the unadjusted index was around 2 % in the fourth quarter. The trend is a rising one, though: in January the rate was 4.5 %. A similar but more moderate trend was observed in building and construction, though production did not quite reach the level of early 1965.

The trend in unfilled vacancies and job applications shows that conditions on the labour market are still easing, though the improvement is slightly less marked. In January and February the unemployment rate, not seasonally adjusted (the ratio of the number of applicants fully able to work to the number of employees registered for unemployment insurance), was 1.4 % (1.1 % in January/February 1965). If the total number of persons seeking employment is the criterion chosen, the rate was 3.1 % (2.9 %).

Imports also reacted to the increase in overall demand, and to an even greater extent than domestic supplies. According to customs returns, the value of merchandise imported in the fourth quarter was about 13 % above the figure for a year previously, chiefly owing to increased purchases in the member countries. Incomplete information available suggests that in this quarter imports of durable consumer goods and semi-manufactures increased more than imports of capital goods.

The upward pressure on prices has continued, gathering momentum from December onwards. According to the general index, retail prices showed an increase of 1.3 % from November to February alone; in the latter month, the index was 4.3 % higher than a year before. In this development it is difficult to discern the essential trend, because an important part was played by the immediate effects of the increase of indirect taxes and of certain public charges. The situation was aggravated by increases in the prices of farm products. Wholesale prices rose even more quickly than retail prices.

Owing to the livelier development of domestic demand, with its effects on imports, there has been no further improvement in the balance of trade, despite the continuing increase in exports. If, however, account is taken of the exceptional factors influencing imports, the fall in the surplus, which amounted to nearly Bfrs. 700 million in the fourth quarter (customs returns), should probably not be regarded as a sign of an essential deterioration. In the fourth quarter of 1965, the balance of current payments showed a surplus of as much as Bfrs. 1 700 million. Net inflows of private capital continued, but capital transactions of the public authorities showed a moderate deficit. The gold and foreign exchange reserves of the monetary authorities and the non-money creating

institutions increased by Bfrs. 2 900 million, after declining by Bfrs. 400 000 in the preceding quarter. If transactions with the International Monetary Fund are left out of account, the net reserves of the National Bank rose by Bfrs. 2 800 million.

National product and expenditure

	1963 ⁽²⁾	1964 ⁽²⁾		1965 ⁽³⁾		1966 ⁽⁴⁾
	At current prices (in Bfrs. '000 million)	% change on preceding year				
		Volume	Value	Volume	Value	Volume
Gross national product	697.9	+ 5.2	+ 10.1	+ 3	+ 7.5	+ 3.5
Imports ⁽¹⁾	259.3	+ 12.6	+ 14.4	+ 7	+ 7.5	+ 10.5
Private consumption	474.2	+ 4.0	+ 8.1	+ 3	+ 7	+ 3
Public current expenditure	91.2	+ 2.9	+ 6.8	+ 4	+ 15.5	+ 2
Gross fixed asset formation	135.6	+ 7.6	+ 13.6	— 1	+ 3	+ 2.5
Exports ⁽¹⁾	254.9	+ 12.8	+ 16.4	+ 10	+ 10	+ 10

⁽¹⁾ Goods, services and factor income.

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

⁽³⁾ Commission estimates.

⁽⁴⁾ Commission forecasts.

Note :

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

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

The inflow of liquidity engendered by transactions with abroad was considerable, but bank lending to enterprises and private individuals was the key to the expansion of domestic liquidity. The growth of bank advances gathered very considerable momentum; at the end of December total outstanding debts were 17 % greater than twelve months before. Part of the recent increase may well be attributable to the "bunching" of credit-financed purchases in the period before the tax increases, and another part to credit operations with foreign enterprises. However, tendencies partaking of the essential trend, such as the financing of increased stock-building and of rising wage bills, also

seem to have played a significant role. The cash transactions of the public authorities likewise helped to expand domestic liquidity. Owing to the rapid rise in central government expenditure the budget deficit rose, although the increased turnover due to speculative shopping brought in additional revenue; the deficit was in part financed by recourse to the money market. These tendencies continued in the first months of 1966.

2. Outlook

Even now that the exceptional influences which boosted domestic demand during the last months of 1965 have disappeared, the economic trend could well prove more expansive than before. Important factors such as the development of external demand and of investment activity do in fact point to a rather brisker rate of economic growth.

In view of economic prospects in the countries which are Belgium's chief customers, the rate of increase in exports of goods and services should remain very high. The forecasts on this matter in the last Quarterly Survey must therefore now be regarded as representing the least that will be achieved.

In the first place demand from the non-member countries can be put a little higher. This applies particularly to exports to the USA; but the developing countries might also step up their imports more than was assumed a few months ago, now that higher world commodity prices, *inter alia*, have strengthened their inflow of foreign exchange.

As for the development of exports to the member countries, the expansion of demand in Germany has slowed down, but this trend will very probably be offset by a larger share in the demand pattern assumed by the other Community countries: the recovery of the business situation in France and Italy, and the persisting strong tendencies to expansion in the Netherlands, are likely to prove a spur to Belgian exports to those countries.

The trend of gross fixed asset formation should gather a little more momentum. It can be assumed that public investment will increase further, and the execution of large-scale investment projects of foreign firms in Belgium should strengthen the upward trend of overall fixed industrial investment. All the same, the development of new orders for capital goods by home firms indicates that the speed-up in growth of expenditure on these investments will not be very pronounced. Admittedly, the situation with regard to the availability of funds to industrial firms has shown no very great improvement recently.

The situation as regards building permits does not prefigure a rising trend in residential construction, although the expansion of expenditure on new low-cost housing may be expected to continue.

The more favourable production prospects and the trend of prices on world markets point to a further increase in investment in stocks.

Public consumption expenditure is likely to continue forging ahead in coming months, and will certainly again outstrip GNP growth in money terms.

In the next few months, private consumers' expenditure will further increase, and quite rapidly. It is true that increases in negotiated wages themselves—i.e. apart from sliding scale clauses—might show a less strong upward tendency. However, these clauses must in fact be expected to come into operation, owing to the swift rise in retail prices; and this is calculated to strengthen the upward trend. An increase in the volume of employment (number of wage and salary earners multiplied by number of working hours per head) and upward adjustments of social transfer incomes will probably also force up the trend of private household incomes. Finally, it is not impossible that the propensity to save of private households will be less than it was, for example, throughout most of 1965—one reason being the steep increases in prices.

Nevertheless, it is to be expected that these price increases will keep the increase in volume of private consumption within bounds.

Adjustment of domestic supply to the faster expansion of demand will no doubt take the form of an increase (apart from seasonal variations) in industrial production, which is likely, however, to depend more on the improved productivity of the workers employed than on an increase in their numbers. But since those industries beset by structural difficulties will probably release more labour, and since the building industry will probably only show a moderate increase, the slight relaxation of strain on the labour market could well continue for a while.

The import trend, especially in respect of raw materials and semi-manufactures, will remain fairly vigorous. Nevertheless, in view of the expected favourable trend in exports, no serious deterioration in the balance of trade (adjusted figures) is to be expected.

The rise in costs will promote, or at any rate tend to promote, a further rise in prices, especially as the development of overall money demand will make possible or even favour the accommodation of cost increases by means of higher prices. Admittedly, the upward pressure on unit labour costs is liable to slacken off, on account not so much of slower increases in wages as of more rapid improvements in productivity; however, the pressure will still remain much too strong. Additional price-raising factors are the further effects of the increase in taxation affecting costs—in which the indirect effects

are steadily gaining in importance—and the further effects of the increase in public charges: these are likewise largely to be regarded as after-effects of demand inflation. Finally, the consequences of increased wholesale prices for imported raw materials and for farm products may also have to be reckoned with.

In general, the outlook is in conformity with the figures forecast in the last Quarterly Survey for the whole of 1966 as compared with 1965.

The persisting tendency for prices to rise should prompt those responsible for short-term economic policy to redouble their efforts towards stabilization. If possible, though, the strategy of the stabilization drive should be such as to avoid hindering a revival of the growth of investment.

Appropriate measures would include a budgetary policy (embracing semi-public and subsidiary public bodies) which would ensure that the overall deficit is cut back more sharply than seems to be intended. Taxes (admittedly, almost exclusively the indirect taxes) have just been appreciably increased, and there may therefore also be a case for curtailing the growth of expenditure. Restrictions should not be applied to expenditure intended directly or indirectly for investment, as has often been done in similar situations in the past, but to public consumption expenditure and such transfer expenditure as stimulates consumption.

For there is hardly any scope for action along alternative lines, namely a further increase of indirect taxes, in a country where indirect taxation is already very high compared with direct taxation and large groups of the population are almost fully protected by sliding scale clauses from such measures. Moreover, when these sliding scales are applied they produce spiral effects on government expenditure in their turn.

If the expansion of public expenditure (in the broadest sense of the word) cannot be appreciably curbed, or if this is not desired, a solution could perhaps be sought in an increase in direct taxation, which is relatively light in Belgium. However, there are other obstacles, of a psychological and political nature, in the way of doing this, as well as defects in collection machinery. Furthermore, a tendency has already emerged to link direct tax rates to indices, i.e. a move which is diametrically opposed to such an increase.

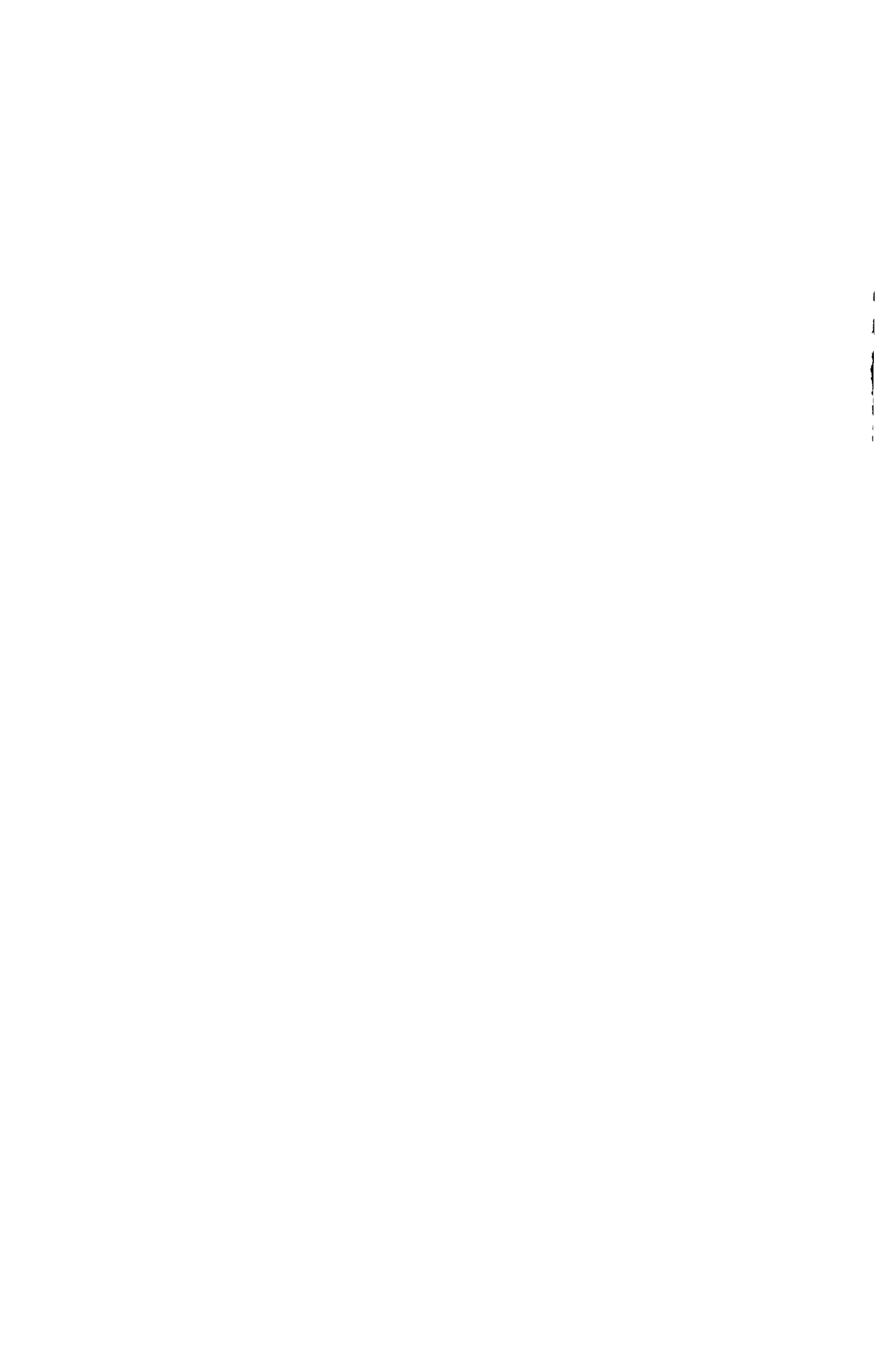
If, however, the overall deficit of the public authorities is not cut back beforehand, it will produce inflationary effects whether it be because part of the deficit is financed by recourse to the monetary market at home or because foreign indebtedness swells. Even if financing is effected by long-term loans, it may have an inflationary character in so far as the funds are in fact provided by the banks. The prospect that the deficit may in fact prove to be smaller, if revenue from taxes rises more than foreseen, cannot be accepted as a counter-argument; for the increase in tax revenue would, at any rate in part, be due to that inflation which owed its existence in part to the unduly high initial deficit.

If budgetary policy should continue to have too expansive an effect, the only way of retarding price and cost inflation—which, apart from its intrinsic harmfulness, would be bound in the long run to threaten Belgium's competitive position—would be to enforce once again more overtly restrictive monetary and credit policy. The considerable speed-up in credit expansion towards the end of 1965 is perhaps sufficient reason in itself for greater stringency.

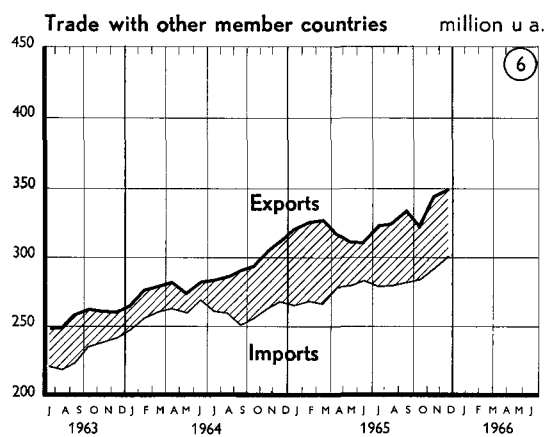
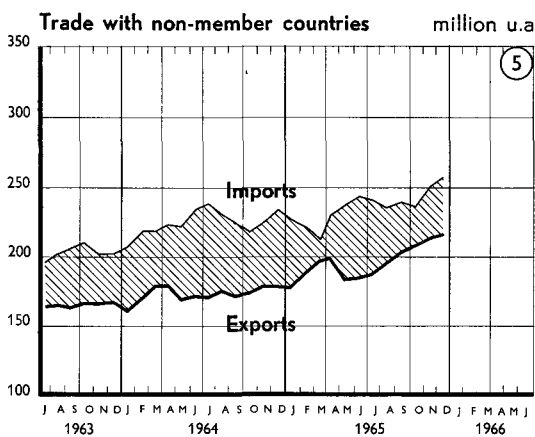
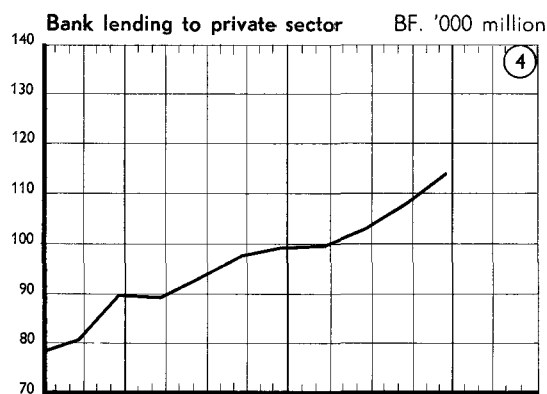
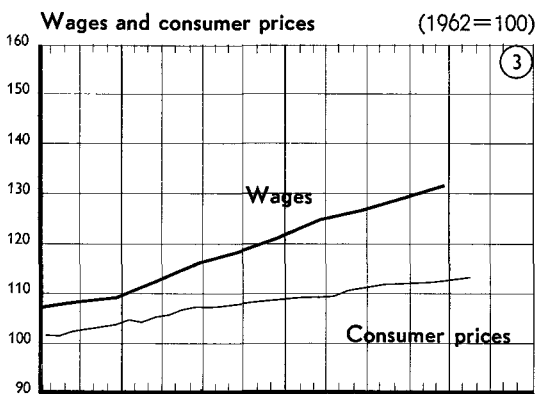
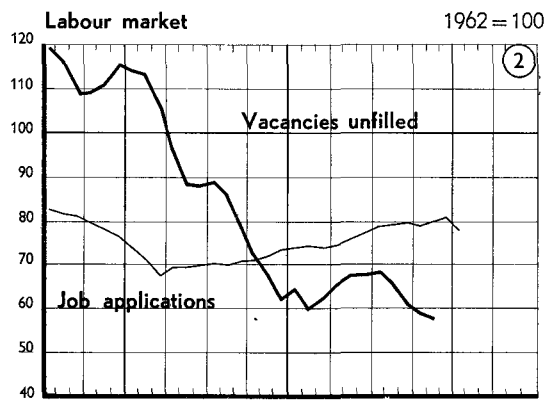
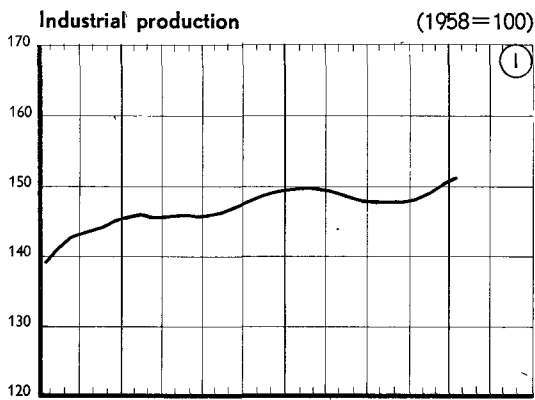
With this in mind, the National Bank again called on the banks at the end of 1965 to show moderation in stepping up their lending. And the Minister of Finance has urged the credit institutions in the public sector and the life insurance companies to exercise more caution. However, this may still not be sufficient in the face of too expansive a budgetary policy, and more radical restrictive instruments might have to be used. But action on these lines would hit investment first, i.e. the very field in which restraint—from the point of view of short-term economic policy—is least needed.

In view of these alternatives, it might perhaps be worth considering whether energetic action ought not to be taken to bring public finances into better order, perhaps through the amendment of existing laws involving government expenditure (this is what has just been done in Germany).

Furthermore, renewed efforts should be made to relieve more directly the pressure exerted on costs by inordinate wage and salary claims, unduly sharp reductions in working hours, inadequate competition on certain markets and a wide range of devices to link charges to price indices. The more energetic and effective the prosecution of such an incomes policy in the widest sense, with the agreement of all concerned, the less need there will be to take restrictive measures with other weapons in the stabilization armoury.



ECONOMIC INDICATORS



NOTES:

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

Graph 1. Trend curve; estimation established on the basis of indices adjusted by the SOEC for seasonal and fortuitous variations (excluding construction, food, beverages and tobacco).

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

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

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

Graphs 5 and 6. BLEU, series adjusted for seasonal and accidental variations (moving averages of 3 months). Exports fob, imports cif. Conversion at official exchange rates. 1 unit of account = 0,888671 gm of fine gold = US \$ 1 at the official rate of exchange.

Belgium

TABLE 1: Basic data (1964)

Total area ('000 sq. km.)	30.5
Total population ('000)	9 378
Density of population per sq. km.	307
Working population ('000)	3 726
Working population, breakdown by main sector (%)	
— Agriculture	6
— Industry	45
of which : Construction	8
— Services	49
Percentage share of gross domestic product :	
— Agriculture	6.6
— Industry	42.6
of which : Construction	8.0
— Services	50.8
Gross product per capita (Bfrs.)	81 900

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

	% change by volume on preceding year						Volume indices (1958 = 100)	Contri- bution (in %) to 1964 GNP
	1959	1960	1961	1962	1963	1964	1964	1964
Gross national product	+ 2.6	+ 5.6	+ 4.7	+ 5.0	+ 4.8	+ 5.2	131	—
Industrial production	+ 4.2	+ 8.5	+ 4.7	+ 6.9	+ 6.4	+ 7.3	144	—
Total imports	+12.2	+12.4	+ 7.0	+ 8.1	+ 8.7	+12.6	179	38.6
Private consumers' expenditure	+ 2.0	+ 6.0	+ 2.2	+ 4.5	+ 5.5	+ 4.0	127	66.7
Public current expenditure on goods and services	+ 5.3	+ 5.4	+ 1.6	+ 9.4	+11.5	+ 2.9	142	12.7
Gross fixed asset formation	+ 8.8	+12.6	+10.7	+ 2.9	+ 1.9	+ 7.6	153	20.1
Total exports	+ 7.2	+ 9.6	+ 8.3	+ 9.5	+ 7.0	+12.8	168	38.6
Gross national product per capita	+ 2.1	+ 5.1	+ 4.2	+ 4.5	+ 4.0	+ 4.1	126	—
Gross national product per person gainfully employed	+ 3.0	+ 5.8	+ 3.7	+ 2.7	+ 4.3	+ 4.1	126	—

TABLE 3: Foreign trade (at current prices)

	% change on preceding year						Indices (1958 = 100)	Million u.a.	% of the total
	1959	1960	1961	1962	1963	1964			
Visible exports									
Total	+ 7.9	+14.7	+ 3.9	+10.2	+11.9	+15.3	133	5 580	100
Intra-EEC	+10.5	+25.2	+ 9.7	+17.7	+19.6	+18.8	254	3 494	62.6
To non-EEC countries	+ 5.7	+ 5.3	- 1.7	+ 1.9	+ 1.6	+10.0	125	2 086	37.4
Exports of food, beverages and tobacco									
Total	+ 0.5	+ 6.3	+15.6	+29.6	+29.6	+ 3.2	214	327	5.9
Intra-EEC	+14.8	+11.8	+18.7	+31.2	+30.7	+ 5.2	275	241	4.3
To non-EEC countries	-18.9	- 4.4	+ 8.7	+25.7	+26.8	- 2.0	132	86	1.6
Exports of raw materials and manufactures									
Total	+ 8.4	+14.9	+ 3.4	+ 9.2	+10.9	+16.3	181	5 253	94.1
Intra-EEC	+10.4	+26.1	+ 8.9	+16.7	+18.8	+20.0	252	3 253	58.2
To non-EEC countries	+ 6.9	+ 5.6	- 2.0	+ 0.9	+ 0.7	+10.8	124	2 000	35.9
Visible imports									
Total	+ 9.8	+15.0	+ 6.6	+ 8.0	+12.2	+15.4	188	5 901	100
Intra-EEC	+10.9	+16.8	+12.7	+ 8.9	+15.5	+17.2	215	3 146	53.3
From non-EEC countries	+ 8.8	+13.3	+ 1.0	+ 7.1	+ 8.8	+13.5	165	2 755	46.7
Imports of food, beverages and tobacco									
Total	+ 6.6	+ 1.6	+ 0.1	+11.0	+ 9.0	+16.8	153	716	12.1
Intra-EEC	+13.2	+ 4.2	+ 7.4	+ 3.2	+17.2	+16.2	178	277	4.7
From non-EEC countries	+ 3.4	+ 0.1	- 4.0	+15.9	+ 4.3	+17.1	141	439	7.4
Imports of raw materials and manufactures									
Total	+10.4	+17.1	+ 7.6	+ 7.6	+12.7	+15.5	194	5 185	87.9
Intra-EEC	+10.6	+18.4	+13.3	+ 9.4	+15.4	+17.6	220	2 869	48.6
From non-EEC countries	+10.2	+15.9	+ 1.9	+ 5.6	+ 9.6	+13.0	170	2 315	39.2

TABLE 4: Basic monthly indicators

	Year	Jan.	Feb.	Mar.	Apr.	May	June	July	Aug.	Sept.	Oct.	Nov.	Dec.
Industrial production (1958 = 100)	1964	141	138	144	151	137	148	128	136	152	162	149	150
	1965	140	141	156	152	145	147	121	139	155	161	154	159
Investment (1961 = 100)	1964	116.3	134.1	138.9	147.9	153.0	152.3	126.2	134.1	147.3	144.8	152.9	149.7
	1965	119.1	125.7	141.0	162.5	161.0	163.9	117.9	141.3	152.5			
Building (1962 = 100)	1964	92.8	108.2	109.5	124.5	112.6	126.0	99.0	111.0	125.2	125.9	116.2	103.9
	1965	86.3	82.1	107.0	117.5	111.4	121.4	79.9	116.8	121.4	120.5	96.9	102.3
Private consumers' expenditure (1961 = 100)	1964	116.7	116.0	118.2	122.1	123.9	124.4	125.6	123.4	122.2	125.2	126.1	129.8
	1965	125.0	126.4	129.0	133.5	133.0	133.3	133.6	131.9	131.5	134.8	135.0	
Total visible imports (million u.a.)	1964	492	475	481	515	479	513	486	419	480	512	491	529
	1965	451	474	539	552	506	514	506	452	541	554	570	609
Total visible exports (million u.a.)	1964	451	449	468	490	426	484	453	377	477	520	491	500
	1965	501	520	571	507	478	548	509	428	580	546	575	617
Balance of trade (million u.a.)	1964	- 41	- 26	- 13	- 23	- 53	- 28	- 33	- 42	- 3	- 8	0	- 29
	1965	+ 50	+ 46	+ 32	- 45	- 28	+ 34	+ 3	- 24	+ 38	- 8	+ 5	+ 8
Official gold and foreign exchanges reserves (million u.a.)	1964	1 796	1 794	1 795	1 789	1 812	1 788	1 796	1 816	1 834	1 870	1 954	1 992
	1965	2 000	2 006	2 002	2 026	2 010	2 000	2 010	2 023	2 018	2 010	2 010	1 996
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	290.4	290.4	294.2	300.3	303.0	310.6	306.3	303.2	307.9	308.6	310.4	320.0

Belgium

NOTES

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

Table 1

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

Table 2

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

Table 3

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

Table 4

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

Grand Duchy of Luxembourg

During the fourth quarter of 1965 a slight improvement in the international iron and steel situation had an invigorating effect on the development of the economy.

In this period, merchandise exports may well have increased a little (apart from variations) under the influence of a marginal growth in deliveries of iron and steel products and also of the recent increase in supplies to the export market by the new industries.

In the last few months, domestic demand has not risen appreciably. The downward trend in gross fixed asset formation seems to have levelled out in the summer, but private consumers' expenditure has increased at a rather slow rate.

Industrial production and imports have risen slightly. The labour shortage has persisted, save that less skilled workers are now not quite so scarce. The upward trend of prices remained fairly lively, partly as a result of certain "autonomous" increases.

In view of the relatively favourable prospects on the international iron and steel market, and the trend of demand in other sectors, the slightly more expansive development of the economy is likely to continue in the next few months.

It would be advisable for the Luxembourg authorities to pursue their endeavours to stabilize prices and costs all the more vigorously now that a relatively satisfactory rate of economic growth for 1966 seems more certain than before.

1. Recent developments

Exports of iron and steel products lost ground until the autumn, but there was a modest upturn in the last quarter of 1965, mainly attributable to a slight increase in demand from the other member countries. Nevertheless, the growth of total deliveries was disappointing; the increase for the fourth quarter of 1965, as compared with the fourth quarter of 1964, was hardly worth mentioning. With two new plants now operational, exports of chemicals are accounting for an increasing share of exports, so that it is likely that Luxembourg exports as a whole have risen appreciably more rapidly. The available data suggest that in the first months of 1966 sales of iron and steel products (volume) were tending to settle at a stable level, while export prices rose slightly.

The slackening in gross fixed asset formation seems to have come to a halt at the end of last summer. After the autumn, the figures for total industrial investment expenditure were probably no longer being forced down, as they had been in the past when major investment programmes reached completion and nothing on the same scale had been put in hand to take their place. Rationalization investment in existing enterprises, especially in the iron and steel industry, also appears to have settled at a stable level. Investment by public authorities, which was still quite hesitant towards the end of the year, has picked up again to a considerable extent, especially since the beginning of 1966. However, there has been scarcely any improvement in residential construction.

The increase in the incomes of private households has continued during the last few months. However, the rate of increase is still rather low, since the level of employment (total number of hours worked) has remained unchanged and wage and salary increases granted have been rather smaller. If the development of transfer incomes and of the other incomes of private households is also taken into account, it may be assumed that private consumers' expenditure has continued to increase at the moderate pace which has been observed since the beginning of 1965.

Domestic supply has continued to expand relatively slowly. Nevertheless, since October, industrial production has picked up again somewhat, even though—according to the official index—in the fourth quarter of the year it was still 0.6 % below the level of twelve months previously. But this index probably understates the real situation.

In the construction sector, too, production (apart from seasonal factors) may well have increased slightly.

The trend in imports has also been rather more expansive, notably owing to purchases of primary and intermediate products by the new industries.

The labour market has been influenced by two opposing factors. On the one hand, production in the "traditional" industries has now been marking time for some months and this has curtailed sharply the demand for additional manpower. On the other hand, job vacancies in the new industries have aggravated the shortage of skilled workers. The situation has admittedly become more varied, but in general over-employment persists.

The upward price movement has not slackened, partly owing to certain "autonomous" factors such as the latest increase in indirect taxes. Their influence is reinforced by the cumulative effects of the sliding wage scale, which came into operation again in December 1965. In the fourth quarter of 1965, the cost of living index was 3.7 % higher than a year before, and in the first quarter of 1966 the annual rate of increase was around 3.5 %.

The higher rates of interest recently introduced by the national savings bank and other financial institutions bear witness to the strain on the money and capital markets, which has grown increasingly acute of late.

National product and expenditure

	1963 ⁽²⁾	1964 ⁽³⁾		1965 ⁽³⁾		1966 ⁽⁴⁾
	At current prices (in Lfrs. '000 million)	% change on preceding year				
		Volume	Value	Volume	Value	Volume
Gross national product	27 496	+ 6.5	+ 10.5	+ 1.5	+ 3	+ 2.5
Imports ⁽¹⁾	23 753	+ 9.5	+ 12	+ 2	+ 4.5	+ 3
Private consumption	16 641	+ 5.5	+ 9.5	+ 3	+ 7	+ 3
Public current expenditure	3 484	+ 2.5	+ 6	+ 0.5	+ 7	+ 3
Gross fixed asset formation	8 826	+ 1	+ 6	- 14	- 11.5	- 6.5
Exports ⁽¹⁾	22 198	+ 13	+ 15.5	+ 4	+ 4	+ 5.5

⁽¹⁾ Goods, services and factor income.

⁽²⁾ Ministry for Industry, Fuel and Power, Luxembourg.

⁽³⁾ Commission estimates.

⁽⁴⁾ Commission forecasts.

Note :

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

b) The estimates and 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.

2. Outlook

If the slight improvement on world steel markets continues, in 1966 the Luxembourg economy could well expand, or at least show a tendency to expand, somewhat more dynamically than was assumed in the previous Quarterly Survey. At the moment, short-term prospects for sales of iron and steel products—at least in terms of value—seem rather less unfavourable: Community manufacturers may well run down steel stocks back to normal more quickly than was originally expected. In addition, partly

for the same reason, demand from the United States is likely to prove slightly stronger. And the fact that the new industries are now fully operational will also have a good effect on the general development of exports.

After the relatively prolonged decline in gross fixed asset formation, which began in 1964, its future development has probably by now ceased to act as a curb on overall demand. Here, the recent expansion of public investment expenditure will no doubt play an essential role. Implementation of the government programme will certainly result in this item rising perceptibly by comparison with last year. A revival in expansion of total investment expenditure in the business sector is no doubt out of the question; but investment will be spurred on, nevertheless, by the need for rationalization and the official measures of support to traditional industries. However, investment in housing should be kept within bounds for some time yet by credit-restricting measures and by the persisting increase in building costs.

The rate of growth of private consumers' expenditure should not change appreciably in the coming months. To judge from forecasts of the level of employment and the development of money wages, no real speed-up in the rise of incomes in the private sector is likely to occur, even bearing in mind the additional increases which may certainly be expected from the application of the sliding wage scale.

Expenditure by public authorities on salaries and wages and social transfers will probably also increase at about the same rate as in the last few months.

The growth prospects for domestic production seem relatively limited, although overall demand has recently gathered a little momentum. Industrial output, in particular, is hardly likely to rise much more quickly, when seasonal and fortuitous factors are discounted; it is more reasonable to assume that growth will continue at a fairly moderate pace. This also applies to imports, especially as purchases of capital goods will probably remain comparatively low.

Under these circumstances, there is probably no cause for fearing that strains on the labour market will become more acute, since the expected increase in production will scarcely exceed the possible increase in productivity.

Nevertheless, the upward pressure on prices is unlikely to slacken perceptibly either. Inflation will still be promoted to a considerable extent by factors such as the continuing rise in production costs, the increase in prices of imported finished goods, and increases in the retail prices of farm products as a result of the abolition of subsidies.

In view of this outlook, the authorities responsible for economic policy would be well advised to concentrate even more than hitherto on stabilizing prices. The prospects for economic growth—which now seem to be more favourable—give them more latitude for resolute action in this respect.

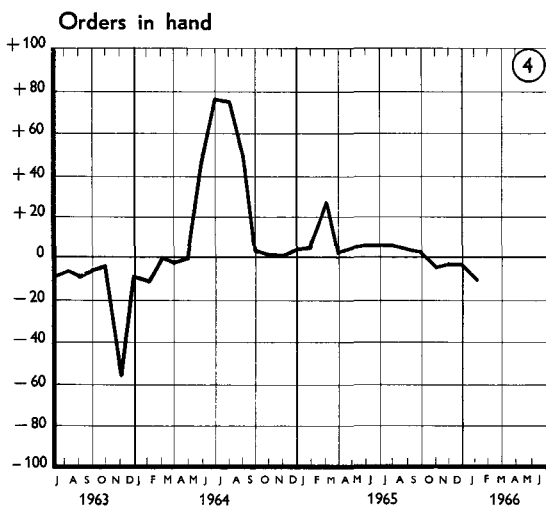
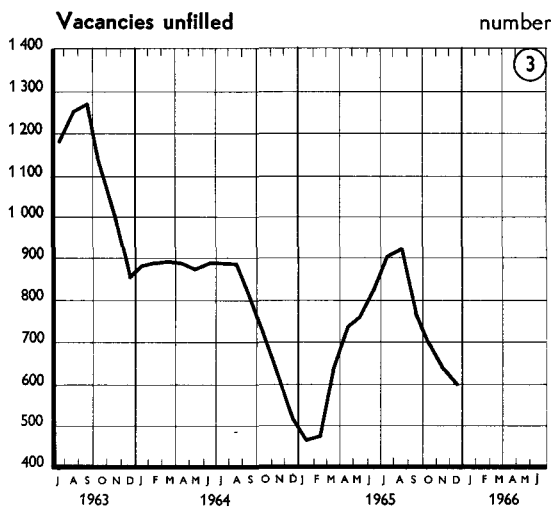
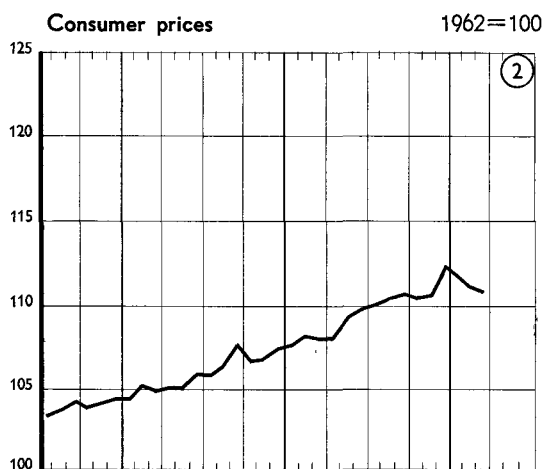
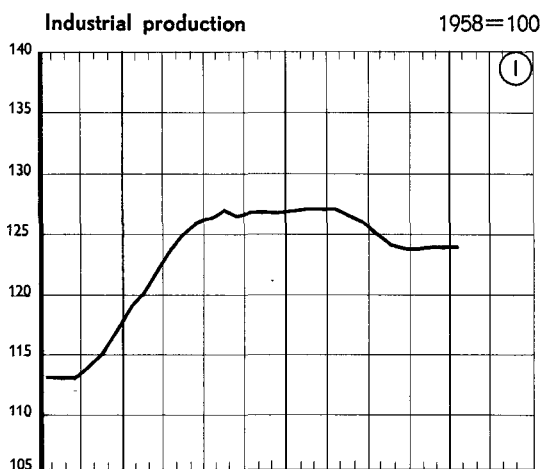
With regard to budgetary policy, particular care should be taken to ensure that the ordinary expenditure estimates are not once again exceeded, especially since the amendments proposed by the Government to the budget for 1966 will probably increase spending by Lfrs. 135 million in any case.

In the field of monetary and financial policy, there are a number of arguments for a further adjustment of bank rate to meet current conditions of supply and demand. This adjustment would not only engender an additional supply of capital, but would at the same time cut back capital investments abroad. Moreover, it would help to ease further the strain which is hampering residential construction.

Finally, in Luxembourg, too, the incomes policy (in the broadest sense) ought to be more energetically pursued, with the object, firstly, of ending the rise in unit labour costs and consequently helping to stabilize prices and safeguard the economy's competitiveness, and secondly, of stimulating internal competition and promoting necessary structural changes. In fact, the authorities do apparently intend to take certain steps to infuse more flexibility into the economic life of the Grand Duchy, notably in respect of distribution.



ECONOMIC INDICATORS



NOTES:

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

Graph 1. Trend curve; estimation established on the basis of indices adjusted by the SOEC for seasonal and fortuitous variations (excluding construction, food, beverages and tobacco).

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

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

Graph 4. Source: EEC business survey.

Grand Duchy of Luxembourg

TABLE 1 : Basic data (1964)

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

TABLE 2 : Basic monthly indicators

	Year	Jan.	Feb.	Mar.	Apr.	May	June	July	Aug.	Sept.	Oct.	Nov.	Dec.
Industrial production (1958 = 100)	1964	115	117	125	129	131	130	123	122	126	127	125	124
	1965	125	129	121	130	132	129	124	116	125	125	127	121
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	395	392	377	372
	1966	369	354										
Building (1958 = 100)	1964	48	57	83	103	106	109	110	96	98	95	73	63
	1965	48	55	82	103	110	102	105	100	96	93	76	58
Workers employed in the iron and steel producing industry and in mining ('000)	1964	23.5	23.6	23.7	23.9	24.0	24.0	24.1	24.1	24.2	24.2	24.3	24.3
	1965	24.2	24.1	24.0	24.0	24.0	24.0	24.0	24.0	24.1	24.1	29.1	24.1
	1966	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	112.9	113.1	114.7
	1966	114.7	113.8										

Grand Duchy of Luxembourg

NOTES

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

Table 1

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

Table 2

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

Trends of wages, productivity and labour costs in industry

Introduction

As in previous years (see Annexes to Quarterly Surveys 2/1962, 1/1963, 2/1964 and 1/1965), the trend followed by labour costs and net production per person in paid employment, by labour costs per unit of value added, and by the implicit price index of value added in industry (including construction), both in member countries and in certain non-member countries, is shown in the following pages in chart form.

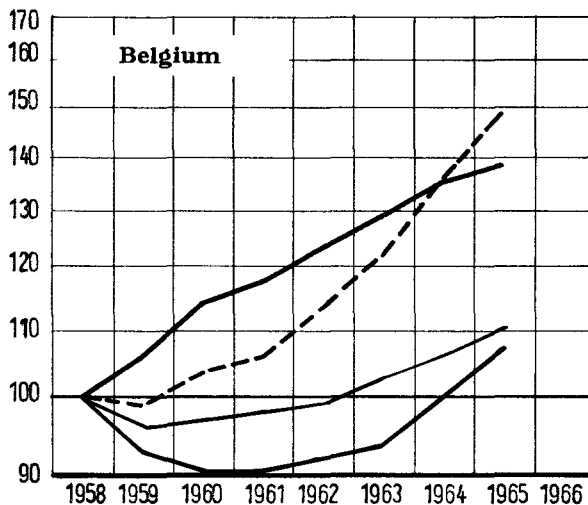
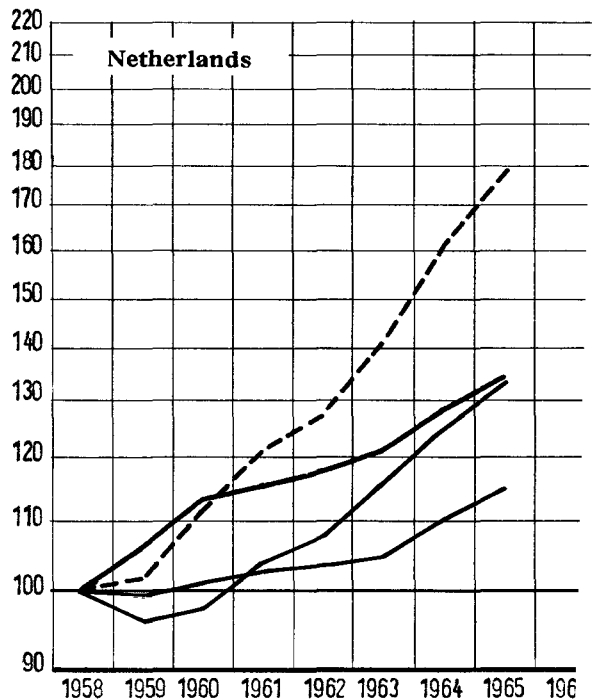
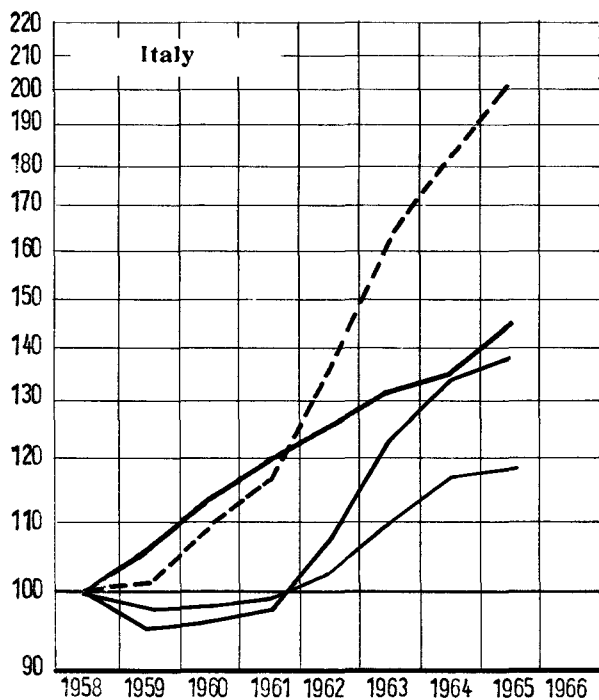
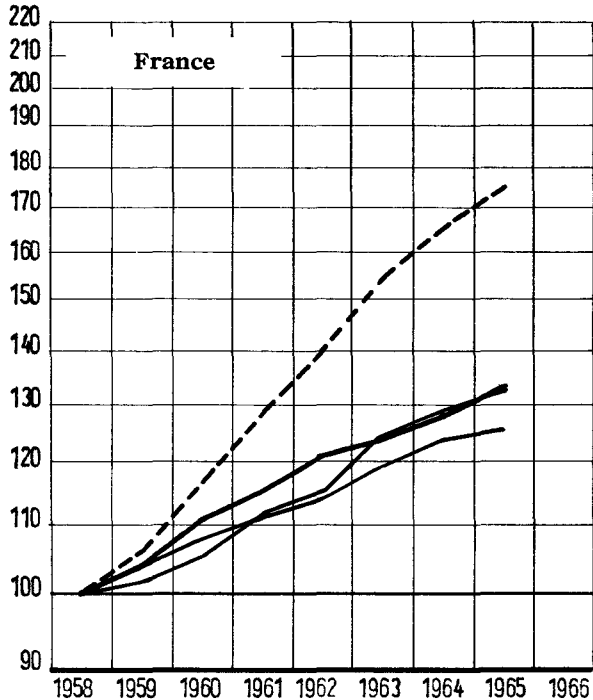
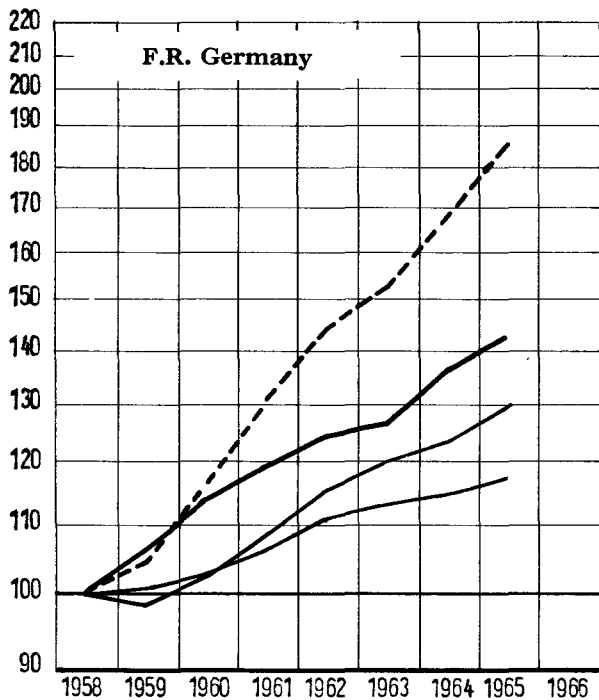
The Commission is continuing this series of charts, because it is convinced that they contain important statistical data, which must be made available to those concerned with economic policy and to the general public. The fact that, owing to the lack of the necessary statistics on cost structure and profits, it is not possible to provide similar charts and figures for other cost components (indirect taxes, social insurance contributions, etc.) and on the gross and net profits of industry is no reason for withholding such information as is available or can be calculated regarding one component of costs—indeed, the largest one.

It must however be borne in mind that the implicit price index given in the charts only indicates the extent to which the trend in value added at current prices differs from the corresponding trend at constant prices. This price index is therefore not representative of the trend in prices of the final products, since it does not reflect the changes in prices of goods and services supplied to industry from “outside” (input). This point is of great importance for a correct assessment of the price climate in 1965, as the prices paid for farm products and imported raw materials (which rose considerably in the course of the year), as well as the relatively sharp increase in prices in the services sector, have substantially contributed to the upward movement of producer prices—and even more, perhaps, of the retail prices—for industrial products.

For the definitions and methods of calculation used, the reader is referred to the explanations in the Annexes to the earlier Quarterly Surveys. Suffice it to recall here that the statistical data have been drawn as far as possible from the national accounts. It must also be emphasized again, to avoid misunderstandings, that while the charts show the actual development of wages and salaries, of “labour productivity”, of labour costs per unit of output, and of prices, they offer no explanation for these movements. For example, the development of “labour productivity” is purely an arithmetical calculation from the trend of value added at constant prices on the one hand and that of the numbers in paid employment on the other. As is well known, attribution of a rise in labour productivity to individual factors such as performance, organization, technical progress, etc., remains extremely problematic.

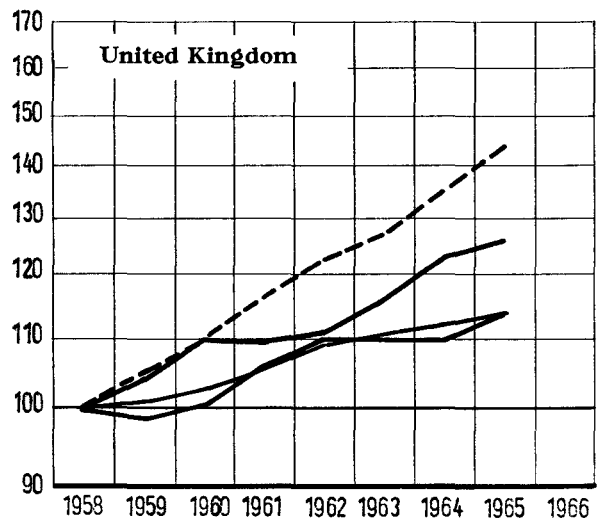
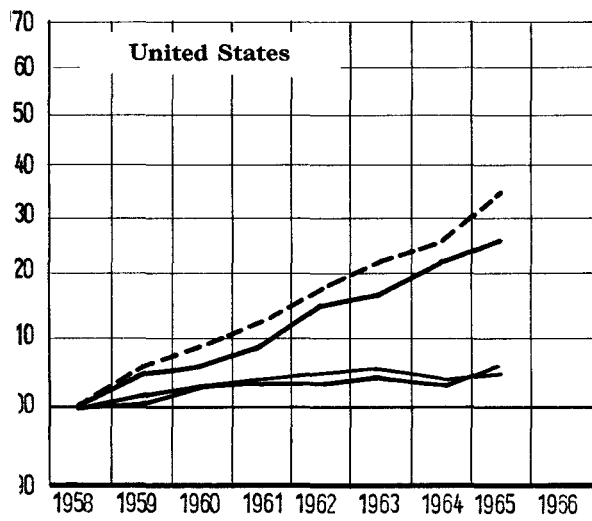
WAGES, PRODUCTIVITY AND WAGE COSTS IN INDUSTRY

1958 = 100



WAGES, PRODUCTIVITY AND WAGE COSTS IN INDUSTRY

1958 = 100



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

Semi-logarithmic scale

The charts are based on the latest available figures, including some which are corrections of figures previously used; data for 1965, in particular, are still provisional, some of them being tentative Commission estimates.

It is inherent in the nature of the curves that they can show only the trend in each country during the period under review; they therefore enable changes within a country to be compared, but do not permit a comparison of the absolute levels between countries. This limitation is all the more important because the relative levels of the various countries in the base year 1958 are themselves far from being entirely "correct". Moreover, the curves are based on calculations in national currencies, and since 1958 there have been some alterations in exchange rates.

Developments in 1965

In 1965, the rise in labour costs per unit of output in the Community's industry as a whole slowed down little if at all. The fact that the upward pressure on wages and salaries has been somewhat less acute in most cases was approximately offset by the fact that the increase in productivity per person in paid employment was also smaller than in 1964: for the Community as a whole it was about 4.5 %, compared with some 5.5 % a year earlier.

The upward trend in labour costs per unit of output in 1965 was fairly moderate only in France and Italy, and very strong in the other member countries—steepest in Belgium, followed by the Netherlands and Federal Germany.

This applies to the full year 1965 compared with the average level for 1964. If, however, the trend throughout the year is observed, a perceptible speed-up in the rise in labour costs per unit of output in Federal Germany can be seen in the third, and even more in the fourth quarter of 1965; this was due to a decrease in the rise in productivity with practically no slackening in the upward movement of wages. From this it can be concluded that the latest trend in labour costs per unit of output has been more steeply upward in Federal Germany than in Belgium and the Netherlands. At the same time, the rises in Italy and perhaps also in France may have slowed down still further in the course of 1965. This development does not come out on the charts, because they are based on annual averages and consequently show year-to-year changes but not changes taking place in the course of the year.

It should also be noted that for the first time in several years labour costs per unit of output were in 1965 quite considerably higher in the United States and the United Kingdom than they had been a year earlier. In the United States this was connected with a slower increase of productivity; as the limits of capacity were approached, the unabated increase in production was accompanied by a considerable increase in the

numbers employed in industry—nearly 4 %—so that, in contrast to the previous year, the increase in production per person employed remained within fairly narrow bounds. On the other hand, the rise in wages speeded up slightly ⁽¹⁾.

In the United Kingdom, the upward tendency in labour costs per unit of output from 1964 to 1965 can be attributed in the first place to the fact that, despite a pronounced slowing down in economic growth, the upward pressure on wages continued undiminished ⁽¹⁾.

In general the curve of labour costs per person employed in industry levelled off in the Community, but only very slightly. According to the very provisional data available, the increase in 1965 was around 10 % in almost all member countries, and substantially less in France.

The rise in productivity (value added per person in paid employment) was very different in the individual member countries; it was least in Belgium, with some 2 %, and highest in Italy with some 7 %. At the same time, however, the tempo in some member countries changed very appreciably by comparison with the previous year. In Federal Germany and in Belgium, for instance, the favourable trend of 1964 has given way to something appreciably slower: in both countries the increase in production per head was only about half as much as in the previous year. In the Netherlands the increase in productivity slackened off just about as strongly as the increase in labour costs per head, so that labour costs per unit of output again rose as sharply as in 1964, when the “wage explosion” took place. In France, the increase in productivity in 1965 was about the same as a year earlier, with a perceptible acceleration in the course of the year. Economic recovery in Italy was accompanied by a very strong improvement in productivity, due mainly to fuller utilization of production capacities when working hours per person employed were lengthened; consequently, the rise in labour costs per unit of output was noticeably more moderate than in the preceding years.

In 1966 the Community is still hardly likely to witness a conspicuous slackening in the rise of labour costs per unit of output. While by comparison with the previous year the productivity of labour might show approximately the same overall increase as in 1965—with an acceleration in France and Belgium and slowing down in Germany and Italy—the upward pressure on labour costs per head shows, on the average, little sign of slackening.

⁽¹⁾ Disparities between results given here and calculations made in the US and the UK are due to differing definitions and methods used. For example, an American calculation for 1965 indicates that US wage costs per unit of output remained stable; the definition of industry used is, however, a narrower one (excluding mining and quarrying, fuel and power, and construction), and it refers to gross final product (not value added).

