

EUROPEAN
ECONOMIC
COMMUNITY

COMMISSION



DIRECTORATE-
GENERAL
FOR ECONOMIC
AND FINANCIAL
AFFAIRS

**THE ECONOMIC SITUATION
IN THE COMMUNITY**

2

JUNE

QUARTERLY SURVEY

1965

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

EUROPEAN ECONOMIC COMMUNITY

COMMISSION

The Economic Situation in the Community

JUNE 1965

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Note :

This survey was completed around mid-June 1965. As regards the most recent developments and where it has not been possible to take them into account, because of the pace at which national statistics are prepared and the time it takes to publish the survey in five languages, number 6/65 of the "Graphs and Notes on the Economic Situation in the Community" can usefully complete the information supplied here.

I. THE OVERALL SITUATION

In the Community as a whole economic expansion continued in the first quarter of 1965 and in the following months.

The adjusted trend of external demand was nearly as lively as in the last quarter of 1964. In the first quarter the year-to-year growth rate of the Community's goods exports to non-member countries was no less than 12 % in value (according to external trade statistics), although certain special factors, like the dockers' strikes in the United States and in Antwerp and expectation of a cut in the United Kingdom import surcharge at the end of April tended to slow activity down for a time.

The underlying trend of internal demand in monetary terms also remained decidedly expansive; the actual growth rate may have shrunk a little, however, largely owing to faltering investment in stocks.

Gross fixed asset formation probably continued to increase, in general, at much the same rate. This was the case for investment in plant and equipment, the adjusted growth rate of which remained relatively moderate: demand from private enterprises remained weak in Italy and in France and there were signs that expansion of spending under this heading was slowing down in Belgium and, to a lesser extent, in the Netherlands; this meant that the effects of the trend in the Federal Republic of Germany,

where the upswing was, if anything, more pronounced, were offset in the Community taken as a whole.

Except in Italy, where the advance of housing construction was again slow, the underlying trend of investment expenditure on building again showed fairly brisk expansion. However, bad weather depressed the unadjusted figures for a time.

Mainly by reason of a substantial growth in mass incomes, consumption expenditure again expanded appreciably: the increase was relatively slow in France, more substantial in Italy and considerable in the Netherlands, in Germany and in the Belgo-Luxembourg Economic Union, where, however, the rate of growth may have declined slightly.

The underlying expansion of internal supply continued at a moderate rate until the spring of 1965. According to the index of the Statistical Office of the European Communities, adjusted for seasonal and random variations, industrial production grew between the fourth quarter of 1964 and the first quarter of 1965 by a bare 1 %. The fact that the unadjusted index showed a first-quarter year-to-year increase of only 3 % was mainly due to exceptional factors, such as differences in weather conditions and in the number of working days.

In France the slight decline in industrial production seems to have halted, and the recovery continued in Italy. In the Netherlands there was no change in the trend. The expansion of production (adjusted) lost a little momentum in Germany, owing to a decline in the elasticity of supply, but the slowdown was more marked in the Belgo-Luxembourg Economic Union, where it was determined by the trend of demand.

Strains on the labour market again eased slightly in France, and signs of easier conditions were also observed in Belgium and, to a much lesser extent, in the Netherlands. Although the number of unemployed was again a little larger in Italy, there were other signs which pointed to stability on the Italian labour market, such as the fact that in several industries working hours lengthened again. Although there was a further slight improvement in the Netherlands, the shortage of labour remained severe, while the situation again deteriorated in Germany.

In contrast with exports the upward trend of imports (adjusted) again slowed down, mainly because of the greater reluctance of enterprises to acquire fresh stocks of imported raw materials and semi-finished products. However, if customs returns show a first-quarter year-to-year growth rate in Community imports of goods from non-member countries of only 1 % (value) this is chiefly due to exceptional factors, such as the dock strikes, which hampered imports more than exports.

The trade balance (based on customs returns) closed in the first quarter with the deficit of 336 million units of account ⁽¹⁾, i.e., only about a third of a deficit at the same period of the previous year. The overall balance of payments probably yielded a surplus, though a smaller one than that for the previous quarter; net imports of capital continued, but were probably less substantial than in the preceding quarter.

The adjusted trend of intra-Community trade continued upwards in the early months of 1965. According to customs returns (imports) the year-to-year growth in intra-Community visible trade was 10 % in value for the first quarter. Particularly noteworthy was a big jump in German imports; this country's year-to-year increase in visible imports from the other five was about 40 %.

Although intra-Community trade tended to iron out differences in pressure of demand, the cyclical upward tendency of prices continued at a slightly faster rate in Germany. In the Netherlands, cyclical strain put an end to the price stability that had reigned for some time. On the other hand, the weakening of underlying factors forcing prices up was again more pronounced in France, Italy and, to a lesser extent, Belgium. But the price trend was also affected by autonomous factors, such as the delayed revision of public service charges and decisions in the field of agricultural policy. In addition, the exceptionally poor weather meant dearer vegetables, potatoes and fruit. The result, particularly in the Benelux countries, was a spurt in the upward movement of consumer prices in the second quarter of 1965.

Economic expansion will in all likelihood continue unabated in the Community until the end of the year.

It seems probable that exports to non-member countries will continue to grow vigorously, all the more since the prospects for the development of demand from industrial countries are quite favourable. Internal demand may also be expected to increase appreciably. Gross fixed asset formation may, on the whole, expand slightly faster, but investment in stocks could well remain weak for a time. Private consumers' expenditure, too, will certainly increase appreciably, above all in the Netherlands and Germany, where disposable incomes should increase sharply, and a notable increase is again to be expected in Italy and France.

The growth of internal supply should continue; agricultural output however is unlikely to increase as much as in 1964. The expansion of industrial production will probably continue at a modest, but perhaps slightly higher, rate. The recovery of industrial production should gather momentum in Italy, and in France also it may

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

expand again in the second half of the year. In Germany, on the other hand, supply is losing elasticity and this seems to be depressing the growth rate a little.

In view of the foreseeable trends of internal supply and demand, there will probably be only a modest growth in imports from non-member countries. This means that the improvement in the Community's trade balance should continue.

Prices may well move up further, but at a slower rate in most member countries than at the same period of last year. In Germany, and particularly in the Netherlands, both demand and costs are likely to continue to force prices up to an appreciable extent, but elsewhere the outlook is that trends will be relatively more stable. However, autonomous or structural price increases are liable once again to exert upward pressure on consumer prices.

All in all, the economic trends recorded so far in 1965 and the current outlook until the end of the year confirm the quantitative forecasts for the full year given in the last Quarterly Survey. The growth of the real gross Community product could be about 4 %.

According to initial forecasts for 1966, which are of course highly tentative, economic expansion in the Community as a whole may actually gather a little momentum. This would be mainly due to a stronger expansion of internal demand, with economic growth more harmonious in the main than in 1964 and 1965. The danger of tendencies towards imbalance in prices and costs cannot, however, be ruled out.

The outlook in this respect could be distinctly improved if short-term economic policy were brought completely into line with the EEC Council of Ministers' recommendation of 8 April 1965.

A. Recent developments

1. Demand

In the first quarter of 1965 overall demand in the Community again expanded appreciably, and the incomplete statistics at present available suggest that this trend continued in the spring months as well.

The underlying growth of external demand (i.e. actual Community exports of goods and services to non-member countries) seems to have been scarcely less vigorous than it was between the third and fourth quarters of 1964. This is true at any rate of visible exports, the upward trend of which, adjusted for seasonal and random variations, reveals virtually no substantial slowdown.

According to external trade statistics, the value of goods exported was up by about 12 % in the first quarter of 1965 on the corresponding figure for 1964, despite exceptional factors temporarily affecting exports, such as the dock strikes in the United States and in Antwerp, and despite the smaller number of working days in the first quarter of 1965. Many exports to the United Kingdom, too, were delayed pending the promised cut in the import surcharge from 15 to 10 % at the end of April.

Demand from most of the industrial countries, buoyed up by the booming business conditions which they enjoyed practically continuously, remained expansive.

This was particularly true of the United States, where the slowdown in the last few months of 1964, which was largely due to fortuitous factors, was followed by a further spurt of economic expansion. Seasonally adjusted, the United States' real gross national product increased between the fourth quarter of 1964 and the first quarter of 1965 by 1.7 % and the year-to-year growth rate was 4.7 %. It is true that exceptional circumstances, resulting partly from negative factors which slowed down activity in the fourth quarter of last year, contributed to this trend : these were mainly the boom in the output of motor-cars after a strike in this industry and the accumulation of stocks of steel products by manufacturers because of a threatened strike in the steel industry. But there was vigorous expansion over the whole field of domestic demand. The increase of private consumers' expenditure was even higher than that of disposable income, although the latter expanded rapidly, and fixed investment by enterprises again advanced distinctly. In the first quarter, the year-to-year increase in exports of goods from the Community to the United States was 11.5 % in value.

Incomplete information at present available suggests that in the second quarter the economic trend in the United States was again less expansive than in the first. The

real gross national product probably increased by only 0.5 %. However, it is unlikely that after the end of the dock strike, imports from the Community expanded more slowly than in the first quarter.

Between the fourth quarter of 1964 and the first quarter of 1965 the adjusted growth of Community exports to EFTA too was quite substantial. In January/March the year-to-year increase in visible exports from the Community to the area as a whole was 10 % in value, although the United Kingdom actually imported 4.5 % less than a year previously.

Visible exports to non-member countries ⁽¹⁾

(% change in values on preceding year)

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

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

It is true that in the United Kingdom the expansion of domestic demand remained rapid in the early months of 1965. Thanks to the fuller utilization of technical production capacity and of available manpower—unemployment reached its lowest level for nearly

four years—domestic output made considerable progress. It failed, however, to keep up with demand, and since in addition purchases abroad were hampered by the import surcharge, the upward movement of prices, and to a growing extent, costs, gathered momentum. This of course gave a strong incentive to import. That imports from EEC none the less slumped is mainly due to the effect of the Government's announcement that the surcharge would be reduced at the end of April. It is quite possible that the converse effects were felt in the second quarter and that the flow of imports again speeded up; the decline in Community exports to the United Kingdom should therefore at least have slowed down.

The tendency for the foreign exchange reserves of the developing countries to shrink has not yet affected Community exports to these countries as a whole. Only exports to the associated overseas countries and territories were sluggish.

The adjusted trend of internal demand (i.e. actual expenditure on goods and services) remained relatively vigorous in recent months. This applies in particular to gross fixed asset formation, which has gone on expanding at much the same rate as towards the end of 1964.

It is true that construction was temporarily slowed down in most of the member countries by unusually bad weather; but here, too, the basic trends remain largely unchanged: expenditure on housing again rose rapidly in France and in the Netherlands but more slowly in Germany—where the level is, however, very high—and in Belgium, and it remained sluggish in Italy. Industrial and commercial building expanded in Germany and the Netherlands and showed signs of recovery in Italy; expansion slowed down, however, in Belgium, and the same was true in France in the private sector. The trend of public investment—which is also, for the most part, construction investment—remained expansive in Germany and France, and a more vigorous upward movement seems to have begun in Italy. On the other hand there was a decline in Belgium and Luxembourg and some weakening of the rate of expansion in the Netherlands, mainly because of measures to curb the growth of public expenditure adopted in 1963 and 1964 as part of the stabilization drive.

Investment on plant and equipment also continued to expand for the Community taken as a whole, but trends varied from country to country. In Germany, it would seem that the progress of this category of investment, which was already very rapid, gained even more momentum. In France, the situation does not seem to have changed appreciably since the previous quarter; investment by public undertakings remained noticeably expansive, but the propensity to invest does not seem to have increased to any appreciable extent in the private sector. Again no distinct recovery of actual investment expenditure by enterprises was discernible in Italy, although the psychological climate seems to have improved there since the latest Government measures to boost investment.

In the Netherlands and in Belgium on the other hand, the expansion of investment by enterprises tended to slacken, and in Luxembourg purchases of capital goods probably actually declined.

Generally speaking, investment in stocks has failed to stimulate the economy to any substantial extent in recent months. In fact, the trend as regards raw materials was quite weak.

Consumption expenditure was again partly expansive. In the first place, public consumption was already expanding in general fairly vigorously at the turn of the year. In the second place, the adjusted growth of private consumers' expenditure in the Community as a whole was scarcely less vigorous than in the fourth quarter of the previous year. It gathered momentum in Germany and remained rapid in the Netherlands and Belgium, though not quite as rapid as in the fourth quarter of 1964; in France its rate of expansion—admittedly very slow—changed only slightly. In Italy, where private consumers' expenditure had hardly advanced at all in the fourth quarter, there are signs of a slight improvement.

The development of private consumption was mainly determined by the disposable income of households—and under this head once again by the trend of total wages and salaries. However, changes in the saving ratio of households also played a part, particularly in Germany, where the ratio again increased slightly, in France, and especially in Italy, where it declined a little.

In Germany, disposable income itself expanded appreciably when income tax was cut on 1 January last. In addition, the underlying upward push of gross wages and salaries, and even more an increase of actual gross earnings, continued at an accelerated pace. In the Netherlands, too, wages increased fairly appreciably, mainly because of the general wage agreement between management and labour concluded last autumn; on average the increases granted even exceeded the agreed limits. In Italy it is true that the average increase in negotiated minimum wages (including family allowances) slowed down in industry, agriculture, commerce and the transport sector. But the shortening of the average working week seems to have stopped, and hours worked may even have increased a little again. Generally speaking, it is likely that total wages and salaries increased a little faster. In France wages continued to rise at the slower underlying rate recorded since the middle of 1964 and the downward trend in total hours worked tended to level out. In Belgium some loss of pace in the sharp upward movement of wages and salaries in the private sector was observed. In this country, as in Italy, there has been some damping effect because the sliding wage scale has come less into operation owing to the slowdown in the upward movement of consumer prices. The growth of transfer incomes continued in all the member countries; it was particularly large in the Netherlands and in the Federal Republic of Germany.

The underlying expansion of consumption in the first quarter was bound up with a modest recovery in the growth of purchases of durable consumer goods, sales of which had been weak towards the end of 1964. The demand for new private cars was expansive in the Netherlands, but less so in Belgium and Germany, while in France, and especially in Italy, there were signs that lost ground was being made up. Demand for electrical appliances also seems to have flickered up in the latter country.

2. Production

In the first quarter, and probably also in the spring months, internal supply adjusted for seasonal and random variations advanced at virtually the same modest rate as previously.

By and large agricultural production continued to expand. True, available data suggest that crops suffered from the rather unfavourable spring weather in certain member countries. But livestock production, in general, made further appreciable progress, though output of beef and veal was low and lagged behind demand.

The underlying growth of industrial production continued at the rather slow pace noted since the middle of last year. The seasonally adjusted index of the Statistical Office of the European Communities (excluding construction and the food, beverage and tobacco industries) increased by a little less than 1 % between the fourth quarter of 1964 and the first quarter of 1965; this is nearly the same increase as for each of the last two quarters of the preceding year.

For the first quarter of 1965 the gross index was running only 3 % ahead of the figure recorded a year previously. It must, however, be remembered that the index was temporarily depressed by exceptional factors, such as the weather, which had been much less favourable than the previous year, and by a difference in the number of working days in the two quarters.

In the various member countries the adjusted trends of industrial production varied little from those recorded between the third and fourth quarter of 1964. In Germany and the Netherlands, expansion continued, broadly speaking, at the same rate. In Italy, the recovery which began in the previous quarter was confirmed, but did not gain any particular vigour. In France, the slight decline in the adjusted trend ceased. By contrast, the growth rate again weakened slightly in Belgium, and the adjusted trend in Luxembourg, which had been moving upwards, seems to have practically levelled out.

As for the pattern of industrial output, a noteworthy development was a further cut-back in the amount of coal mined in the Community during the first quarter; the year-to-year comparison showed a decline of 3 %, although pithead stocks were increased to 22 million metric tons by the end of April, compared with 15 million a year previously. Iron and steel production was also more hesitant at the beginning of the second quarter, mainly, it would seem, because of the slowdown of new orders from non-member countries, notably the United States, once the danger of a steelworkers' strike had been averted at least for the months immediately ahead. But in the other basic industries, e.g. chemicals and building materials, there was no weakening of expansion.

Capital goods production continued to grow at a slightly slower rate. Towards the end of the first quarter, output of commercial vehicles was showing signs of recovery, particularly in Italy.

The growth of consumer goods production remained steady but unspectacular. However, output of motor-cars seemed to be gathering momentum, particularly in the second quarter. The main reason for this was a notable improvement in the trend of orders in Italy, and to a lesser extent in France. In the first quarter, the production of passenger and estate cars was still running 3 % below the level in the first quarter of 1964, since the incipient recovery in these two countries meant at first only a run-down of the very large stocks.

In building and construction, the underlying expansionary trend remained quite strong. This applies particularly to new housing in France, the Netherlands and, to a lesser degree, Germany. In Italy on the other hand it would seem that the adjusted trend of activity in this industry was still clearly declining. The total number of dwellings completed in the Community in the first quarter of 1965 was 4 % up on that recorded at the same period a year previously. As for industrial and commercial building, there were scarcely any changes in the individual countries in the trends recorded, most of which have already been mentioned when discussing demand. One point of interest, however, is that there were signs of a recovery in this sector in Italy. Civil engineering production was fairly brisk in France, grew again in Italy and was relatively weak in Germany and—probably only temporarily—in the Netherlands. In Belgium and Luxembourg signs of a downward trend were noted.

By and large, the expansion of services has tended to lose momentum. Hesitant expansion in a number of basic industries meant a corresponding loss of growth momentum in freight transport by rail. By contrast, the expansion of commercial activity may well have speeded up a little in some member countries: there would seem to have been a modest recovery in this field in Italy and, of late, in France as well.

For the Community as a whole the number of persons in paid employment increased only slightly in the first quarter. The reasons for this are the persistence of serious

manpower shortage in those countries where economic expansion has remained vigorous and the relative weakness of demand for manpower in the countries where business is quieter. The adjusted trend of unemployment reflected this pattern: the number of unemployed again increased slightly in France and in Italy. To a certain extent signs of easing of strain also emerged in Belgium and—less perceptibly—in the Netherlands, where the labour market in general remained very severely strained. In Germany, unemployment figures continued unchanged at a very low rate. It would also seem that the decline in the number of hours worked in Italy has now been arrested: in certain industries an increase in the actual number of hours even became noticeable there.

3. The balance of the markets

The underlying growth of imports of goods and services from the non-member countries probably lost a little more momentum. This was certainly true of visible imports (customs returns) whose seasonally adjusted value was lower in the March quarter than in the fourth quarter of 1964. True, certain exceptional factors, such as the strikes in the American ports and in Antwerp and the number of working days, played a part here. The year-to-year growth rate, which was still running at 7 % in the fourth quarter, fell to 1 %. However, in terms of volume, that is taking into account the decline in import prices since the first quarter of 1964, it was probably somewhat higher (about 3 %).

The main reason why imports grew more slowly was the reluctance of enterprises to add to their stocks of imported raw materials and semi-manufactures. However, the easing of domestic inflationary pressure and slower economic in some Community countries were contributory factors.

In this way, purchases outside the Community by France and the Benelux countries declined in the first quarter of 1965. This more than offset the still fairly rapid progress of German imports and the—rather sluggish—recovery of import demand in Italy.

Community imports from the industrial countries were down 2 % in the first quarter on the same figure for the preceding year: there was an appreciable decline in purchases from the United States, due especially to the strikes mentioned, while those from the United Kingdom were relatively weak, partly owing to the increased pressure of domestic demand in that country. Community imports from the other EFTA countries were more expansive in general, but those from the developing countries marked time: their year-to-year increase (value) was only 4 % in the first quarter, after appreciably higher growth rates in 1964. A quite pronounced feature of trade with the associated overseas countries and territories was the slowdown in purchases of raw materials.

Visible imports from non-member countries ⁽¹⁾

(% change in values on preceding year)

Imports from	1964	1964				1965
		1st quarter	2nd quarter	3rd quarter	4th quarter	1st quarter
United States	+ 7.5	+ 14	+ 4.5	+ 5.5	+ 7.5	- 8
EFTA	+ 7	+ 14	+ 8	+ 1	+ 5.5	+ 3.5
including :						
United Kingdom	+ 5.5	+ 14	+ 9	- 2	+ 2	- 1.5
Developing countries	+ 11.5	+ 16	+ 16	+ 5.5	+ 9.5	+ 4
including :						
Associated overseas countries and territories	+ 8	+ 6	+ 18	+ 5	+ 3.5	- 4
Total non-member countries	+ 9	+ 16	+ 10	+ 4	+ 7	+ 1

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

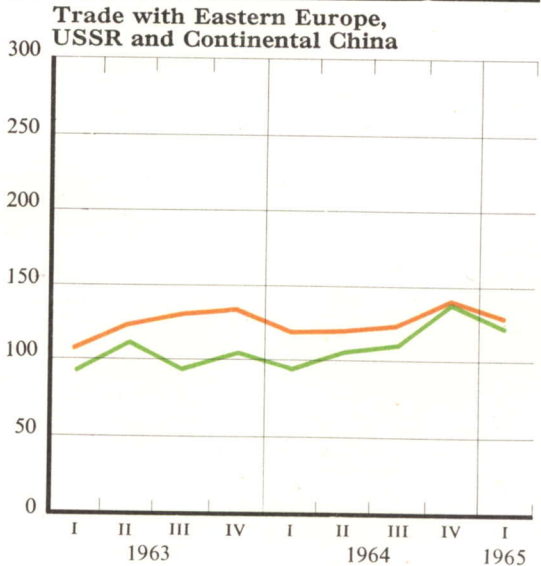
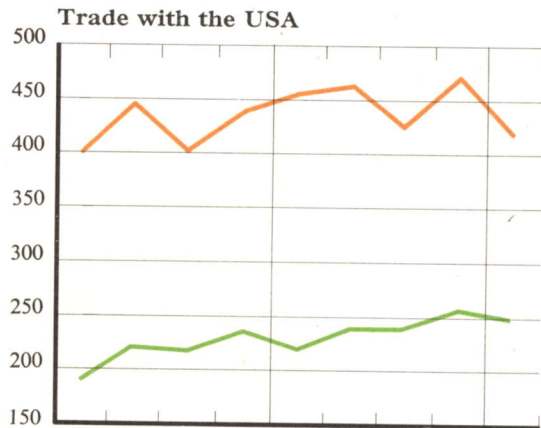
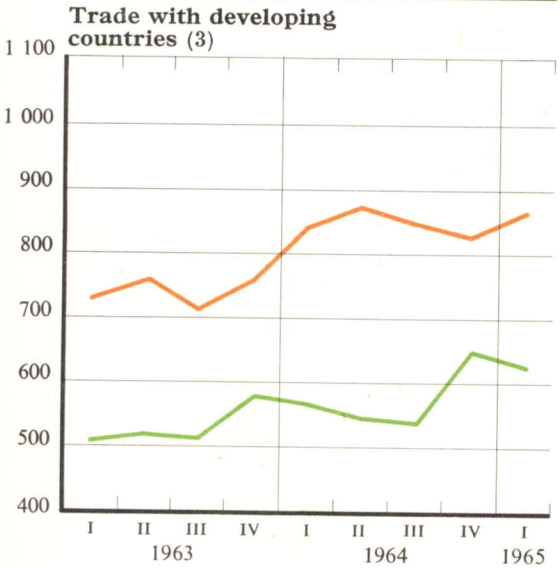
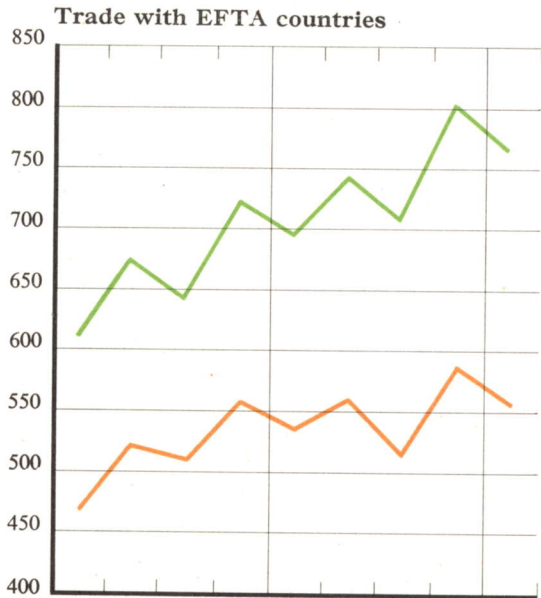
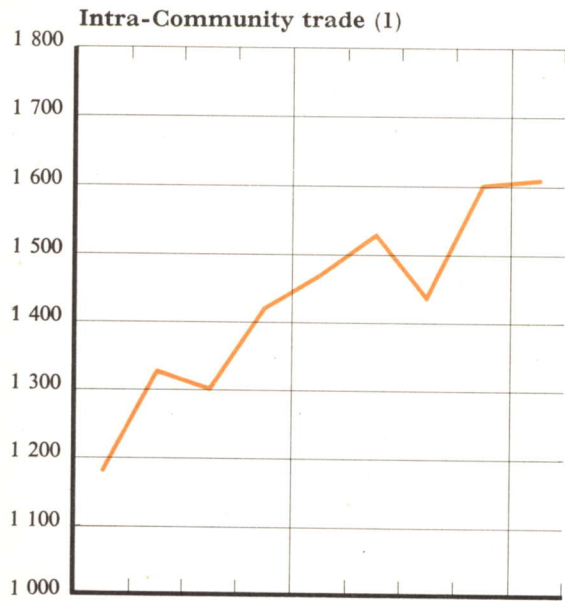
The underlying expansion of trade between the member countries continued in the early months of 1965. Measured on the basis of customs returns (imports, value), the seasonally adjusted increase in visible trade between these countries and again between the fourth quarter of 1964 and the first quarter of 1965 was 1.5 %. Compared with the first quarter of 1964 the rate of growth was 9 %.

Imports by Germany were the main growth factor. They had already gathered considerably momentum in the fourth quarter of 1964 and continued to forge ahead in the first quarter of 1965, when they were running as much as 40 % above the corresponding 1964 figure. On the other hand, imports of the other member countries from the Community hardly increased at all. In the case of France they remained at the level reached in the spring of 1964; in Benelux, chiefly because of a weakening of the expansion of demand for capital goods, they made no appreciable progress from the fourth to the first quarter. The underlying recovery of Italian imports from the Community was still relatively weak in the first quarter.

COMMUNITY TRADE

Monthly averages

In millions of U.A.*



— Exports

— Imports

(1) According to import returns.

(2) A.O.S. : Associated Overseas States (overseas departments, countries and territories).

(3) According to GATT classification : non-industrialized regions other than A.O.S.

* 1 U.A. = 0.888671 gramme of fine gold.

The very brisk expansion of German imports was reflected in a noteworthy development of the exports of the other member countries. In particular, French sales to Germany rose sharply. Benelux exports to Italy expanded appreciably.

As for the trade balances of each member country vis-à-vis the rest of the Community, there was a further decline in the German surpluses, due to the considerable development of imports; the returns, corrected for seasonal variations, might even show a slight deficit. As against this, the Netherlands and, particularly, the French deficits continued to contract appreciably. Italy's visible trade with the other member countries again yielded an appreciable surplus. The trade balance of B.L.E.U. with the rest of the Community also showed a further substantial excess of exports over imports.

Apart from seasonal and fortuitous variations, the price trend again quietened down in most member countries. In Italy and Belgium prices rose more slowly. The upward movement of the cost-of-living index also slackened a little in Luxembourg, although this was probably due in part to more stringent price controls. On the other hand consumer prices in the Netherlands, after remaining stable for several months, again rose appreciably and there were new price increases in France. In Germany the general upward movement continued at a slightly more rapid pace.

Mainly owing to the trend of demand, prices of manufactures remained practically stable, save in Germany and the Netherlands. The decline in the prices of a number of imported raw materials and semi-finished products, noted in the second half of 1964, again helped to hold down costs in all member countries. The recovery of production, the consequent improvement of productivity and the slowdown in the upward movement of wages probably combined to ease the pressure of wage costs in Italy. In France and in Belgium the improvement of productivity was only very slight, and the impact of the slower rise in wages on the trend of unit costs was therefore not so marked. In Germany the growth of productivity tended to lose momentum while wage costs rose faster. In the Netherlands too, wage increases were more substantial in the first quarter of 1965 than at the end of 1964.

Prices for services, which react fairly strongly to the upward movement of wage costs, though often only after a certain time-lag, again rose appreciably in the first quarter of 1965. Adjustments to controlled rents and, in several member countries, alignments, to conform with the price trend, of charges for public supply and transport services played a part here.

Apart from seasonal and fortuitous variations, producer prices in agriculture remained practically unchanged until March. The upward movement in the prices of crop products did not exceed the normal seasonal proportions. At the same time, prices

of animal products declined slightly, with a constant steady trend of cattle prices in particular contrasting with a decline in pig prices.

From April onwards, however, the prices of fruit and vegetables rose in most member countries because of the cold and damp weather in the spring. Potatoes from the 1964 crop were poorer in quality and quantity than those of the 1963 crop, but they were dearer. These factors, to which must be added fresh increases in the price of beef, lent force to the upward movement of the consumer price index in the Benelux countries.

In April the year-to-year, increase in consumer prices was 2.6 % in France and Germany, 2.7 % in Luxembourg, 3.4 % in the Netherlands, 4.1 % in Belgium and 5.5 % in Italy.

In view of these export and import trends, the deterioration of the Community's visible trade balance between the fourth quarter of 1964 and the first quarter of 1965 remained well within the limits of what is usual for this time of the year. According to customs returns, the deficit was 336 million units of account; this amount is only a third of that recorded a year earlier, when the Community was admittedly beset by particularly severe imbalances. The situation therefore probably helped to improve the Community's current account. In addition, there were again heavy net inflows of capital. However, since these were distinctly smaller than in the preceding quarter, the surplus on overall payments probably declined a little between the fourth quarter of 1964 and the first quarter of 1965. There was a very substantial improvement in the net foreign exchange position of the commercial banks, mainly because of the end-of-year "window dressing" for their balances, which usually involves a deterioration in the early months of the year and a swing in the other direction immediately afterwards. The member countries' official gold and foreign currency reserves increased by only 100 million units of account in the first quarter of 1965.

Thus, in the first quarter, balance-of-payments trends had a somewhat less expansive impact on internal liquidity in the Community than in the preceding quarter. In most member countries, it was the surpluses on current account which contributed to an increase in domestic liquidity; Germany was the exception : here liquidity increased almost solely because of an influx of long-term investment capital. In the early months of the year the cash transactions of public authorities in several member countries had a less expansive impact than in the fourth quarter of 1964. One reason for this was the seasonal rhythm of disbursements, with tax revenues continuing to increase at a high rate. Contrasting with a deficit at the same period of 1964, there was a Treasury surplus in France, and public cash transactions had a contracting effect on liquidity, as they did in Germany and in the Netherlands also. In the last country, issues of Treasury bills in

excess of financing needs were a special contributing factor to this trend. In Italy on the other hand, public disbursements were stepped up in order to maintain economic activity, and in Belgium the Government expedited its payments, particularly current spending. In both these countries public cash transactions tended more or less to swell domestic liquidity.

Bank liquidity has declined in Germany, and of late also in the Netherlands, because market factors (increase of note and coin circulation, etc.) led in general to a drain on liquidity which was financed by recourse to reserves. In addition, the monetary authorities in both countries encouraged the export of funds by the banks. Thus, interest rates tended in the main to rise on the money markets of these two countries. The business boom was a spur to the expansion of bank credit to industry, which remained very brisk in Germany and forged ahead again after a short lull in the Netherlands. In Germany a probable additional factor stimulating the demand for credit was that the slump in security prices in the first four months of the year made financing through the capital market more difficult.

In the other member countries on the other hand, bank liquidity increased especially because of balance-of-payments surplus or the cash transactions of the public authorities. In Italy the persisting weakness of demand for loans by enterprises enabled the banks further to cut back their indebtedness vis-à-vis the Central Bank and to abroad. This was also true to some extent in France and Belgium. In France the underlying expansion of demand for loans has lost some momentum. But the greater abundance of funds on the capital markets also played a role here. Enterprises thus enjoyed favourable conditions in which to consolidate their short-term debts. The actual increase in bank lending in France remained within the limits fixed by the monetary authorities.

In the early months of the year there were signs of certain changes of trend in the capital markets of some member countries. In Germany the heavy demand for capital by public authorities, the net outflow of foreign capital due to the new withholding tax on bonds held by non-residents ("Couponsteuer") and the unwillingness of domestic investors to place new funds pending an increase in interest rates, all combined to depress German bond market prices appreciably in the spring. Issuing establishments are now under pressure to raise par interest rates to the 7 % prevailing on the market. In the Netherlands the considerable influx—up to mid-March—of foreign capital in search of employment led to a further decline in interest rates. On the bond market, however, this trend gave way to an upward movement, the more so as extra public spending to be financed from the capital market is expected in addition to increased demand for funds from trade and industry. In Belgium, too, the slight downward trends of interest rates ceased in the spring, and in Italy they became markedly slower. In France funds were raised on the bond market in very large quantities with no material change in interest trends.

Stock market prices stopped falling in France at the end of March, i.e., when the Government laid before Parliament its proposal for a reform of corporation tax. The at first quite lively recovery of stock exchange quotations was not maintained. However, the markets—buoyed up by the more favourable economic outlook—proved much more resilient than they had been in January and February. In Germany, on the other hand, share prices tended to be weak, despite current expansion and good growth prospects; this may have been partly due to the heavy increase in interest rates on bonds. In the other member countries the trend showed little change.

Supply and utilization of goods and services (1)

	1962	1963	1964 (3)	1965 (4)
	At current prices (in '000 million u. a. (2))	% change by volume on preceding year		
Gross Community product	226.7	+ 3.9	+ 5.5	+ 4
Private consumption	138.1	+ 5.5	+ 4.4	+ 4.5
Public current expenditure	32.4	+ 5.7	+ 1.9	+ 4
Gross fixed asset formation	51.8	+ 3.9	+ 6.7	+ 4
Balance exports (5) less imports (5) (in \$ '000 million, current prices)	+ 1.6	+ 0.5	+ 1.3	+ 1.8

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

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

(3) Commission estimates.

(4) Commission forecasts.

(5) Goods, services and factor income.

B. Outlook

The prospects for the Community's economic development between now and the end of the year were outlined in the last Quarterly Survey and have not changed to any material extent since. The only point of significance is that the expansion of demand, and consequently of production, will prove a little greater than was originally expected. The main reason for this is the improvement in Italy: measures to inject new life into the economy ("super decree") were adopted in Italy towards the end of the first quarter. These will bear some fruit in 1965 and they have also changed the general picture in the Community. External demand, too, i.e. actual exports of goods and services of the Community to non-member countries, could well prove a little more dynamic than was to be expected three months ago.

This view is supported, in the first place, by a change in the outlook in the United States, where the slowdown of economic growth in the second six months still generally expected at the beginning of the year is now thought likely to be less pronounced. It is true that the trend of stockbuilding could retard expansion, particularly if a final settlement replaced the provisional steelworkers' agreement due to lapse in August. As against this there are important factors working for expansion. For example, the latest industrial surveys and the profit boom in industry in the early months of 1965 point to a continuing strong increase in investment by firms. Nor is private consumers' expenditure likely to lose momentum; in any case, the wage increases planned or already approved in a number of leading industries, the increase in the number of persons in paid employment, the greater number of hours worked per week the planned reduction of indirect taxes and improved social benefits are all factors suggesting that mass incomes will continue to swell in the United States. Lastly, defence expenditure having exceeded expectations public consumption expenditure might also make a rather more vigorous contribution to economic activity. This expansion of domestic demand, which will be considerable in the aggregate, will lead not only to a further and vigorous rise in production—though perhaps at a slightly slower rate than in the early months of the year—but it will also stimulate imports.

In the United Kingdom, the expansion of domestic demand could well slow down a little in the second half of the year: the main reason is to be found in the measures of monetary and credit policy adopted at the end of the autumn and recently made more effective; these could well contribute to the slowdown in the growth of the investment of private enterprises towards the end of the year, which in any case is to be expected for cyclical reasons. In addition, certain indirect taxes have been raised to a marked extent. On the other hand, however, the expansion of wages would seem, if anything, to be gathering speed, at least for the time being. In view of the extremely low unemployment rate, the arrangement on incomes policy between the central workers' organizations and

the Government gearing wages to productivity is unlikely, in fact, to produce results in the coming months. In this respect, it must also be stressed that the attainment of the incomes policy objectives is hardly facilitated by the recent price increases, some of them due to the barrier to import competition created by the import surcharge. The incomes of households are likely therefore to continue rising rapidly. In addition, the new budget, seen as a whole, will have a scarcely less expansive impact on domestic economic activity than last year's, unless certain changes are made, for example with regard to Treasury transactions. Public investment—and not only by the Government but also by the subordinate local authorities—and also investment by public undertakings and transfer expenditure, seem particularly expansive. In these circumstances, demand for imports may very well be less depressed than was initially supposed. Moreover, the more domestic wages and prices rise the less effective the surcharge will be. As long as no firm date has been given for the abolition (or further reduction) of this surcharge, the possibility of a further “announcement effect” slowing down imports as in the first quarter is moreover ruled out.

No substantial change has occurred to affect the comments made in the last two Quarterly Surveys with regard to the outlook for economic activity and import demand in the other EFTA member states, the remaining industrialized countries and the developing countries.

Among the factors on the supply side which affect the development of Community exports—competitiveness, the reaction of the supply of exports to changes in the domestic demand/production ratio—new developments since the last forecasts have also been few. There is still reason to expect that these factors will curb the expansion of exports, notably Netherlands and German exports, to some extent.

The expansion of internal demand could well gather a little momentum.

This would seem especially true of investment expenditure (gross fixed asset formation). In Italy, in view of the short-term economic policy measures adopted, there is every reason to expect the growth rate of public investment to speed up. In Germany and in France the progress of this type of expenditure remains quite rapid. However, it seems unlikely that either the measures of relaxation adopted in Belgium or the new policy in this field in the Netherlands can lead to any appreciably more expansive trend before the end of 1965.

Expenditure on housing will probably continue to increase quite appreciably in France, the Netherlands and—to a lesser extent—Germany. For Italy a recovery in

the expansion of actual expenditure in this field is to be expected but not before the end of the year.

In the second half of the year, investment spending by private enterprises will probably stage a slight recovery in Italy and perhaps also in France. On the other hand, its growth is likely to slow down to some extent in the Netherlands and in Belgium. In Germany the investment boom appears to have lost only a little momentum.

It is thought unlikely that the decline of capital inflows into the Community following the recent action on payments balances by the United States authorities will appreciably impair investment or general economic activity in the Community. In two member countries—Germany and the Netherlands—the only effect on domestic economic activity of a decline in the net capital inflow will be to dry up some surplus inflationary demand; moreover, credit policy is growing more effective in these countries, and can now make a more substantial contribution to slowing down the expansion of demand. Accordingly these two member countries have already adopted more or less effective measures of their own to curb a part at least of the influx of capital before the new programme to re-establish the United States balance of payments on a sound footing is launched. The problem is rather different in France and particularly in Italy: investment demand by private enterprises in these countries is still developing more or less hesitantly, at the very time when a feature of domestic business activity in Italy is the under-utilization of production factors. But in France in any case—and in Belgium too—it would seem that credit policy and action on the monetary and capital markets will suffice to offset—from local resources and to the extent required by economic policy objectives—any shortfall of foreign investment and loan capital which could result from the action of the United States authorities. This will perhaps be a little more difficult in Italy, where there is a special shortage long-term risk capital for enterprises. But in this country too, given the abundance of domestic liquidity and the Issue bank's credit expansion policy, there is no reason why domestic credit should not take the place of American bank loans, whether in the form of direct or indirect credits to American enterprises operating in Italy or of funds borrowed on the Eurodollar market by Italian enterprises. As for long-term capital, one solution would be to offset the decline in the inflow from abroad by further action on the capital market to channel more liquid saving into long-term employment. A second and certainly appropriate solution would be to step up the inflow of capital into Italy from other Community countries.

In the Community as a whole, private consumers' expenditure will also continue to grow quite strongly in the second half of 1965. In Germany, with speedier wage increases, tax cuts and improvements in transfer payments in train or completed, it is expected to continue at a faster pace. More rapid expansion is also expected in the Netherlands, the more so since direct taxes there will be appreciably reduced at mid-year

and wages will again increase. In Italy a more pronounced spurt in the growth of private consumers' expenditure is to be reckoned with because of the recovery in business activity now believed to be on the way. Consumption will probably also gradually gather momentum in France. Only in the Belgo-Luxembourg Economic Union is the development of this growth component likely to slow down.

In view of these demand trends, the growth of domestic supply—i.e. the production of goods and services—will probably also be a little faster than could have been expected.

However, agricultural output—less closely dependent on demand than industrial production—will probably be an exception to this general observation. Even if normal weather could be counted on—but spring was unusually cold and wet in most parts of the Community—the year-to-year growth rate of agricultural production would be certainly lower for 1965 than for 1964, since weather conditions in the latter year were specially propitious for most crops.

By contrast, industrial production might well grow a little more rapidly than could originally be expected. An important contribution to this trend should be the pronounced rate of expansion in Italy resulting from measures to stimulate a revival of activity. In the aggregate, however, the rate of growth of the Community's industrial production will remain fairly modest: in the first place the elasticity of production is declining somewhat in Germany, and possibly in the Netherlands also, despite heavy investment, because production factors are stretched to the full. In the second place, given the trend of demand, expansion is likely to be slower in Belgium, and in France the expected recovery may not occur until relatively late in the year.

It seems unlikely that the basic trends of imports of goods and services from non-member countries recorded in the first quarter and in the spring will change materially. Except in Italy, the development of visible imports will probably continue to suffer from the reluctance of enterprises to run up stocks of imported raw materials and semi-finished products. True, Italy's imports are likely to prove more markedly expansive, but those of France will in all probability react to the revival of domestic demand only with a certain time-lag.

Accordingly, the Community's visible trade balance should continue to improve in the second half of 1965 and this trend should be reflected in the current account figures, though these are as yet unlikely again to show heavy surpluses.

Upward price tendencies, due mainly to demand inflation, are still to be feared in Germany and in the Netherlands. This is all the more likely to entail a further upward

price push in these two countries as the increase in costs is gathering speed, or (in the Netherlands) is still fairly considerable. As against this, cyclical upward price trends may be expected to quieten down further in Italy and to remain weak in France. In the longer perspective a similar trend is emerging in Belgium and Luxembourg, although for the time being the direct post-inflationary upward thrust of costs is still quite strong in these two countries.

In addition, rents and the tariffs of public supply or transport enterprises are being adjusted upwards in line with the general price trend in all member countries, while, in some of these, prices of certain agricultural products will increase as a result of the alignments required by the common agricultural policy. Furthermore, in all the Community countries, but particularly in Italy, France and B.L.E.U., structural factors continue to force prices up, especially in commerce and in certain services industries.

All in all, developments since the beginning of the year and the prospects outlined above confirm the forecasts, given in the last Quarterly Survey, of the quantitative changes in the sources and utilization of goods and services for the full year 1965 compared with the preceding year. For the reasons mentioned it is possible that the real growth of the gross Community product may be a little more substantial than had been supposed when the last Survey was prepared (4 % instead of 3.5 %). The industrial production of the Six as defined for the Index of the Statistical Office of the European Communities (i.e. excluding construction and food, beverages and tobacco industries) could well increase by some 4.5 %.

As they did at the same period of last year for 1965, the Commission's staff have already established tentative forecasts of the Community's economic development in 1966. At the same time the member countries' experts submitted to the Commission the preliminary economic budgets for the same year. All these documents suggest that economic expansion in the coming year might speed up a little for the Community as a whole, mainly as a result of the livelier advance of internal demand.

On the other hand, world business may well be less vigorous than in 1965, and external demand will probably suffer in consequence. For one thing, there is great likelihood of economic expansion in the United States being slower: fixed investment there could lose vigour and the growth of capacity might now finally outstrip the expansion of production. Again, the incentive to investment and consumption provided by tax reductions in 1964 and 1965 will be largely a thing of the past. True, the Government plans to spur on demand again by further reliefs—this time of indirect taxes; but unless plans as known at present are changed, the stimulus provided in this way can hardly be as substantial as in 1964 and 1965. In addition, the rise in social security contributions decided on for the beginning of 1966 will tend to curtail the expansion of the dispo-

sable income of households. Lastly, the slowdown in the expansion of demand could well be aggravated to some extent by a greater reluctance of firms to build up stocks.

There is reason to believe that in the United Kingdom the weakening of economic activity will be more pronounced than in the United States, if the authorities wish to eliminate the balance-of-payments deficit in 1966 and also enable the international loans contracted during the payments crisis to be repaid over the coming years. On this assumption, the prospects for the growth of Community exports to this country are not particularly bright, even if the remaining 10 % of the import surcharge is again cut or completely abolished at the beginning or in the course of 1966. However, given the economic trends emerging and the general lines of the United Kingdom's economic policy, it is not absolutely certain that the assumptions made will in fact prove justified.

In most of the other EFTA member countries, as in the remaining industrial countries, development prospects seem more expansive, although not as expansive as for 1965. It is therefore prudent to expect some loss of momentum in the growth of Community exports to these countries.

As for the developing countries in general, they might well show increasing reticence with regard to imports from the Community. Their gold and foreign exchange reserves began to fall off in the second half of 1964. The general trend of commodity prices, the phase of the stocking cycle in which most of the industrial countries at present lie, and the fact that development aid seems still to be in the doldrums are all factors which are hardly conducive to any appreciable improvement in the near future in the foreign exchange holdings of the developing countries and, consequently, to any lively development of their imports.

In contrast with this probable trend of external demand, it is by no means impossible that the expansion of the Community's internal demand may gather a little momentum: the recovery of demand now under way in Italy and expected in France for the second half of the year will probably gain strength in 1966. With the present expansionary public budgetary policy, there might be some speed up of demand in the Netherlands. In Germany the factors making for expansion will almost certainly remain effective, although their impact will be less marked than in 1964 and 1965, since the contribution of investment and external demand will be less vigorous. As against this, it would seem that production elasticity will also have declined, so that the vigorous contribution to activity provided by German import demand should continue. This in turn could contribute to maintaining the upward trend in the other Community countries, notably Belgium.

A still very tentative initial estimate by the Commission is that the real gross Community product could increase by 4.5 % in 1966 as compared with 1965.

The prospects outlined above and those indicated in the second part of this Survey concerning the individual member countries suggest that, purely in terms of growth, the Community's economic development could again be more harmonious than in 1964 and so far in 1965. After a recessive period, the economy has begun to expand again in Italy, where appreciable growth rates could well be achieved next year. In France, too, economic growth will doubtless be at a more assured pace in 1966. At the same time, production is continuing to expand in the other Community countries. It is estimated that in all member countries, save perhaps Luxembourg, the gross national product will grow at a virtually uniform rate of 4 to 5 %; in the Netherlands an even higher rate is expected. In this process Italy and the Netherlands, where output per head is the lowest in absolute figures in the EEC, would again be up with the leaders.

But expansion is not the only criterion in matters of economic policy. The main problem is still to restore stable prices and production costs per unit of output and to consolidate stability once it has been regained.

This is quite clear from the EEC Council recommendation to the Member States of 14 April 1964 ⁽¹⁾ "for measures to be taken under Article 103 of the Treaty to restore the internal and external economic equilibrium of the Community" (Point 1 and particularly Point 2). In November 1964, the Council decided that this recommendation should also apply to all economic policy measures for 1965. On 8 April 1965, on a proposal from the Commission, it addressed to the Member States another recommendation "concerning the economic policy to be pursued until the end of 1965", the text of which is given as an annex to this Survey. The Commission's proposal had been discussed previously with the Short-term Economic Policy Committee, whose studies greatly facilitated the planning and drafting, and which endorsed it in an opinion of 25 March 1965 (also given in an annex to this Survey). The new Council recommendation extends until the end of 1965 points 1 to 9 of the recommendation of 14 April 1964 and consequently maintains the stabilization of prices and of costs as a priority goal.

But this does not mean that the objectives of satisfactory economic growth and an adequate level of employment should be neglected. That the Council reshuffles priorities in good time in response to changes in the situation is shown, for example, by its approval of a policy of restimulating domestic demand in Italy which exempts this country—and this country alone—from the 5 %-rule governing the permissible increment

⁽¹⁾ Published in an annex to Quarterly Survey No. 2-1964 as well as in the official gazette of the European Communities.

in public spending. Again, for France, Belgium and Luxembourg promotion of investment or some relaxation of the measures restricting it are envisaged if necessary.

Just as the recommendation of 14 April 1964 cannot be regarded as "deflationary", since its sole aim was to slow down and not to stop the expansion of demand, it is quite impossible to consider the recommendation of 8 April 1965 as absolutely restrictive. It is particularly concerned with questions of employment and the social problems inevitably bound up with stagnation or even recession.

However, this second recommendation also makes it clear that even in those member countries where economic expansion is now weak or there is stagnation the objective is not to restore a high rate of GNP growth at the earliest possible moment and at all costs, even at the risk of a further spurt in the upward movement of costs and prices. The stabilization of prices and costs is and remains the overriding objective of a short-term economic policy co-ordinated at Community level, and expansion should be stimulated only in so far as it is compatible with the attainment of this essential goal.

The prospects for economic development until the end of 1965 outlined above for the Community as a whole and in the other chapters of this Survey for the individual member countries, and the tentative forecasts for 1966, provide no reasons for departing from the general economic policy laid down for the Community in the recommendations. On the contrary, they corroborate the analysis on which the Council based its recommendation of 8 April 1965. They confirm the need for the Member States to bring their economic policies into line—in some cases, considerably more strictly than hitherto—with the Council's recommendations.

This applies especially to the Netherlands, where demand and cost trends and—in increasing measure—public expenditure policy constitute a threat to efforts to restore internal equilibrium. It is fairly certain that in 1965 alone prices will have increased by about 5 %, following an increase of some 6 % in 1964. Barring a falling-off (which would be undesirable from the angle of longer-term growth) in private industrial investment, which is in any case far from dynamic, the prospects for stabilization seem scarcely any better for 1966 unless something is finally done to bring general economic policy more into line with the Council's recommendation of April 1964. This applies in particular to the whole field of budgetary policy. If, for structural reasons especially, decisions have been taken here to increase specific expenditures and reduce direct tax rates, other items of public spending must be correspondingly cut back and/or other sources of revenue further increased. True, such action is being considered, but only for the budgetary year 1966, which could well be too late : strains might persist until near the end of 1965, or even grow worse, with the danger of course that the important decisions to be taken

at this time for 1966, e.g. with regard to the increase of incomes, would again be too expansionary.

Although less marked, the trends in Germany raise similar problems, at least in respect of internal equilibrium. The overall expenditure of the Bund and of the Länder has, in 1965, already again become more expansive than in 1964, when the budgetary policy of the Bund at least conformed with the Council's recommendation. In this country too, a further cut in direct taxes, fully warranted from the structural angle, has been decided on but nothing has been done, despite economic policy requirements, to offset this measure on the revenue side. Domestic imbalance has been tempered by an increase in imports, clearly reflected in the tendency for the current account to run up a deficit. The repercussions of such trends on the other Community countries should be allowed for. It is true that economic trends in these countries are now in general more settled than were those of Germany and the Benelux countries at the time when the intra-Community trade balances of Italy and France were deteriorating sharply, and when, consequently, Germany and the Benelux countries "were importing" inflation from France and Italy. The economic situation in a number of Germany's EEC partner countries is nowadays such that they are well in a position to cope with a certain amount of additional pressure arising from German demand for their exports. But firstly this is not the case for the Netherlands, where, on the contrary, excessive pressure of demand from Germany is an almost direct cause of strains. Secondly, there is no reason to expect that in the longer run the situation in the other member countries will remain such that a substantial deterioration of the German current account would be without danger of inflationary contamination for them.

It would, therefore, be advisable for Germany to endeavour to conform even more closely with the Council's recommendation of 8 April 1965. There was good reason for singling out this country specifically in this document. If public spending and fiscal policy do not contribute to stabilization—or even work in the opposite direction—central bank policy must be more restrictive than would otherwise be necessary.

In the other member countries, the problems of short-term economic policy arising from the economic situation and outlook differ, though in varying degree. For example, in Italy, in sharp contrast with the Netherlands, the prospects of a further increase in the rate of expansion of domestic demand in 1965/66 in themselves involve no problems of equilibrium, not even from the angle of the stabilization of prices and costs, since there is scope for relatively substantial improvements in productivity through the fuller utilization of available production capacity.

However, it would seem that certain conditions, the importance of which has been stressed both by the Short-term Economic Policy Committee and by the Council, are

not fulfilled for the time being at least or are fulfilled only in part. For example, expansion seems so far to depend relatively closely on consumption and on items of public expenditure which directly or indirectly stimulate it and not enough on business investment. At the same time the Treasury deficit, which has increased appreciably, raises financing problems, which are apparently being solved by recourse to the money market.

Two dangers to be avoided are (a) that the expansion of demand may remain too closely bound up with consumption and that adequate investment by private firms—the factor making possible in the longer term the expansion of supply and, particularly, lower costs—may be neglected and (b) that too much liquidity may accumulate in the economy. If these dangers are not avoided, the final result, despite everything, might be over-rapid expansion of demand and a swift deterioration of the balance of payments. What is needed, then, in Italy, is more effective encouragement of investment by enterprises, particularly through a reform of the credit and capital markets, greater restraint in the expansion of public consumption and transfer expenditure not earmarked for directly productive use, and a gradual transition to sounder methods of financing Treasury deficits (this would probably depend partly on the reform of capital markets).

The situation in the Belgo-Luxembourg Economic Union is typically post-inflationary, i.e. the expansion of overall demand is tending to slow down sufficiently but cost inflation continues—in the wake of the excess demand situation. However, in Belgium, too, inflation has of late again received delayed stimulus from demand, notably through public expenditure. There is no longer any real doubt that in this country, too, the 5 % ceiling fixed by the Council has been exceeded for 1965, although to a far lesser extent than in the Netherlands or Germany. This is by no means due only to a certain easing of measures curtailing investment: all the other headings of government expenditure are also affected. The Treasury's financing needs have again grown. Moreover, economic activity in Germany and the Netherlands is giving an additional boost to demand in Belgium.

Although the rate of price increases in Belgium—5 % in May above the May 1964 figure—is partly due to accidental factors, it should again induce more caution in public spending and the postponement of any further relaxation of monetary and credit policy.

In France, economic policy—and in particular government budgetary policy—are broadly speaking in line with the requirements of the economic situation and outlook, and thus with the Council's recommendations. None the less, problems—of contradictory nature—do arise, in the first place in the building industry, where signs of overheating are in fact still noted and are likely to recur, and secondly with regard to private industrial investment, which, so far at least, is showing scarcely any signs of recovery.

If, in accordance with the policy now to be followed, the state—whose revenues are for cyclical reasons likely to grow more slowly for a time—maintains a balanced budget in 1966, the consequence might well be that the curtailment of expenditure necessary to do this would hit public investment most of all. The effect of this, however, could be a dangerous weakening of fixed investment as a whole in France.

If private industrial investment should tend to be weak in the second half of 1965, there would be a case, then, for providing certain additional incentives, perhaps in the form of tax reliefs. Secondly, an effort should be made to sustain as far as possible the expansion of public investment in 1966 as well, and for this purpose the brake should be applied rather to certain consumption and transfer expenditures. Finally, in the new housing sector, demand should be guided carefully in relation with supply opportunities.

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

A. Federal Republic of Germany

In 1965 the economic trend has so far been marked by a strong cyclical upswing.

The resumed expansion of exports already observed in the fourth quarter of 1964 has continued. Owing to a relatively long winter the seasonal slowdown in building activity was more pronounced than usual, but gross fixed asset formation as a whole continued to develop vigorously because of a very rapid rise in expenditure on equipment goods. Disposable income of households went up sharply, mainly because of a speedier rise in wages and the reduction in income tax which took effect at the beginning of the year. Private consumers' expenditure grew at a more rapid pace, yet savings also increased further, not only in absolute terms but even in relation to total disposable income.

The number of foreign workers rose considerably. Nevertheless, severe strains continued on the labour market. Despite the continuing rapid expansion of domestic supply, economic growth was slowed down to some extent in many sectors because of increasingly severe shortages of manpower and production capacity. Industrial production was 7 % higher in the first quarter than in the corresponding period of the previous year.

Imports continued to expand very briskly. Nevertheless the upward trend of prices became rather stronger in recent months. Not only was the excess pressure of demand heavier but, above all, costs also rose at a distinctly faster pace.

The slight increase in the surplus on the balance of goods and services observed in the fourth quarter was not maintained. The current account (including unrequited payments) continued to be slightly in deficit. Nevertheless, the overall payments balance for the first quarter closed with a surplus of DM 1 560 million, in particular because capital movements showed a substantial net inflow largely attributable to exceptional factors.

The expansion of demand seems likely to remain very vigorous for the remainder of 1965. There will doubtless be a further distinct rise in exports. The expansion of investment demand and private consumers' expenditure will remain very rapid, while public current expenditure may increase a little more slowly by comparison.

Although strains on the labour market will probably be again aggravated, expansion of industrial production should still be quite considerable. However,

it is likely that there will be some further slackening of pace, for capacity is stretched to the limit and labour is in short supply. The very rapid expansion of imports is also likely to lose some momentum, since the stocking of raw materials and semi-manufactures may slow down.

Although foreign trade will probably continue to exert some moderating influence, it must be feared that the price climate will again tend to deteriorate, the more so as the rise in unit costs threatens to speed up a little further.

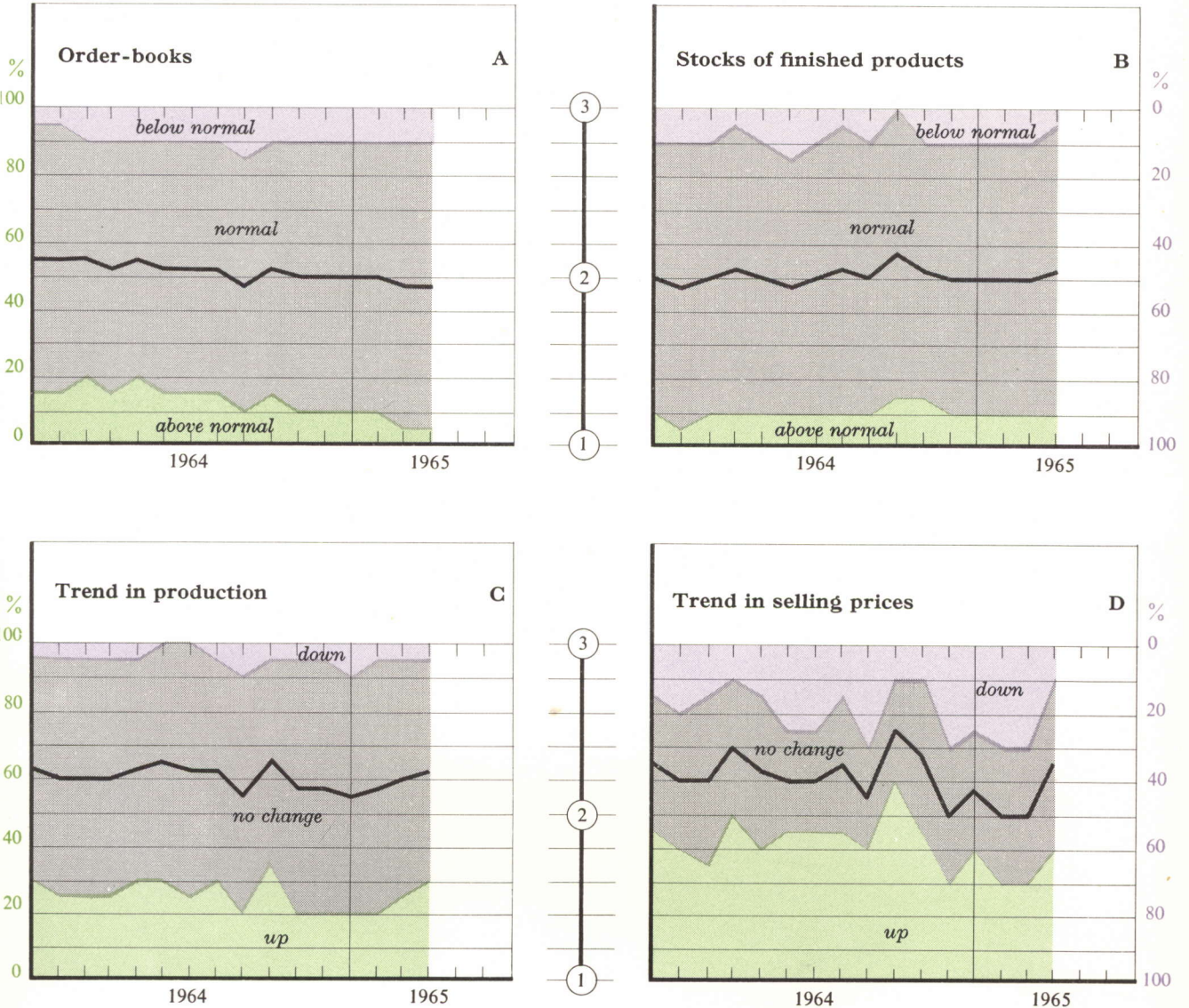
The initial outlook for 1966 is that expansion of total demand will continue, the emphasis falling probably on consumption and exports. The prospects for capital expenditure are a little less certain; nevertheless it is likely to continue upwards. At the same time, production elasticity might further decline in a few sectors. All in all, it is at present considered feasible to step up the gross national product in real terms by about 4 % between 1965 and 1966. The rise in unit costs seems likely to continue. As demand will still make it possible to pass on increased costs in the form of higher prices, at least in part, there is little reason to expect an appreciable slowdown in the price rise.

In fact it does not seem possible to achieve price stabilization without a more consistent anti-cyclical policy. It is particularly budget policy, which should be re-aligned to conform more closely to the recommendations, lately reiterated, of the Council of the Community.

1. Recent developments

The renewed spurt in the expansion of exports of goods and services observed in the autumn of 1964 continued in the early months of 1965. According to customs returns, exports in the first quarter were up 11.6 % in value on their level a year before. In April, however, they were slightly below the level of April 1964, but only because there were fewer working days. Although exports to the United Kingdom were slowed down by the introduction of the customs surcharge last November, and deliveries to the United States were temporarily impeded by a strike of American dockers, sales to non-member countries increased strongly in the aggregate. Their year-to-year growth rate reached about 15 % in the first quarter. Sales to the EEC countries, which in 1964 had stagnated or even declined, also picked up to a marked extent in recent months,

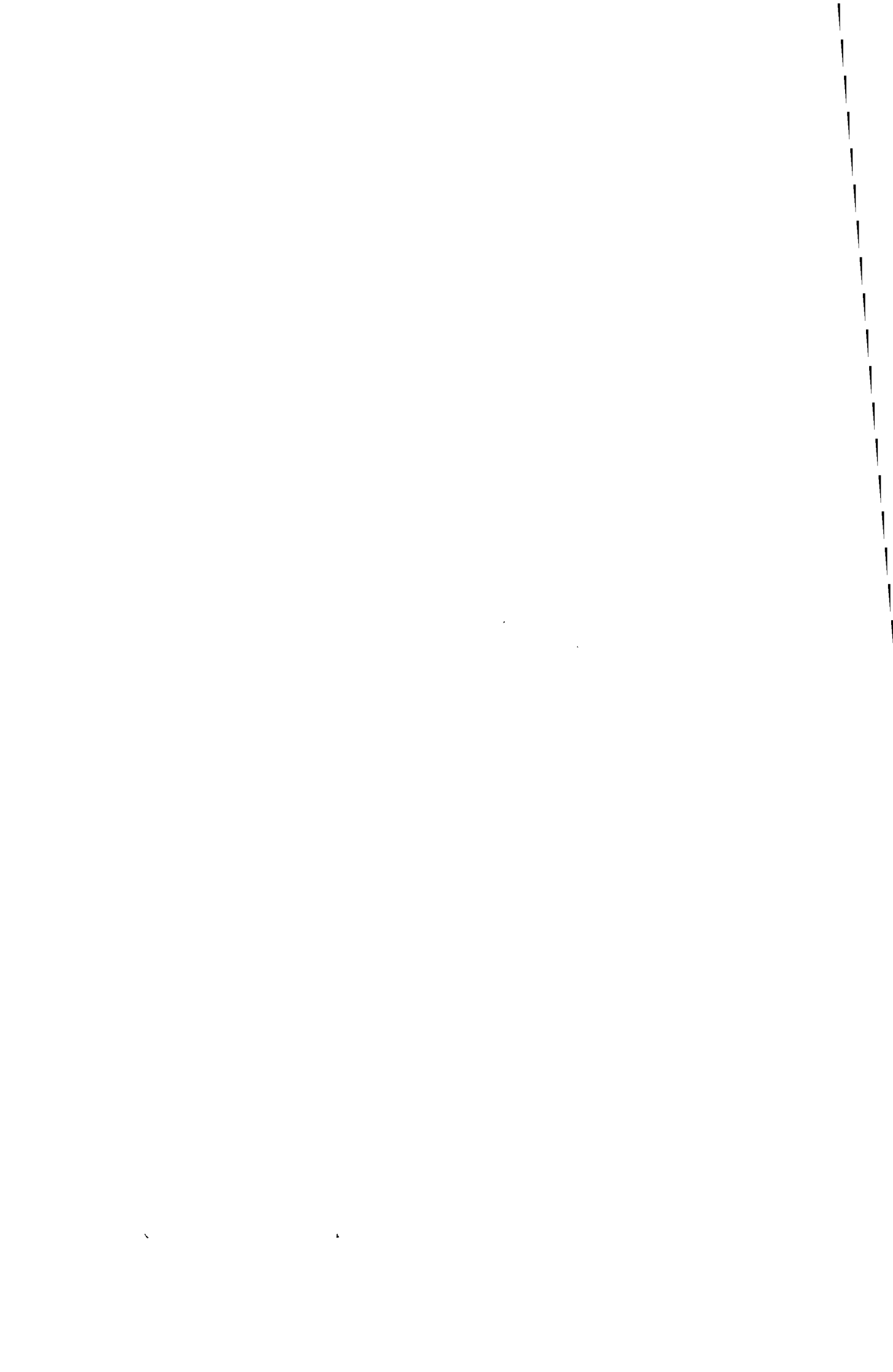
BUSINESSMEN'S VIEWS ON THE INDUSTRIAL SITUATION



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

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

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



with the exception, however, of those to Italy. In the first quarter they were up about 6 % in value on the very high level attained in the first quarter of 1964.

A vigorous stimulus was provided by the expansion of internal demand. The very strong upsurge in gross fixed asset formation has not so far shown any signs of slackening. True, the development of building investment was temporarily affected by the relatively long winter. But it would seem that the growth of investment in equipment has, if anything, speeded up in recent months. In any case domestic sales by the key capital goods industries and also imports of equipment goods increased strongly.

Investment in stocks, too, again boosted demand. However, to judge by certain important partial indicators, restocking of intermediary products by enterprises has probably passed its peak. On the other hand, in trade there has been a very appreciable replenishment of stocks in the expectation of a new and vigorous expansion of private consumption.

In fact the expansion of consumer expenditure is now also more clearly influencing the general business trend. On the one hand public current expenditure has considerably increased, and on the other the advance of private consumption has again been vigorous, even though the proportion of disposable household income saved again rose. In the first quarter of 1965 retail sales, which, it must be admitted, account for only about 50 % of household spending, were up 6.6 % in value and 3.7 % in volume on their level of a year earlier. For April the figures were 15 % in value and 12 % by volume.

A determining factor in the strong expansion of private consumption was the rapid increase in disposable income. From new collective agreements it is evident that the accentuated rise in wages is continuing. The level of agreed hourly wages was up by 7.7 % in the first quarter on that of a year earlier, and it is likely that actual earnings rose considerably more than negotiated wages. In addition, transfer incomes again increased strongly. In the aggregate, with greater numbers employed and lower income tax, the volume of net income was 11 % higher in the first quarter than a year earlier. Finally, the amounts drawn from their business by self-employed persons seem to have increased considerably, as did investment income, since interest rates and company dividends were higher.

The rapid increase in wages was due mainly to persistent strains on the labour market. At the end of May there were 106 500 unemployed, or 16 % fewer than a year earlier. At the same time the employment exchanges had 683 500 unfilled vacancies on their books, nearly 56 000 more than at the same time in 1964. This trend is all the more significant since German firms have apparently been finding rather less difficulty in

recruiting workers abroad. At the end of March the number of foreign workers in the Federal Republic was 1.06 million, an increase of more than a quarter over the same period of the preceding year. There was in particular a marked increase in the number of Italian workers, partly as a result of the labour market trend in Italy, but also to some extent because of the measures taken in Switzerland to limit the employment of foreign labour.

The vigorous increase in numbers employed in industry (2.5 % more at the end of March than a year before) is due largely to the appreciable influx of foreign manpower.

The growth of domestic supply continued fairly rapid. This was the case especially with industrial production (measured by the index per working day) which, despite some temporary and exceptional decline in activity in sectors dependent on climatic conditions, was 7 % higher in the first quarter and 8.7 % higher in April than at the corresponding periods of the previous year. Productivity therefore continued to increase, but noticeably more slowly than in 1964. This slowdown is doubtless connected with the optimum capacity utilization which has been attained in many branches and is also reflected in longer delivery dates.

This situation—a lively expansion of demand barely matched by domestic supply—explains the continuing boom in imports of goods and services. According to customs returns, imports of goods in the first quarter were up almost 25 % in value and 21 % by volume on the corresponding period in 1964. In April the year-to-year growth rate in value was 13 %. While the hitherto very rapid growth of raw material imports declined somewhat and imports of foodstuffs advanced rather slowly, imports of finished goods again went up sharply. In the first quarter of 1965 imports of goods from other Community countries were no less than 43 % higher than a year earlier. Those from non-member countries were up 14 %.

Despite the fairly rapid expansion of overall supply the conditions making for balance continued to deteriorate in recent months. Since, in addition, unit costs again rose, the upward trend of prices not only persisted but in some cases became stronger. In April producer prices were up 7.3 % in agriculture and 2.6 % in industry on the same period of the previous year. The cost-of-living index rose further. In April it was 2.6 % higher than a year before. Rises affected not only rents and certain services but also, to an increasing extent in recent months, industrial consumer goods.

The slight improvement in the fourth quarter of 1964 in the balance on goods and services with abroad was not maintained during the early months of 1965. The surplus on trade, which reached DM 1 100 million in the first quarter of 1965, was only slightly

higher than in the fourth quarter of 1964 and down by about 50 % on the first quarter of the same year. In April 1965 the trade balance was practically level. The balance of current transactions which, in addition to trade and services, also covers unrequited payments, including remittances by foreign workers, closed with a slight deficit in the first quarter—DM 190 million as against a surplus of DM 1 190 million for the same period of 1964. However, as the balance on capital movements (exclusive of variations in the foreign exchange position of the banks) showed a net import of about DM 540 million due particularly to the financial transactions of certain German subsidiaries of foreign companies and a surplus of DM 1 210 million on the residual items—some of them seasonal—not included in the statistics, the general balance of payments for the quarter showed a surplus of DM 1 560 million, as against a deficit of DM 1 370 million in the preceding quarter and a surplus of DM 2 230 million in the first quarter of 1964. While the banks' net foreign exchange position improved by DM 2 070 million, the official gold and foreign exchange reserves of the Bundesbank declined by DM 510 million to DM 29 800 million.

Supply and utilization of goods and services

	1962 ⁽²⁾	1963 ⁽²⁾	1964 ⁽²⁾	1965 ⁽²⁾
	At current prices (in DM '000 million)	% change by volume on preceding year		
Gross national product	354.5	+ 3.2	+ 6.5	+ 5
Imports ⁽¹⁾	65.3	+ 8.3	+ 11.2	+ 10
Private consumption	204.0	+ 2.8	+ 5.3	+ 6
Public current expenditure	53.1	+ 8.0	+ 0.1	+ 4.5
Gross fixed asset formation	90.2	+ 2.2	+ 11.0	+ 7
Exports ⁽¹⁾	69.0	+ 9.6	+ 10.1	+ 7

⁽¹⁾ Goods, services and factor income.

⁽²⁾ Wirtschaft und Statistik, January 1965.

⁽³⁾ Commission forecasts.

Note :

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

(b) The forecasts are approximations based on 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.

Despite the expansive impact of the balance-of-payments position on bank liquidity, and leaving out of account a short period prior to the increase in Bank rate mentioned in the previous Quarterly Survey, the money market was generally tight. On the one hand, as is usual at the time of year, public cash transactions tended to restrict liquidity, although distinctly less than in the previous year, since tax revenue was reduced from February onwards by tax reductions and expenditure continued to increase sharply. Furthermore, the banks had an incentive to build up again the foreign assets repatriated on a large scale at the end of the year for considerations of "window dressing", the more so as capital exports to the United States were again stimulated by the Bundesbank's swap policy.

However, bank liquidities were still so abundant that in the first quarter a fresh and appreciable speed-up in the expansion of bank credit was possible. In particular, credit to industry increased strongly. An important factor here is that firms are obliged to call increasingly on outside capital to finance their heavy investment expenditure and that it is obviously becoming more difficult to raise funds by issues on the financial market.

2. Outlook

It may be expected that the upsurge of business will continue to be very vigorous for the rest of the present year.

External demand should continue to rise, particularly if the improvement in the business climate recently noted in Italy and France—countries which, in 1964 accounted for nearly one fifth of German exports—should lead to a more lasting revival of the expansion of demand in these countries. In the first quarter of 1965 industrial orders from abroad were up almost 6 % on their already high level of the same period in 1964 and were 8 % higher than sales abroad. However, the export drive is likely to slacken because of booming internal demand and the high degree of capacity utilization, and this will set limits to the growth of German sales abroad. This tendency is further strengthened by the fact that despite the higher prices for many export products profit margins are often better at home than on export markets.

Expenditure on gross fixed asset formation will continue to increase strongly. Although construction projects have recently show a distinct tendency to slow down it is by no means certain that this portends any basic reversal of the trend of building demand. In terms of estimated costs construction authorized in the first quarter was

still up by 1 % for public buildings, by more than 9 % for housing and by 5.5 % for industrial and commercial building on the same period of the previous year—when it was already exceptionally high in certain cases. In any case the backlog is so large—if not in the road-construction sector at any rate in building—that, given the limited capacities of the industry, the trend of actual spending on construction will probably hardly be affected in the immediate future even if the number of projects falls off.

The strong propensity of firms to invest is reflected particularly in their orders for capital goods. In recent months the industries supplying these have again registered a very rapid advance in domestic orders. On the average for capital goods industries as a whole, new orders were up by 14.6 % in the first quarter on their level of a year earlier and exceeded actual sales by 9.4 %. In mechanical engineering the corresponding rates of growth were respectively 14.4 % and 15 %.

Public consumption will probably continue to increase, although doubtless a little less rapidly than the other elements of total demand.

Despite a probable fresh increase in the saving ratio the expansion of private consumers' expenditure is if anything likely to speed up further. In fact a fresh speed-up in the growth of the disposable incomes of households must be expected. First, the upward trend of wages will doubtless accelerate further, given the continuing strains on the labour market and the favourable way general demand is shaping from the point of view of the entrepreneur. In addition, the expansion of disposable income will also be encouraged by the continuing strong advance in transfer incomes and by a new and appreciable increase in the amounts drawn from their business by self-employed persons.

The stimulus imparted to production by the trend of demand also points to an appreciable increase in domestic supply. However, the expansion of industrial production might tend to slow down again a little in the course of the year, the more so as it is highly probable that manpower shortages will continue to worsen. The effects of the rationalization which goes hand in hand with high investment will in fact be felt only after a certain time-lag.

Assuming normal weather conditions, a further slight increase in agricultural production can be expected in 1965.

The cyclical expansion of imports might slacken off somewhat in the coming months. Commercial imports of manufactures will doubtless show a further strong increase, but the stocking of raw materials and semi-manufactures, which has now been

going on for nearly two years, is likely to taper off unless political developments set off fresh speculation on world price rises.

Because of the undoubtedly too rapid expansion of general demand in money terms and the speed-up in the increase of unit costs, particularly wage costs, it must be feared that the upward trend of prices will probably be somewhat stronger in the second half of the year.

This outlook tallies broadly with the quantitative forecasts for 1965 in the last two Quarterly Surveys. Nevertheless, the increase in the volume of consumption and external trade—both imports and exports—in real terms may be more vigorous than has been estimated hitherto.

Preliminary studies of the probable economic trend in 1966 indicate with some degree of certainty that overall demand will continue to expand fairly vigorously. This expansion could affect not only external demand but also, to a special extent, consumer spending. Future trends of investment are more difficult to evaluate at present. Growth might be less rapid in the public investment sector and in housing, but there are many reasons to believe that total expenditure on gross fixed asset formation will continue to increase. This would probably be the case even if the present investment boom, particularly in industry, were to slow down, for example because of difficulties in finding finance. The total of industrial and commercial investment projects undertaken but not completed at the end of 1965 will probably be very large in view of the relatively long delivery dates for capital goods.

Taking into account the factors of uncertainty which in the nature of things are still very considerable, and also the fact that the elasticity of domestic supply will certainly diminish further despite the high level of investment, the Commission at present estimates at about 4 % to 4.5 % the increase in the gross national product at constant prices between 1965 and 1966. Compared with the trend between 1964 and 1965 this would mean a further slight slowdown in economic growth.

For the time being, however, this outlook in no way justifies a policy to stimulate expansion. On the contrary, the Council of the European Economic Community emphasized in its most recent recommendation on short-term economic policy (8 April 1965) that in view of the worsening imbalance between the expansion of nominal domestic demand and real domestic supply, the Federal Republic of Germany should adhere to the policy of moderation already laid down in the Council recommendation of 14 April 1964.

The present and foreseeable rising price trends are no longer stimulated by external economic developments—which would if anything now tend to deflate prices;—their origin lies rather in the tempo of the expansion of demand, which could well be controlled by official economic policy.

It has already been pointed out repeatedly that it is the public authorities especially who should themselves follow the recommendations of the Council more strictly in their budget policy. Already in 1964 the increase in public spending in general was far in excess of the 5 % limit recommendation by the Council, even if allowance is made for all permissible “additions”. But in 1965 too, the available partial indicators of the actual trend of public expenditure in the first quarter and the budgets for the year as a whole show that the Council recommendation is not being adequately complied with. This applies in particular to the Länder and the local authorities, who are again planning to increase their expenditure to an extent exceeding—sometimes greatly exceeding—the 5 % margin.

This development is all the more regrettable from the short-term economic policy angle since the growth in the revenues of the central administrations should tend to slow down following the tax reduction on 1 January 1965, so that credit requirements will increase—a state of affairs hardly consonant with the demands of short-term economic policy.

To judge by the trends already discernible, it is to be feared that in 1966 too the behaviour of the public authorities will not be in line with a policy of establishing and maintaining stability of prices and keeping the economy on an even keel—unless some special effort is made *in extremis*. This time the most marked expansive trends seem to affect the Federal budget, which will provide for many increases in expenditure, some of them already decided on and others announced as more or less certain. Moreover, when the brake has been applied hitherto the result does not always seem to have been to curb increased spending, but simply to postpone it. It will hardly be possible to carry such postponement beyond 1965.

However, credit policy could act as an effective instrument for moderation, particularly through the capital market. Now that inflows of capital with an inflationary impact have largely ceased, capital has become scarce in places and new and appreciable rises in interest rates have been registered, despite greater savings. At the beginning of May, the yield on newly issued public loans was over 7 %, as against about 6 % a year earlier. This could lead to a slowdown in borrowing, especially by local authorities, and a review of numerous investments which are sensitive to interest rates, particularly building projects.

In view of the close interdependence between the money and financial markets in Germany it is particularly important in these circumstances to continue to keep a tight rein on credit. As long as interest rates do not rise to the point where the barriers erected against the tide of foreign capital are overthrown—and the critical level has probably been further raised by the new measures of the United States Administration to redress the balance-of-payments situation—a high interest rate can only be welcomed from the angle of stabilization policy.

However, it is also important to keep more effective limits on the expansion of bank credits to businesses and private persons. Measures recently introduced should make it more difficult for the banks to continue to increase their credits at the same pace as hitherto. Among these we may mention the new “regulation on interest rates” which came into force on 1 March 1965; the widening of the possibilities of open market policy by the admission of social security institutions to the markets; a review of rediscount quotas to reduce their amount from the high level of recent years and, finally, certain changes in the regulations concerning minimum reserves (exemption from the compulsory reserve obligation for mortgage banks but inclusion of their assets held at the banks in the minimum reserve obligations of the latter).

The curbing effect of the restrictive credit policy measures would certainly be more rapid and effective if the public authorities did not make such large resources available for housing and other economic activities, either by direct help or through interest rebates and capital subsidies. According to Bundesbank estimates, the capital invested in housing and the rest of the economy (including agriculture) via these various forms of aid amounted to between DM 13 000 and DM 15 000 million in 1964. This is between 12 % and 14 % of total spending on gross fixed asset formation in that year. In the present situation public aid on this scale to investment can only aggravate strain on national resources. Considerable possibilities doubtless still exist in this field for implementing a short-term economic policy aimed at stabilizing prices.

3. The economic situation in West Berlin

In West Berlin also economic activity in the first quarter was marked by a continued expansion.

Exports of goods advanced strongly and were up 19 % in value in relation to the corresponding period of the previous year. Deliveries to West Germany also made further progress. In the first quarter their value was 12 % higher than a year earlier.

The seasonally corrected expansion of gross fixed asset formation may well have speeded up, chiefly as a result of vigorous growth in the construction sector. Under the influence of the continued rapid increase in disposable income, private consumers' expenditure also advanced considerably.

Thanks to immigration, the labour force in industry increased for the first time since the summer of 1961. Serious strains nevertheless continued on the labour market. In fact the number of unemployed was distinctly lower at the end of April than a year earlier, while vacancies were up by more than 1/3 on the corresponding level in 1964.

Industrial production has continued its upward trend. According to the index per working day it was up by 8.5 % in the first quarter on January/March 1964. In the producer goods industries output was 3.7 % higher than in the corresponding period of the previous year, while the growth rate in the consumer goods sector was 13.6 %.

In trade with West Germany purchases in the first quarter again exceeded sales. The balance on trade in goods with the Federal territory closed with a deficit of DM 89 million, which was lower than that of the fourth quarter of 1964 (DM 142 million). However, the deterioration in relation to the corresponding period of the previous year was still considerable: in the first quarter of 1964 there had been a surplus of DM 25 million.

Consumer prices have again hardened in recent months. In April the cost-of-living index was up 2.9 % on April 1964.

The trend until the end of the year will probably remain expansive. Now orders to industry have again increased appreciably, being up 12 % in the first quarter on January/March 1964. In electrical engineering, which had experienced a temporary lull, there has lately been a distinct pick-up in new orders.

The trend of demand—particular external demand—would consequently suffice to maintain a vigorous growth of production. Thanks to the impact of the high level of investments on the rate of productivity increase, production should be sufficiently elastic to permit considerable expansion. However, the overall demand/domestic supply relationship still seems strained. In particular, manpower shortages prevent the growth of production from keeping entirely in step with that of demand.

B. France

The slacker business trend, which had become very marked in important sectors of the economy towards the end of the previous year, appears to have come to a halt in the early months of 1965.

There was in fact no further slowing down in overall demand. Exports even gave a slightly stronger impetus to economic activity. Certain inhibiting factors—such as a weaker propensity to invest on the part of private industry, a tendency of traders to run down stocks, and a certain reserve on the part of consumers—continued to influence the trend of domestic demand, but these factors were less significant. During the spring, there were even signs here and there of a slight improvement. Capital expenditure of public authorities and publicly-owned enterprises, together with building investment, provided very powerful support for production and employment.

The slightly recessive trend of industrial production ceased towards the end of the first quarter, although the level remained a little below that of the previous year. Production continued its upward swing in the building sector. This led to a certain stabilization of the employment situation, and the tendency towards an easing of the labour market was only slightly accentuated.

While the cyclical factors tending to increase prices continued in general to lose their force, there were new, and appreciable, price increases of a more autonomous and structural nature, particularly in the foodstuffs sector. There was therefore a somewhat more rapid rise in the level of consumer prices in the early months of 1965.

As imports declined slightly, there was an appreciable improvement in the balance of trade, and since the net inflow of capital continued very high in the first quarter, the overall balance of payments showed a large surplus. The official gold and currency reserves rose during this period by FF 1 042 million, and in April/May by a further FF 126 million.

There are certain pointers to a brisker rise in economic activity in the coming months. In the first place there are good prospects of a further, and probably rather more pronounced, increase in foreign demand. Secondly the inhibiting factors which have hitherto affected domestic demand will slacken more and more. As regards the trend of gross fixed asset formation, there would appear to be little likelihood of any greatly increased propensity to invest on the part of private industry in the near future. However, there should be a somewhat more rapid increase in investment

by public undertakings. Furthermore, it is fairly safe to assume that investment in stocks will spur production and employment. Finally, with further increases in gross income, which is moreover less heavily taxed, distinctly greater household expenditure on consumption may be expected.

Brisker demand should lead to a recovery in industrial production and—although perhaps with a short time-lag—to a rise in imports. The price situation will continue to be influenced less by cyclical than by structural and autonomous upward trend.

There is every reason to suppose that economic growth, which has picked up again, will go on right through the year and even gain momentum in 1966. The main emphasis may shift from foreign to domestic demand, and in this sector to private investment. At the present time, it is estimated by Commission staff that the increase in real gross national product will be roughly 4.5 %; this is an initial, and of course tentative, working hypothesis.

Having regard to the present situation and future prospects, there is certainly no reason for any radical change in the short-term economic policy followed hitherto, since this would jeopardize all the progress towards stabilization achieved so far and prevent the consolidation which is necessary if a suitably rapid and balanced rate of economic growth is to be achieved in the longer term. This does not rule out the possibility that certain stabilization measures may gradually be relaxed or abolished, as and when market factors can themselves establish a balance. It would certainly be advisable to lend a cautious measure of support to the incipient revival of economic activity by encouraging private investment. Steps have already been taken to this end.

1. Recent developments

In the early months of 1965, foreign demand formed one of the main pillars of economic activity. Exports of goods and services, which had become brisker during the last quarter of 1964, continued to show a strong upward trend.

In February and March, the year-to-year growth rate in exports of goods, in value and according to customs statistics, was nearly 11 %. However, taking the average for the first quarter, the previous year's level was exceeded only by 5.5 %—owing to a fortuitous recession in January. In the April/May period, the growth rate again reached 15%.

There was a particularly strong, and even rather more rapid, rise in French exports to the other Community countries, especially to Germany. On the other hand, exports to non-member countries developed in a less lively fashion. In the first place, the effects of the special surcharge introduced by the United Kingdom in the autumn of 1964, and the expectation of its being reduced in the near future, resulted in a further sharp drop in exports to that country. In the second place, there was a further slight reduction in exports to the franc area, which account for approximately 30 % of total French exports to non-member countries.

Domestic demand continued very quiet at the beginning of 1965. Not until the spring were there signs of a somewhat more sustained increase, although even then it could hardly be described as a definite resumption of the upward trend.

As before, the growth of gross fixed asset formation was mainly attributable to expenditure by the Government and public undertakings which, in accordance with current programmes, rose at an annual rate of 13 % and 10 % respectively. Expenditure on housing continued its expansive trend. In the first quarter, the number of completed dwellings exceeded the level reached at the same time last year by approximately 18 %. On the other hand, private firms appeared on the whole to maintain a somewhat cautious attitude as regards investment during the early months of this year. At any rate the INSEE Survey did not reveal any increased propensity to invest on the part of private industry.

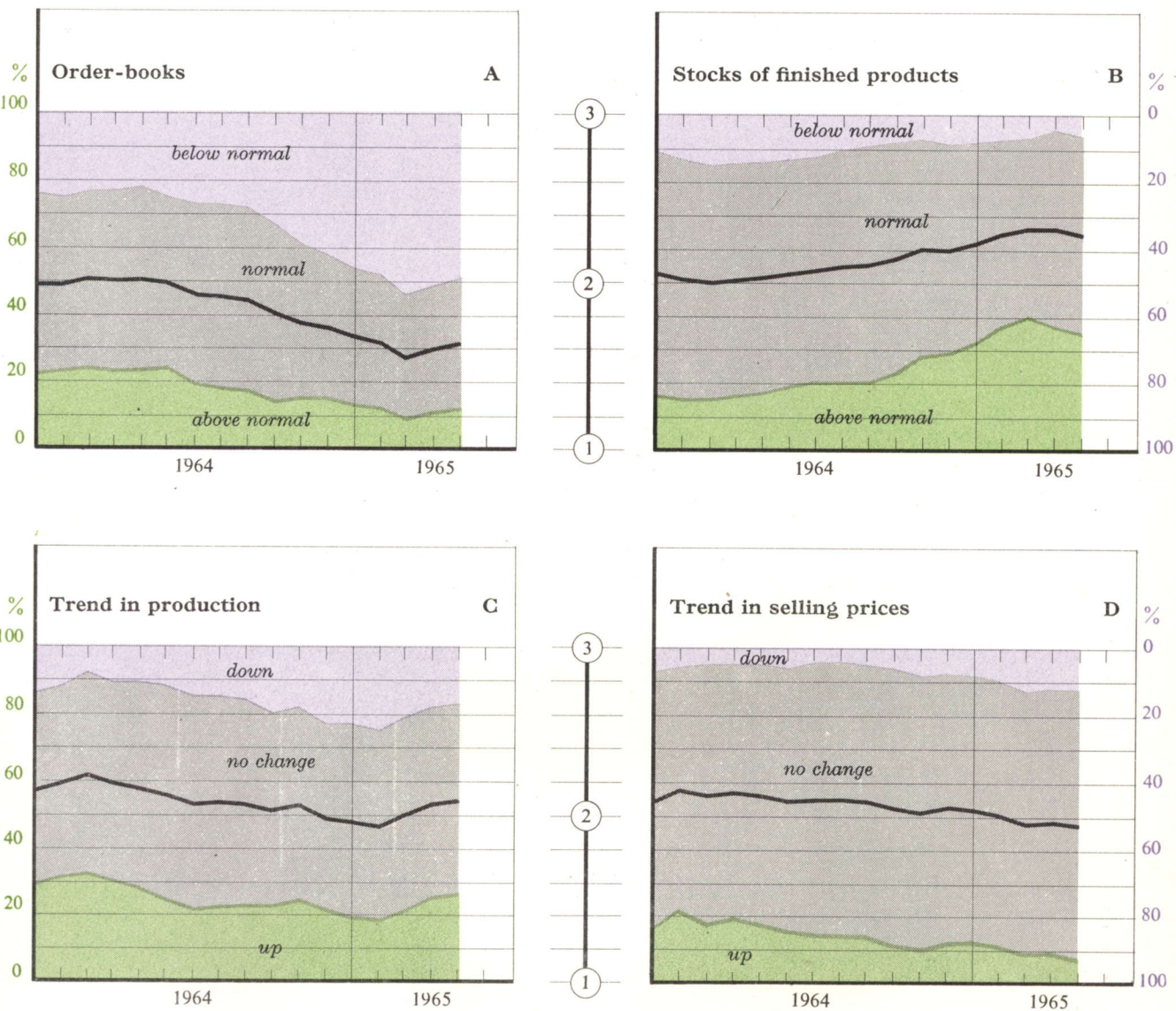
The weaker trend in stock-building seems to have continued. There was a considerable run-down of stocks in retail trade, while industry also apparently reduced its stocks of finished goods. Stocks of raw materials seem also to have declined.

As certain orders by public bodies were placed more rapidly, there was a rather sharper rise than hitherto in public expenditure on consumption.

On the other hand, as regards private consumers' expenditure, the trend continued rather slack in the early months of the year. There would appear to have been only a slight increase in turnover in retail trade. However, the spring brought the first signs of a rather brisker demand in some branches. New car registrations, which had been declining almost continuously since the first quarter of 1964, have recently shown a slight tendency to rise. Finally, expenditure on services probably continued to increase.

There seems to have been a slightly improved trend of wages and salaries recently owing to the fact that the fall in the level of employment slowed down very perceptibly. Moreover, wages and salaries continued to rise, in both private and public sectors, at much the same rate as in the first six months of 1964 (about 1.3 % per quarter). The guaranteed minimum wage was increased by a further 2 %. In addition, certain insurance benefits (old age, disability and accident) were increased on 1 March or 1 April

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by 11 %. It is true that gross income was rather heavily burdened by advance income tax payments, which were based on the amount of tax liability for 1964 and did not yet reflect the reductions applicable from 1965 onwards; but on the other hand it is not unlikely that the saving ratio of households has declined. At any rate the increase in liquid savings has shown a distinct tendency to slow down in recent months.

The slackening of domestic production, which began in the autumn months of the previous year, probably came to a halt towards the end of the first quarter of 1965. At all events, industrial production, which was adversely affected in December and January both by slack business conditions and also to a considerable extent by special factors, such as strikes and a large number of public holidays, became stable as from February—to judge from the seasonally adjusted INSEE index. In April, however, the gross index (excluding construction) dropped by a further 1.4 % as compared with the highest level so far reached, that of April 1964.

In certain branches, there has been some modification of earlier trends in recent months. The recession in the motor industry came to a halt; motor-car production held steady and even showed the first signs of a revival. On the other hand, the growth rate in certain basic industries slackened off; metals even showed a slight downward trend. Energy and chemicals advanced strongly as before, while in construction no change in the upward trend was discernible, although results in the first quarter were adversely affected for a time by rather unfavourable weather conditions.

The stabilization, or perhaps even slight tendency towards improvement, shown by domestic production was reflected in the employment situation. It is true that the total number of persons employed again decreased slightly between 1 January and 1 April 1965, but there was no further shortening of the working week; in fact, slightly longer hours were worked in certain important branches of industry during the early spring. At the same time, there has been some slowing down of the trend towards an easing of the labour market situation: the number of unfilled vacancies, which had fallen sharply in the second half of 1964, has definitely been stable since the beginning of the year, while the number of persons seeking employment dropped considerably—in spite of the fact that at the present time the “bulge” is reaching school-leaving age and immigration of workers has continued at a very high rate. Although there are still certain employment problems in individual sectors and branches, the overall unemployment rate ⁽¹⁾ was only slightly higher than last year.

Imports of goods and services, which had shown a growing tendency to slacken off during 1964 with the continuing quiet business conditions on the domestic front, dropped slightly in the early months of this year. During the first quarter, imports of

⁽¹⁾ i.e. the ratio between the number of persons seeking employment (seasonally adjusted) and the active population.

goods—according to customs returns—were 3.4 % and 1.6 % lower in volume and value respectively than in the first quarter of 1964. In April/May the volume and value of these imports fell about 2 % and 0.2 % respectively below the level of a year earlier. Imports of raw materials and semi-finished goods, in particular, showed a recessive tendency, but imports of industrial finished goods also appear to have fallen off somewhat.

This breakdown according to products is also reflected in the breakdown by countries of origin; whereas imports from the EEC countries, which for the most part consisted of industrial products, remained static on the whole, imports from non-member countries, and in particular from the United States and the franc area, fell off considerably in the first few months of the year.

Although the general supply and demand situation remained more or less evenly balanced, there were nevertheless certain trends towards higher prices in some markets from the beginning of the year onwards. The retail price index rose by 1.1 % between December 1964 and April 1965, whereas it had risen by only 0.7 % during the last four months of 1964 and from December 1963 to April 1964. The year-to-year rise increased a little, and amounted in April 1965 to 2.6 %. Although in the case of industrial consumer goods and also of most services in the private sector prices in fact largely remained steady under the influence of the somewhat hesitant attitude of consumers and users, particularly as direct price controls were either retained or replaced by so-called “stability contracts”, food, on the other hand, has shown a tendency to become more expensive since the beginning of the year, contrary to the seasonal trend. The heading in the official statistics for January 1965 also showed a very sharp rise, although the annual increase in controlled rents does not take effect until July. This rise would appear to be due to an increase in building costs, which were 7.6 % higher at the end of 1964 than a year earlier.

With a continued rise in exports and a drop in imports, there was a considerable improvement in the balance of trade. In the first quarter, the deficit amounted to only FF 876 million, according to customs returns, as compared with FF 1 674 million a year earlier. The balance of current transactions once again showed a considerable surplus, and since net capital inflow continued at a very high level and the transactions of the other countries in the franc area again brought in high net receipts, the overall balance of payments in the French currency area was extremely healthy during the first quarter of 1965. The official gold and foreign exchange reserves showed an increase of FF 1 042 million (to FF 26 243 million) during this period as compared with a rise of only FF 100 million during the first quarter of 1964.

The development of internal liquidity was thus once again given a strong impetus by the balance-of-payments position during the early months of this year. However, since public financial administration had a compensatory effect, the annual increase in the supply of money (notes and coin in circulation plus sight deposits) remained at the relatively low level of 8 %. In fact, the cash transactions of the Treasury (including

redemption of loans) closed in the first quarter with a surplus of FF 120 million, whereas there had been a deficit of FF 435 million at the same time last year. Treasury indebtedness, in particular to the banks, showed only a slight increase of about FF 700 million as compared with a rise of FF 1 850 million in the first quarter of 1964. At the same time, the demand for credit on the part of industry and private individuals slackened off considerably. The total short- and medium-term credit granted by the banks and credit institutions showed a decrease of FF 1 800 million between December 1964 and March 1965. During the same period in the previous year they rose by almost FF 1 200 million.

The slight downward trend of interest rates on the money market was accentuated by a further temporary drop in the minimum reserve obligation of the banks. In addition, Bank rate was reduced from 4 % to 3.5 % on 8 April 1965. Finally, the rate used as a basis for interest charged to borrowers has been twice reduced since the beginning of the year, on the last occasion at the end of April. Conditions on the capital market were easy. During the first quarter, issues totalling roughly FF 4 500 million were made without difficulty, as compared with FF 4 100 million (including a government loan of FF 1 500 million) in the first three months of 1964.

2. Outlook

The end of the recession in important markets and, above all, the appreciable improvement in the business climate, as reflected in the results of the latest inquiry among heads of firms, may be taken as the first sign of a fresh spurt of overall economic growth.

In the first place, it is not unlikely that exports will pick up during the coming months. At any rate the assessment by heads of firms of the amount of orders abroad and of the number of such orders in hand, which had been somewhat reserved up to February, has since become much more promising. As regards stepping up exports to the other EEC countries, the decisive factor, in addition to the boom conditions existing in Germany and the Netherlands, may be that demand for imports in Italy is again showing a strong upward trend. With regard to exports to non-member countries, the reduction of the special surcharge in the United Kingdom and the incipient recovery of exports to the franc area are other positive factors.

As regards internal demand, the adverse factors which have mainly affected stock-building and private consumption should gradually disappear.

On the other hand, in view of the large amount of unused capacity, there appears to be little likelihood of private industry stepping up its investment programmes for 1965 in the near future. Nevertheless, it should be borne in mind that the tax and interest measures taken during the past few months will probably have certain favourable psycho-

logical effects—even if the material effects of the reform of company taxation will not be fully felt until 1967. At all events gross fixed asset formation should continue to expand at at least the same rate for the rest of the year. In the first place, government investment will continue its strong upward trend and that of public undertakings will increase rather more rapidly, probably as a result of relevant government measures, and expenditure on equipment goods may well increase relatively more rapidly than expenditure on construction. Secondly, housing construction will again increase fairly vigorously; there is a large carry-over from last year; a large number of new building permits have been issued; the terms for financing with the help of public funds have been further improved; saving for building purposes has been encouraged, and, last but not least, households are prepared, as appears from the INSEE consumer inquiry, to devote a large part of their increased income to house purchase.

Investment in stocks may be expected to show a brisker trend during the coming months. The run-down of stocks of finished goods, in trade at any rate, should come to a halt, and a certain amount of restocking may follow. Moreover, a recovery in production may make it necessary to increase stocks of raw materials and semi-finished products, which will presumably have dropped to a very low level in the meantime.

The expected increase in private expenditure on consumption should be the decisive factor in a slight acceleration of economic growth. According to the consumer inquiry referred to above, the main development is expected to be a progressive and rapid revival of demand for private cars. Moreover, there should be an appreciable increase in purchases of household equipment or fittings—with the possible exception of certain electrical appliances—as a result of the growing number of new houses completed. Spending on goods of this type is all the more likely as the employment situation will again tend to encourage rises in wages and salaries and as there seems to be no reason to expect any further slackening of the trend towards higher hourly rates. The income of self-employed persons might also show a stronger tendency to rise, particularly in agriculture, as a result of certain measures taken in that sphere. Another factor is that the tax reductions in 1965 will take full effect in the final income tax payments in the autumn, so that disposable income will then increase more rapidly than gross income.

A renewed expansion of final demand—even if rather slow—will probably lead fairly rapidly to a revival in the expansion of industrial production, since, as already pointed out, the stocks held in trade will have meanwhile been heavily run down. This applies more particularly to the consumer goods industries, where order-books have in fact been filling up much more rapidly in some important branches, while in capital goods industries no change in the present trend seems likely in the near future, although in this sector production estimates for the coming months have become distinctly more optimistic. In the building industry, production will continue to expand at a relatively rapid rate.

In agriculture, only a slight improvement on the very satisfactory results of last year can be expected—assuming normal weather conditions.

A certain period of time will no doubt elapse before imports of goods and services react to the brisker domestic demand, so that with the possible exception of raw materials their growth will most likely be somewhat tardy at first and will not speed up to any great extent before the autumn months.

As the outlook for exports is very favourable, there will be an improvement in the balance of trade. Surpluses on the balance of transactions will increase and the overall balance of payments will continue to be strongly on the credit side, even if net capital imports drop as a result of the steps taken in the United States to stem the outflow of capital.

The price trend will in all probability continue to be influenced by the same factors as before. On the one hand, the underlying factors making for higher prices will probably remain weak (except in the building sector where the pressure of demand is still very strong in relation to the elasticity of supply), especially as the pressure of costs might relax with a new rise in the use of capacity. On the other hand, the structural factors tending to raise prices will again exert a strong influence mainly in consequence of imperfect competition and a lack of elasticity in the distribution sector. Another point is that certain price increases will result from decisions taken in France in pursuance of the common agricultural policy. All things considered, the level of consumers prices is likely to go on rising slowly—probably at a rate no less than in 1964.

Since the results achieved up till now and the prospects outlined here largely conform to the pattern given in the last Quarterly Survey for the whole of 1965—a dull business climate during the early months of the year, followed by slightly brisker conditions later on—there is no reason to modify the preliminary estimates in real terms for the supply of goods and services and their principal utilizations.

The outlook for the remainder of 1965 has features which suggest the course of developments in 1966. The fresh spurt of overall economic growth now beginning will possibly continue into the new year and gain momentum. First, a stronger impulse will come from the Government, even if it pursues a strict budgetary policy; as a result of the relatively quiet business situation in 1965, revenue will rise more slowly, whereas public spending may show a stronger upward trend, perhaps in consequence of the launching of the Fifth Plan. Secondly, heads of firms may well adopt a more expansionary policy. After three years during which investment was slack, and with expectations of sales be-

coming more optimistic, an increase in expenditure on extension and modernization of plant is all the more likely as, mainly owing to taxation changes and the reform of the capital market, financing should be easier—as regards both ploughing back profits and raising fresh capital. Finally, consumer expenditure should again increase in view of the favourable development of the employment situation and of rising incomes. However, foreign trade may make less contribution to economic growth in 1966 than it did in 1965, as there is some possibility that the rise in exports will slacken off and that imports will at the same time increase. The net result, having regard to these prospects for demand in 1966, may well be that the real gross national product will rise by approximately 4.5 % over 1965.

Supply and utilization of goods and services

	1962 ⁽²⁾	1963 ⁽²⁾	1964 ⁽²⁾	1965 ⁽²⁾
	At current prices (in FF. '000 million)	% change by volume on preceding year		
Gross national product	356.2	+ 5.1	+ 5.4	+ 2.5
Imports ⁽¹⁾	48.3	+ 12.9	+ 11.8	+ 5
Private consumption	229.7	+ 6.6	+ 4.3	+ 3.5
Public current expenditure	48.0	+ 2.7	+ 3.0	+ 3
Gross fixed asset formation	70.2	+ 6.9	+ 10.5 ⁽⁴⁾	+ 5
Exports ⁽¹⁾	51.3	+ 8.8	+ 7.3	+ 7.5

⁽¹⁾ Goods, services and factor income.

⁽²⁾ Rapport sur les comptes de la Nation 1964; SEEF, Paris.

⁽³⁾ Commission forecasts.

⁽⁴⁾ Including a number of new unsold dwellings which were classified under "Change in stocks" in the 1964 "Comptes de la Nation".

Note :

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

(b) The forecasts are approximations based on 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.

In these forecasts for 1966, which are naturally of a tentative nature at the present stage, it is assumed that there will be no fundamental change in trade-cycle policy. There would in fact be nothing to gain by completely reversing the trade-cycle policy pursued over the past two years, which has aimed at restoring internal and external balance. The authorities have succeeded by a careful dosage of various measures, applied at first cautiously but later with increasing stringency, in eliminating inflationary demand while avoiding any damaging social or economic effects, undesirable economic and social consequences. It is now a question of consolidating these gains and of ensuring that in any future upturn—and the first signs of one are already discernible—a rapid rate of economic growth can be achieved in the long term without any further strain on prices and the balance of payments.

This by no means rules out the possibility that certain stabilization measures may gradually be withdrawn, as and when the realities of the economic situation make them superfluous. In fact, the Council itself, in its recommendation of 8 April 1965 to the Member States on the economic policy to be followed till the end of 1965 ⁽¹⁾ expressed the view that a certain relaxation was called for.

The measures taken by the authorities in the past few months are in complete harmony with this new recommendation. They do not aim at reviving a massive overall demand, but they do encourage and cautiously support a spontaneous recovery, especially by stimulating private investment.

Restrictions on the expansion of bank credit were largely maintained, and there were no changes in the main lines of budgetary policy. However, a number of precautionary measures taken in pursuance of the stabilization programme introduced in the autumn of 1963 were relaxed or abolished. For example, Bank rate was reduced from 4 % to 3.5 %, the minimum interest rate charged by the banks to borrowers was likewise reduced, there was greater flexibility in advances to certain branches of industry, public orders were placed more rapidly, heavier loans for capital programmes were made to public undertakings, consumer credit was made more readily available by lowering the cost of credit facilities, and the period for the purchase of motor-cars by instalments was extended from 21 months to 24 months.

In addition, certain reforms in connection with the financing of capital projects were introduced or carried further, reforms which promise to have an appreciable effect in the long run. Great importance must be attached in particular to the reform of company taxation, since, by reducing the tax on distributed profits it directly encourages saving and attracts more funds to the capital market, and should also indirectly lead to improved scope for self-financing. The further reform of the financing of house-building, the main feature of which will be the introduction of a savings systems for building purposes, and

⁽¹⁾ See appendix.

the first steps towards the creation of a mortgage market, are also of great interest from the standpoint of stabilization policy. They tend to divert a larger proportion of income from consumption to investment and to convert short-term savings into long-term investments.

However, the example of housing construction clearly shows that, in addition to the measures taken to counteract inflationary trends in demand—in this case by replacing financing from the money market more and more by financing from long-term savings—structural measures are also necessary to eradicate price-raising trends. The considerable strain which continues to be felt in the building market can only be eliminated, in view of the backlog to be made up, if supply can by appropriate measures be made more flexible and productivity increased.

In other fields, too, more intensive action will have to be taken to counter the structural factors which tend to drive prices up. In particular, more energetic efforts should be made to rationalize and modernize distribution, which is still a serious bottleneck to rapid and balanced economic growth. The proposed changes in the turnover tax system should be a decisive step in this direction, but they will not take effect until 1 January 1967.

C. Italy

The slight recovery in economic activity, of which there were signs towards the end of 1964, continued in the early months of 1965.

There was once again a brisk increase in exports of goods and services, and there was evidently also some recovery in the growth of domestic demand. It is true that, on the whole, investment in fixed assets remained fairly hesitant, although signs of a revival could be discerned in individual sectors. On the other hand private consumers' expenditure, in particular, appears to have advanced more rapidly than before under the unfluence of a rather more favourable development of the volume of employment and perhaps also because the propensity to save weakened a little.

Whereas production appears to have been virtually static in the agricultural sector, the underlying trend of industrial production was again distinctly upward. For the first four months, however, the ISTAT production index was still some 2 % below that of a year ago.

There was also a further rise in supply from abroad. Although imports of goods were still well below the level of a year before during the first quarter (15 % in value) the difference continued to narrow.

Probably owing to relatively more rapid increases in productivity and the considerable degree of production elasticity in the economy at present, there was apparently a slight drop in prices at production level. At all events, wholesale prices fell a little between December and April. At the same time there was a distinct slowdown in the rise of consumer prices. In April the wholesale price index and the consumer price index were respectively 1.3 % and 5.5 % above the level of April 1964.

That the upward trend of prices has, on the whole, levelled out is also shown by the fact that the increases in cost-of-living allowances paid under sliding-scale wage agreements were lower during the first five months of 1965 than a year earlier.

The surplus on current items in the balance of payments dropped during the first four months. Since during the same period capital movements resulted in a slight deficit, the balance of payments as a whole showed a relatively small surplus. The increase in official gold and foreign exchange reserves from December to April was smaller than this surplus, because the banks again reduced their indebtedness to abroad in view of an apparently continuing hesitant demand for credit by enterprises.

Mainly as a result of stimulants applied by the Government, the economic recovery should become more definite as the year goes on. It will probably continue to be supported by foreign demand and private consumption, but also to an increasing extent by investment in fixed assets—at first mainly public works—as well as by restocking of raw materials and intermediary products. There are indications that firms may show a greater propensity to invest in fixed assets.

The gross national product in real terms may well increase by a full 3 % from 1964 to 1965. The trend towards rising prices will probably continue, although the rate may slow down. There will probably be a deficit on current account, although this should not yet give cause for concern.

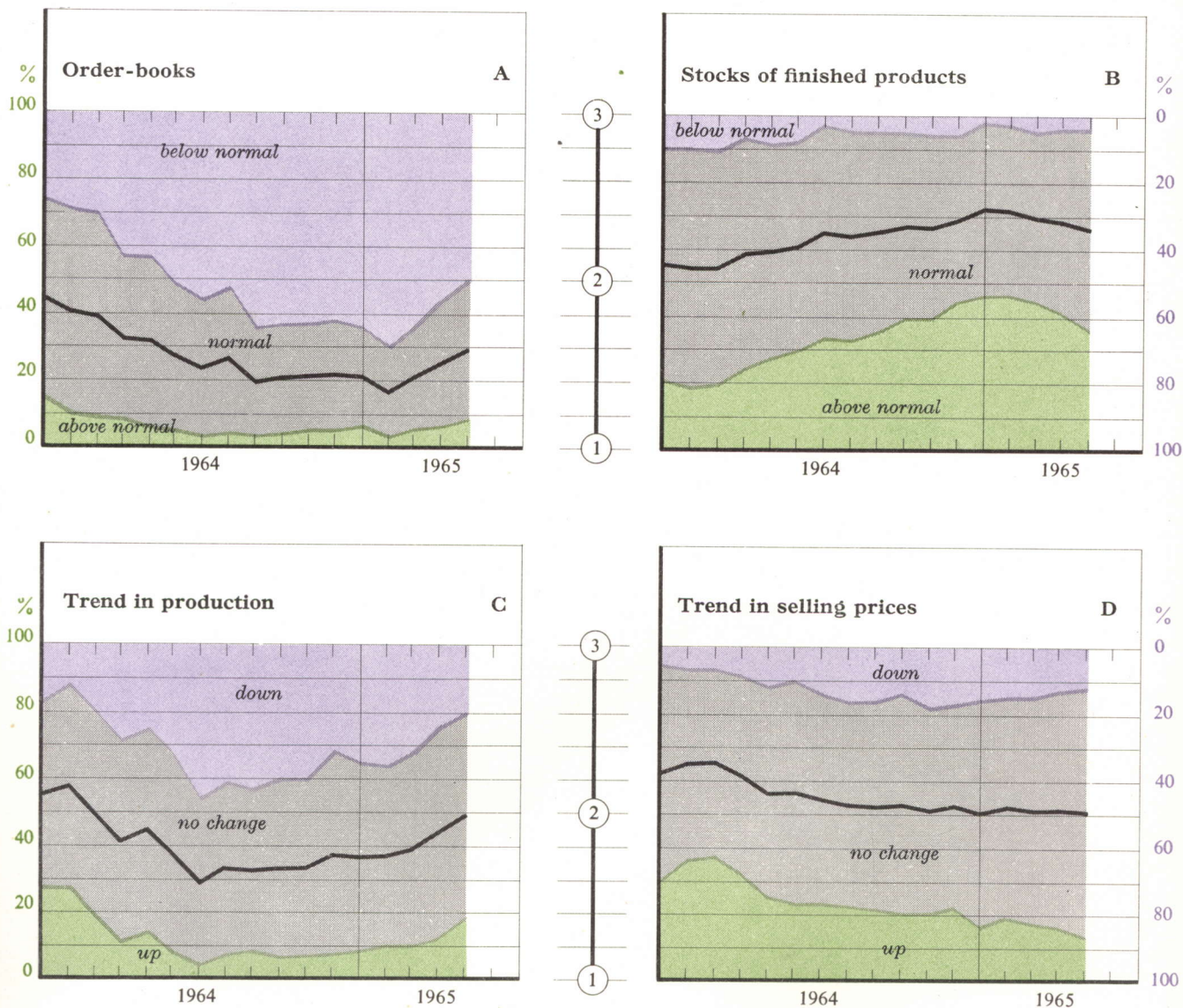
It may be fairly safely assumed that the brisker development of economic activity, which is now beginning, will continue in 1966, and possibly at a more rapid pace. All the important factors of domestic demand should contribute to this upward movement, whereas on balance the stimulus from external trade may be less strong. At present, the Commission's relevant departments take it as an initial and naturally still very tentative working hypothesis, that the gross national product in real terms will increase by 4 % to 5 % between 1965 and 1966.

To ensure that this growth is a balanced one, it is necessary to pursue an economic policy which, on the one hand, encourages rapidly productive investments and thereby improves the real conditions of growth, and on the other prevents consumption, and therefore total demand, from getting out of hand. This would avoid the process of cost and price stabilization being interrupted by the new recovery and giving way to a new inflationary trend, in the end with further deficits on the balance of payments.

1. Recent developments

Exports of goods and services probably increased further in the early months of 1965. At all events external trade statistics show that exports of goods during the first quarter, seasonally adjusted, were up by a good 6 % in value on the level of the fourth quarter of 1964. Compared with the rise between the third and fourth quarters of 1964 (2 %), this means that the growth rate speeded up, partly however because of the

BUSINESSMEN'S VIEWS ON THE INDUSTRIAL SITUATION



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

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

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

need to make up the leeway at the end of 1964 caused by strikes. The value of exports in the first quarter of 1965 was again up considerably—by 25.5 %—on the corresponding period in 1964.

Exports of iron and steel, plastics, man-made fibres, chemical fertilizers, and textile machinery were particularly expansive, with deliveries to the Community and to the developing countries in the lead.

On the other hand, exports of services may have increased rather more slowly than during the fourth quarter.

Domestic demand as a whole probably remained weak, although certain trends towards a recovery in some limited sectors continued. Expenditure on gross fixed asset formation probably dropped once again. At any rate there was a further downturn in activity in the construction sector. True, state spending on public works rose strongly, but other building investment probably declined in the aggregate. At least this was the case with housing, where projects in terms of dwelling space were as much as 48 % below the corresponding level of the previous year. However, dwelling space actually completed was considerably above the 1964 level (13.5 %). In commercial and industrial building completed in the first quarter there was a particularly marked decrease (down to 16.5 %) in the year-to-year growth rate by volume (cubic metres). However, the trend of new housing projects put in hand may well have been somewhat livelier.

To judge by the trend of production and external trade in the mechanical engineering sector, investment in plant and equipment continued slack on the whole. Domestic demand for commercial vehicles would however appear to have picked up somewhat.

Consumption expenditure may have been rather brisker than in the closing months of the previous year. This applies, first of all, to public current expenditure, which rose considerably, for institutional reasons among others. In particular, however, private consumers' expenditure was somewhat more expansive than towards the end of 1964. At any rate domestic demand for motor-cars increased considerably, which strengthened the trend apparent as early as the autumn of 1964 after the special tax on purchases of new private cars was abolished. True, in the first quarter the number of new registrations was still considerably lower (by 18.5 %) than a year earlier, but the gap had clearly narrowed compared with the fourth quarter, when the disparity was 30 %. In April and May, the number of new registrations again exceeded the admittedly very low level of the previous year—by 19 % and 41 % respectively. There has also apparently been some revival in the tourist industry in Italy itself.

The growth of total income was probably somewhat more pronounced in the early months of 1965 than hitherto. True, the increase in income per person employed

and per hour may perhaps have been rather slower, although new collective wage agreements were concluded in a number of sectors, cost-of-living allowances were raised under the existing sliding-scale agreements and family allowances also went up. But, on the other hand, some improvement may have occurred in the volume of employment ⁽¹⁾ as compared with the fourth quarter of 1964. In addition, pensions were increased, while the special allowance paid to civil servants in December 1964 may also have boosted consumption in the early months of 1965. Another important factor may have been that households showed greater propensity to spend.

According to the ISTAT Surveys in January 1965—no more recent statistics are yet available—the number of wage- and salary-earners was 3.3 % lower than at the same period last year. In the construction sector the decrease even amounted to 4 %. However, the underlying trend of the volume of employment in the first quarter was almost certainly more favourable than would appear from these partial statistics. In the first place, numbers in employment were probably very high in January 1964 because of the specially mild winter. Secondly, the total of wage- and salary-earners probably tended to become stable from January onwards. Another important point is that the average number of hours worked per person appears to have increased a little for the first time for a long period. A further reason for thinking that the volume of employment rose slightly is that there has apparently been an appreciable drop in the number of persons working in the services sector, which had risen in 1964 as a result of growing underemployment.

True, in January the number of unemployed was 16.5 % higher, according to ISTAT statistics, than a year ago : in July 1964, however, the annual rate of increase had been 21 % and in October even as much as 33.5 %.

According to ISCO estimates, agricultural output was again virtually static during the first four months of 1965, whereas it had shown an upward trend during the first three quarters of the previous year.

Industrial production, on the other hand, showed further progress. The ISTAT index, seasonally adjusted by ISCO, rose by almost 1 % between the fourth quarter of 1964 and the first quarter of 1965 and, according to provisional estimates, even showed a particularly appreciable upward trend in April. The gross index for the first four months was only a bare 2 % below that of the corresponding period last year.

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

Not only was the production of chemicals and of iron and steel again quite expansive in the first quarter of 1965—in the latter case, mainly owing to the commissioning of a large modern steelworks, which led to an increase in steel exports and some substituting of home-produced for imported steel—but motor-car production also advanced strongly. On the other hand, output of cement and textiles, in particular, was still slack. Construction, too, continued to decline on the whole.

The expansion in imports of goods and services probably continued in the first quarter. This applies at any rate to imports of goods, which however were probably influenced by the same special expansive factors as exports. Calculated on the basis of customs returns, the seasonally adjusted increase over the fourth quarter of 1964 in the value of goods imported was 3 %. The increase by volume was probably hardly less. In terms of value the gap between imports in the first quarter and those in the corresponding period of the previous year narrowed to 15 %.

The expansion of imports of chemicals and vehicles, both from other EEC countries and from non-member countries was particularly brisk.

The upward trend of prices continued to slacken off in the early months of 1965. In the December-April period, wholesale prices even dropped slightly (0.3 %). This fall, due mainly to the continuing weakness of building demand, was confined to industrial products. Food prices on the other hand rose a little and seem to have continued to do so in May. Although the consumer price index again rose between December and April, the increase was less than during the same period last year. It nevertheless amounted to 1 %, and, at this level, food prices in particular again rose distinctly. Consumer prices in April were still up 5.5 % on the corresponding period of the previous year. The disparity was only 1.3 % in the case of wholesale prices.

In spite of the more rapid underlying increase in exports of goods as compared with imports, the deficit on trade rose from Lit. 48 000 million in the first quarter of 1964 to Lit. 65 000 million in January/March 1965. The seasonal drop in net receipts from services, too, was probably particularly marked in the first four months. The balance of current payments nevertheless continued to show a considerable surplus during this period. Since, however, the balance of capital transactions, which had still shown a large surplus towards the end of last year, revealed a slight deficit, there was a sharp drop in the surplus on the balance of payments as a whole (from Lit. 423 000 million in September/December 1964 to Lit. 110 000 million in the first four months of 1965). However, as a result of a further sharp reduction in the short-term external indebtedness of the banks, official gold and foreign exchange reserves rose to a much smaller extent (by Lit. 35 000 million). At the end of April, their net total was Lit. 2 382 000 million. Probably in May they again rose.

In contrast to the last three quarters of 1964, during the first four months of 1965 the trend of the balance of payments thus gave very little impetus, in the aggregate, to the banks' domestic liquidity. Moreover the increase due to Treasury transactions was relatively small (approx. Lit. 15 000 million). Since the demand for bank advances continued to stagnate—in contrast to demand for advances at favourable interest rates from the special credit institutes, which appears on the contrary to have been very brisk—the banks once again used the inflow of liquid funds to reduce their rediscount commitments and secured advances from the Banca d'Italia (by Lit. 334 000 million between December and April). The banks' liquid funds nevertheless remained at a high level; in March, they amounted to 7.2 % of customers' ordinary deposits (in February and October 1964, 3.7 % and 5.6 % respectively).

The uneven trend of the market for securities continued during the early months of 1965. Whereas demand for shares remained weak there was again no lack of buyers for fixed-interest-bearing securities, although the public authorities (in the broad sense of the term) made frequent bond issues. The falling trend of interest rates levelled out, however. The yield of debentures dropped only slightly (from 6.9 % to 6.7 %) between December and March.

2. Outlook

Since the economic "super-decree" of 16 March, prospects for expansion have improved, both as regards the general mood of business and in real terms.

As far as foreign demand is concerned, there are firm prospects of an upward trend. The continuing favourable economic outlook in the countries which are Italy's main customers, the effects of export promotion measures—such as easier arrangements for refund of turnover tax on exports, which came into force on 1 April—and the still satisfactory competitive position of the Italian economy, all point to such a development. The recent reduction of the British import surcharge may also help Italy's exports to some extent. Nevertheless, the expected brisker development of domestic demand will probably tend to depress exports.

Several factors point to such an increase in domestic demand later this year. As regards expenditure on gross fixed asset formation, there is every possibility of a recovery in the building sector. True, as already pointed out, the number of housing projects was still tending to contract in the first quarter. For a variety of reasons—some of them of an institutional nature—a rapid upturn in this sector is not very probable, despite the efforts of the authorities concerned. As against this, the partial indicators available

seem to foreshadow some recovery of commercial and industrial building in the coming months, and it may be expected, in particular, that public works, which were of course mainly affected by the "super-decree" referred to, will go ahead more rapidly.

These prospects should encourage a reaction among firms from their hesitant attitude to investment in plant and equipment, still evident at the beginning of 1965. In addition, the fierce competition from abroad and the constant, if no longer quite so rapid, rise in unit wage costs constitute powerful incentives to capital investment for rationalization purposes, the more so as the latter was largely neglected during the previous year. An additional factor is that the economic measures taken on 16 March provided credit facilities for the acquisition of machinery and improved the profit situation of enterprises to some extent. However, it cannot be denied that as a result of the heavy pressure of costs over a long period, this situation is still unsatisfactory in the case of many enterprises. Nevertheless, the latest information is that domestic orders in the capital goods industry are again looking up and that heads of firms are more optimistic in their assessments of future developments. Thus there appear to be grounds for thinking that investment in plant and equipment will increase in the next few months.

Investment in stocks, which dropped considerably last year, will in all probability give a strong stimulus to overall demand.

Finally, there will most probably be an appreciable increase in consumption expenditure. This applies both to public current expenditure, particularly as policy in this sector is again generally expansive, and to private consumers' expenditure. As regards the latter, an appreciable increase in total income is in the first place probable, for although increases in agreed wages and the rise in actual earnings per head should be relatively moderate, total income from wages and salaries will probably increase considerably owing to a higher level of employment. Furthermore, a rise—perhaps a considerable one—in transfer income is to be expected. A further point is that, under the influence *inter alia* of official social policy measures, households may be less cautious than last year in their spending, in other words, they may tend to save a smaller proportion of their disposable income.

In view of this outlook for demand, the recovery of industrial production should continue and a further considerable increase may be expected as the year goes on. There has been a similar improvement in the outlook for the construction sector, although it is still fairly uncertain in the case of housing at least. Finally, production in the services sector should also benefit from the expected revival in the expansion of demand.

In these circumstances, there should be a further considerable increase in imports, not only on account of the greater demand for raw materials and semi-finished products to replenish stocks and provide for rising production, but also as a direct consequence

of the recovery of consumption and of investment in fixed assets. In addition, the latest trend of crop production and the outlook in this sector point to a further rapid rise in imports of foodstuffs.

The price rise will probably continue, although at a slower rate, the more so as the pressure of costs is still very great—mainly because of the trend of wage costs in recent years—and, with demand again increasing, it is easier to pass increases on to the consumer. On the other hand the favourable influence on unit costs of improved capacity utilization will tend to curb the upward trend. However, there are still a number of rising price trends of a structural nature, particularly in services—in trade and transport especially—and in agriculture.

The balance of trade is likely to deteriorate further and the surplus on overall current payments will probably tend to contract. However, it is quite possible that results for the full year will show an increase in this surplus compared with the previous year; however, it will doubtless be much less marked than the increase between 1963 and 1964.

A comparison of the outlook described above with that set forth in the last Quarterly Survey shows that a period of more favourable economic development is now to be expected. The main reason for this lies in the economic measures taken under the “super decree”, which, as already pointed out, came into force on 16 March 1965, i.e. after the analysis made for the last Quarterly Survey. Because of pressure of time it was not possible to do more than list the measures; no assessment of them was attempted. This has now been done, and the resultant improvement in the outlook is, of course, also reflected in the quantitative forecasts of supply and utilization of goods and services for the full year 1965. In general these figures have been adjusted upwards in varying degree.

The more favourable outlook for 1965, particularly for the latter half of the year, naturally influences preliminary forecasts for developments in 1966. There may well be a further strong upward trend in total demand, attributable mainly to investment spending but also to a further strong increase in consumption. However, the rise in the rate at which exports are growing might slow down further, on account both of a rather more subdued business climate in countries which are leading importers of Italian goods and of the very fact that domestic demand is buoyant. At the same time the accelerated rise in imports will probably continue. In these circumstances, the gross national product, in real terms, may very well show an increase of 4 % to 5 % between 1965 and 1966.

The authorities responsible for economic policy are faced with the task of directing the recovery and further growth of the economy in such a way that the trend towards price stabilization is not interrupted, or even replaced by a new upward price thrust,

and that a satisfactory equilibrium of the balance of payments is ensured. This means that domestic demand must on no account expand very rapidly or indeed precipitately; the pace of growth must again be steadied at the first sign of overheating.

Supply and utilization of goods and services

	1962 ⁽²⁾	1963 ⁽²⁾	1964 ⁽³⁾	1965 ⁽⁴⁾
	At current prices (in Lit. '000 million)	% change by volume on preceding year		
Gross national product	24 789	+ 4.8	+ 2.7	+ 3
Imports ⁽¹⁾	4 365	+ 20.7	— 5.9	+ 5
Private consumption	15 006	+ 9.7	+ 2.4	+ 3
Public current expenditure	3 645	+ 5.7	+ 3.9	+ 5
Gross fixed asset formation	5 846	+ 5.7	— 9.2	— 6
Exports ⁽¹⁾	4 357	+ 6.3	+ 10.9	+ 10

⁽¹⁾ Goods, services and factor income.

⁽²⁾ General Statistical Bulletin 1964, No. 11, Statistical Office of the European Communities.

⁽³⁾ "Relazione generale sulla situazione economica del paese (1964)".

⁽⁴⁾ Commission forecasts.

Note :

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

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

Although it is possible to agree with the Italian authorities' view that, because of the leeway in investments and inadequate domestic saving, Italy will have to be a net capital importer for a number of years, care must be taken to ensure that the corresponding deficits in the current balance of payments are not brought about primarily by a very rapid expansion of internal demand and of costs and prices. On the contrary, adequate and dependable inflows of long term capital must first of all be made available and corresponding deficits in the current balance of payments should arise from these inflows.

The policy of cautiously guiding domestic demand, which we have said is necessary, can be all the more effective, from the standpoint of growth policy, if those investments are supported and encouraged which promise the quickest rise in productivity.

Successful efforts in this direction would in fact not only slow down the price rise, but would also widen the margins for future growth of production. The need for a revival of these productive investments, which are naturally very sensitive to the state of the business cycle, is emphasized by the fact that, according to the government economic survey published in March, they fell by over 15 % in value and as much as 20 % by volume between 1963 and 1964, whereas other forms of investment in fixed assets increased considerably.

All measures which encourage adequate formation of capital from savings and its supply at the lowest possible cost are therefore welcome. Obviously, however, considerable importance attaches at present, i.e. at a time when profit margins are very much under pressure, to reducing the cost of bank advances. Moreover it is now more essential than ever to pursue a moderate incomes policy. The more successful this policy the better will be the prospects for reviving the propensity to invest and attaining price stability.

The Italian authorities' short-term policy is mainly along these lines. It therefore conforms in the main to the Council's economic policy recommendation of 8 April 1965 (see Appendix).

This applies first to the economic measures contained in the "super-decree" referred to earlier, which have meanwhile been slightly modified by the legislative authorities. The main amendments concern the raising of the credit ceiling for the purchase of machinery by small and medium-sized enterprises and certain extensions of tax reliefs for housing. In short, the main purpose of the "super-decree" is to support investments, the only direct encouragement to consumption being the grant of family allowance to the unemployed. The financing of these measures—mainly by the issue of bonds—would appear to be unobjectionable, provided that the public purchase the bonds.

It should be borne in mind, however, that the "super-decree" is mainly concerned with infrastructure investment, i.e. public works and housing, whereas productive investment is less effectively encouraged. Thus, the taking over by the State of part of the burden of social contributions borne by firms, which was one of the economic measures laid down on 16 March, is no absolute guarantee that the firms will in fact use the money thus left in their hands to finance further productive investment. A surer means of achieving this would perhaps have been tax reliefs tied to investments. Admittedly the Italian tax system lends itself less easily to effective action of this kind than those of other EEC countries, which again underlines the urgent need for a tax reform, particularly to improve the instruments of economic policy. There should nevertheless be possibilities of stimulating investment by fiscal means.

Since 16 March, a number of further measures of considerable importance from the angle of the economic trend have been either taken or proposed. In particular, a Bill has been drafted to reorganize and improve pensions. Another Bill proposes bigger loans, state subsidies and interest rebates for industrial and agricultural enterprises and certain services in the underdeveloped areas of Northern and Central Italy. Finally, funds have recently been made available from the budget to enable a total of Lit. 130 000 million to be spent over a two-year period on building and modernizing hospitals.

Whereas pensions increases, being in the nature of transfers which tend to encourage private consumption, are only justifiable from the economic policy angle and compatible with the recommendation of the EEC Council of Ministers if applied with great moderation, the proposed assistance to enterprises in the regions mentioned and the investments in the health field are to be unreservedly welcomed. It is to be hoped that these steps will shortly be followed by measures to increase the supply of capital from savings, such as the authorization of investment trusts, which has been under discussion for some time.

Finally, all reforms and measures likely to eliminate the structural factors tending to push up costs and prices—whose effect is particularly pronounced in Italy, especially in agriculture, goods transport, distribution and other services—should be rapidly applied or intensified. This does not always require large investment spending. In many cases strong pressure on prices can probably be created simply by abolishing or amending out-of-date administrative instructions and by effectively combating restraint of competition. The stronger the influence these structural factors continue to exercise, the lower in the longer term will be the rates of economic growth which can be sustained while remaining reconcilable with the demands of internal and external balance.

Since the completion of this survey, the Italian Government has tabled three new draft laws the implementation of which would affect short-term economic policy. The first provides for budget appropriations of Lit. 15 000 million each year for five years for harbour construction work. The second draft is designed to provide new regulations governing access to occupations in the distribution sector. In the third proposal the Government has proposed that certain payments made to assist the fully and partially unemployed should be improved or extended over a further period.

D. Netherlands

The rapid expansion of overall demand continued in the first three months of the year, but it may have slowed down a little, at least temporarily.

Exports, which rose quite strongly in the fourth quarter of 1964, continued to expand (apart from variations) in the following quarter. In the first three months of 1965 the value of visible exports was up 12 % on the first quarter of 1964.

As regards domestic demand, gross fixed asset formation again showed a distinct increase, but such indicators as are available confirm that last summer's tendency for expansion to slacken off somewhat continued. Private consumers' expenditure kept on rising—thanks to higher incomes resulting chiefly from negotiated wage rises and to the perceptible increase in transfer incomes at the beginning of the year. However, this element of demand too seems not to have quite matched its vigorous expansion in the closing months of 1964.

The slight decline in the growth of overall demand did not affect domestic production. Industrial output in the first quarter of 1965 rose at much the same pace as in October-December 1964, with the national index showing a year-to-year growth rate of more than 6 %. Strains on the labour market eased only slightly.

Imports reacted more definitely than industrial production to the movement of overall demand; the main reason for this was probably the greater caution exercised in stocking imported raw materials and semi-manufactures. And at times imports were inhibited by fortuitous factors. The value of visible imports was thus only 2.4 % higher than a year before.

Chiefly as a result of further cost increases and the continuing pressure of demand on internal resources, upward price trends again made themselves more strongly felt on a number of markets. The retail price index went up 5 % between December and April, when it was 3.5 % higher than in the same month of 1964.

The balance of trade again improved a little. The current account showed a surplus of some Fl. 70 million in the first quarter. As there were still net inflows of capital, the overall balance of payments was in surplus by about Fl. 150 million.

The outlook until the end of the year is for continuing expansion. There may be some decline in the corrected growth of exports, but domestic demand should at least keep on rising without losing pace. While the underlying expansion of capital expenditure by firms might again taper off a little, that of private consumers' expenditure especially is likely to speed up—the rate of acceleration depending on the mid-year decision on additional wage increases for 1965. On the whole, the growth of industrial production should maintain its tempo of recent months. Imports will most probably be livelier than in the first quarter. The upward price trend will presumably persist, and the balance of current payments will doubtless tend to deteriorate further.

Recent developments and the prospects that can be discerned at this stage confirm in the main the estimates for the full year given in the last Quarterly Survey. The increase in gross national product could be about 4.5 % (volume).

The outlook for the Dutch economy in 1966 is that public investment, expenditure on housing and—largely as a direct and indirect result of continuing labour market strains—private consumers' expenditure will again expand quite vigorously. Exports, on the other hand, and especially investment in plant and equipment by private business, will probably have a less stimulating effect on the economy. Gross national product should increase by 4 to 5 % in real terms. If budgetary policy were to be more expansionary than it is at present, growth could perhaps be more considerable, but prices would then most probably rise quite sharply, and the current account might even close with a deficit again.

The EEC Council's recommendation of 14 April 1964 still holds good: priority must be given to restoring equilibrium—which means not only a satisfactory balance on current account but also stabilization of prices and unit costs. In order to achieve this aim, the economic policy of the responsible authorities must be brought more firmly into line with the various points in the Council recommendation. Where budgetary policy does not sufficiently meet the case, credit policy will have to be greatly tightened up.

1. Recent developments

Exports of goods and services maintained their underlying upward trend in the first quarter and, as far as can be judged, into the spring months as well. The rate of expansion may even have increased.

This is true in any case of visible exports (as defined in the national accounts), which—after adjustment for seasonal variations—went up sharply between the fourth quarter of 1964 and January-March 1965. External trade statistics show that the value of goods exported in the first quarter was 12 % higher than in the first quarter of 1964. In April, however, the year-to-year growth rate was 5.8 %.

Adjusted sales to other Community countries again rose sharply—particularly those to Germany and to Italy, where the hitherto greatly reduced demand for Dutch products tended to recover ground. On the whole, exports of farm products went up more rapidly than those of manufactured goods.

The underlying upward trend of domestic demand continued, though some signs of a slowdown were apparent. This applies in particular to gross fixed asset formation, which did indeed show a further increase after seasonal adjustment, but at a slower pace than before.

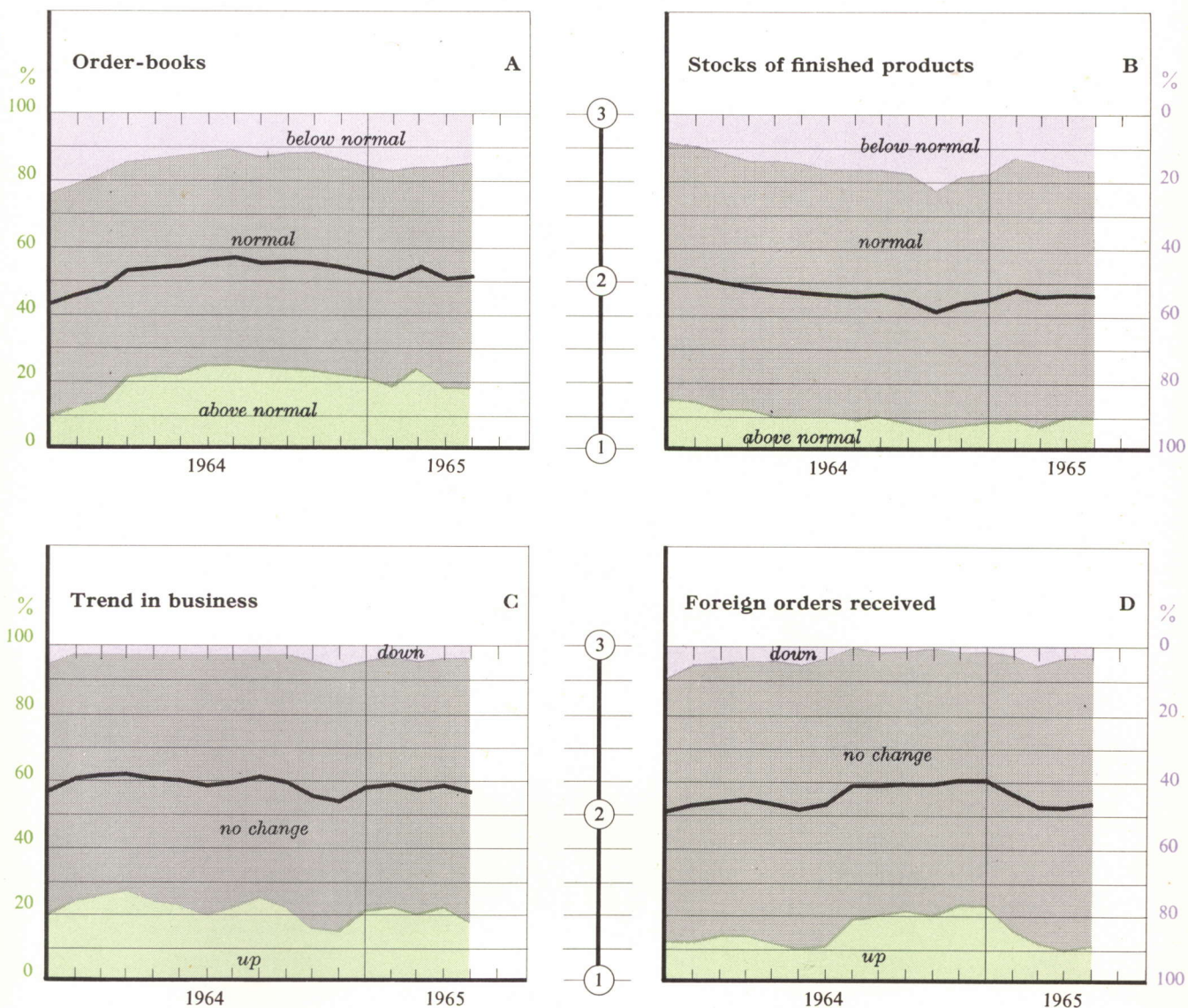
Expansion of investment by enterprises seems to have flattened out slightly. The continual pressure of costs on profit margins that has been felt for years and has not been completely offset by the increase in nominal turnover, and the effects of the restrictive measures imposed in 1963 and 1964, presumably played a part here. It was chiefly the smaller and medium-sized firms that were less inclined to invest and, in any case, found difficulty in financing growing investments. Investments by major concerns, particularly those involved directly or indirectly in opening up natural gas deposits, have gone some way towards counteracting this trend. In general, the propensity to invest draws considerable support from efforts to stem increasing costs by rationalization. The expansion of industrial and commercial building also provides a stimulus for purchases of capital goods. Moreover, expenditure on housing is expanding at a consistently rapid pace.

There was once again an underlying increase in public investment in fixed assets, though the decline in the growth rate as a result of the Government's policy of restraint seems to have been particularly appreciable.

Nothing definite can be said at the moment about the movement of investments in stocks, though it may be supposed that stockbuilding of imported raw materials and semi-manufactures was rather hesitant.

The slowdown in the expansion of consumption expenditure was less marked than in that of capital expenditure. Public current expenditure on goods and services rose

BUSINESSMEN'S VIEWS ON THE INDUSTRIAL SITUATION

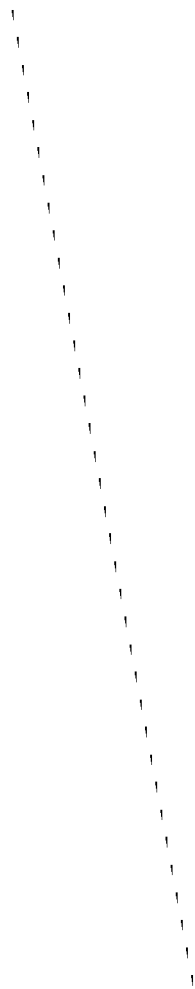


Source : Business survey of the Centraal Bureau voor de Statistiek.

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

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

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



rapidly, mainly owing to further strong increases in civil servants' wages and salaries. These exceeded 7 % and were higher than the agreed increases in the private sector. They were put through as the last part of the four-year programme for the revision of salary scales in the public service.

The underlying trend of expansion in private consumers' expenditure kept moving at a considerable pace, though a little more slowly than in the fourth quarter of 1964. Earnings of households again went up sharply. As regards income from wages, negotiations in the private sector produced an average increase of about 3.5 % during the first quarter; the rise in women's wages was about 5 %. On the whole, wage increases under collective bargaining agreements do not seem to have kept strictly within the overall limits agreed by both sides of industry in December—particularly if it is borne in mind that negotiations in some important branches were still in progress after the end of the quarter. In several industries, moreover, the wage drift appears to have been quite considerable. Lastly, the total number of hours worked (number of persons in paid employment multiplied by average working week) probably continued to increase. The rise in wages and salaries was accompanied by appreciable increases in transfer incomes (old-age pensions, family allowances, disablement pensions) which were only partly offset by higher contributions. Non-wage incomes accruing to households also seem to have kept rising.

The slight slowdown in the increase of overall demand had but little effect on domestic production. Industrial output continued to expand in the early months of 1965 at the same rate as in the second half of 1964, if seasonal and random factors are disregarded. In the first quarter the CBS unadjusted index was 7 % higher than for January-March 1964.

Building and construction was held up from time to time by rather bad weather, but maintained its upward trend.

There were again some slight signs of relaxation on the labour market. Unemployment figures rose a little in the course of the year, apart from the usual seasonal movement : at the end of April they stood at 30 900—5 100 more than in April 1964. However, much of this increase represented building and farm workers and was thus attributable to the fact that the weather was worse than a year before. The monthly average of registered vacancies in the first quarter was 118 000—4 % higher than in the March quarter of 1964. In April the number was rather lower than in April 1964, but there were still almost four vacancies for every unemployed worker. Strain continued to ease slightly during May.

Imports of goods and services reacted more strongly than production to the trend of overall demand. Customs returns show that the year-to-year growth rate of visible

imports for the first quarter was only 2.4 % in value (2.5 % by volume), but it should not be forgotten that imports soared in the first quarter of 1964. Imports also seem to have been influenced by various special factors (such as differences in the number of working days) : in April they were down as much as 4.1 % on April 1964.

Imports of consumer goods were fairly lively during the first quarter, while the trend for capital goods was relatively weak. Imports of raw materials—and of farm products in particular—declined markedly, which was probably due in part to the effects of the dockers' strike in the United States. Particularly in terms of this trend according to products, it should be noted that imports from other member countries made a better showing than those from outside the Community.

Owing to government price controls, it is difficult to assess the underlying price trend in the Netherlands. Nevertheless, the upward movement may be said to have continued with increased vigour. Wholesale prices for finished goods—which had remained stable from September to January—rose once more, thus offsetting the effects of lower prices for raw materials (largely a result of the world market situation) on the overall index. The increase in building costs continued.

The retail price index, which had remained steady in the third and fourth quarters of 1964 after a sharp upswing from the first to the second quarter, again began to move up : there was a 5 % increase from December to April. The year-to-year growth rate in April was 3.5 %, but it should not be forgotten that there was a very sharp jump in prices from March to April 1964. The most recent increases in the index, however, were partly due to higher prices for public services (postal and telegraph charges, local transport) certain farm policy decisions, and fortuitous factors, such as higher prices for potatoes and vegetables.

Customs returns show that the balance of visible trade tended to improve, though only slightly, between the fourth quarter of 1964 and the March quarter of 1965. There was a first-quarter deficit of Fl. 910 million, as against Fl. 1 340 million in the first quarter of 1964. The current account (on a transactions basis) closed with a surplus of Fl. 70 million (compared with a first-quarter deficit of Fl. 542 million in 1964). As there were still net capital inflows, the overall balance of payments in the first quarter was Fl. 151 million in surplus. The commercial banks improved their net foreign holdings by Fl. 180 million; gold and foreign exchange reserves of the monetary authorities fell by Fl. 35 million.

Transactions with abroad in the first quarter had a slightly expansionary effect on total domestic liquidity, but government transactions had the opposite effect because of the policy of issuing Treasury bills in excess of financial requirements. Nevertheless,

the banks had no great difficulty in accelerating appreciably the expansion of short-term loans to the economy, which had slowed down somewhat. The Central Bank, which had set a 4 % ceiling on the expansion of these bank loans for the January to April period (on the basis of the average for the first half of 1963), raised this by 1 % for May-August. Penalty deposits, which had fallen temporarily, rose again from March; on the basis of the end-April credit position, they stood at Fl. 169 million for June and July.

Supply and utilization of goods and services

	1962 ⁽²⁾	1963 ⁽²⁾	1964 ⁽³⁾	1965 ⁽⁴⁾
	At current prices (in Fl. '000 million)	% change by volume on preceding year		
Gross national product	48.09	+ 3.6	+ 7.5	+ 4.5
Imports ⁽¹⁾	23.67	+ 9.6	+ 14	+ 6
Private consumption	27.98	+ 7.1	+ 6	+ 6
Public current expenditure	7.19	+ 2.8	+ 1.5	+ 1.5
Gross fixed asset formation	11.55	+ 3.9	+ 15	+ 5
Exports ⁽¹⁾	24.30	+ 6.4	+ 11	+ 7.5

⁽¹⁾ Goods, services and factor income.

⁽²⁾ General Statistical Bulletin 1964, No. 11, Statistical Office of the European Communities.

⁽³⁾ Commission estimates.

⁽⁴⁾ Commission forecasts.

Note :

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

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

Demand on the capital market was particularly heavy. In the first three months of 1965 enterprises (particularly those part-owned by the state) placed more than Fl. 400 million worth of bonds and shares. This has a bigger total of issues than for the whole of 1964. The "Bank voor Nederlandsche Gemeenten" (Bank for Dutch Municipalities) also increased its issues. Long-term interest rates began to rise in the spring after falling slightly between December and March.

2. Outlook

Economic growth seems likely to continue until the end of the year.

The effect of demand from abroad, i.e. of actual exports of goods and services, on the economy will again be fairly expansionary. However, some decline in the upward trend of visible exports is not to be excluded. Sales of plant and equipment may be expected to rise less rapidly, as is indicated by the results of the most recent Community business surveys. Working time assured by foreign orders has again contracted, not only as a result of the sharp expansion of capacity in several industries but also because of the hesitation with which new orders are coming in. Another relevant factor has probably been the increased difficulty Dutch firms have had in competing on certain foreign markets. In addition, there is the possibility that an upsurge of domestic consumer demand will to some extent limit the growth of exports in certain industries producing consumer goods. It is unlikely furthermore that exports of farm products will continue to benefit from the exceptional factors that have been at work since the autumn of 1964. Lastly, total exports will probably slacken temporarily because a large programme of arms deliveries is coming to a close.

As regards domestic demand, short-term forecasts of expenditure on gross fixed asset formation are affected by a number of uncertain factors. On the whole, however, expenditure will presumably maintain its upward trend.

The signs of a weaker trend in expenditure by enterprises on plant and equipment could become more distinct. Purchases by public utilities and transport undertakings will go up appreciably, but private firms may be less keen on investing in plant and equipment. The same factors as were mentioned under "Recent developments" are likely to have their effect here too.

On the other hand, the significance of this weaker trend should not be overestimated, for it seems that profits went up quite satisfactorily in 1964—at least for companies. Moreover, potential demand for industrial and commercial building is still growing, as is evidenced by the number of permit applications. Potential demand has long been held back by official licensing policy; it is now well ahead of what the industry can supply. Should there be any decline in the propensity to invest, the issue of building permits will probably suffice to keep expenditure high—including that on equipment for the new buildings.

Public investment spending may go on rising at a slower pace for a time, after which the clearly expansionary policy again being introduced in this field should provide new stimulus.

Lastly, we may count on the continuation of the sharp upswing in expenditure on housing, especially as everything is being done—as regards both financing and permits—to keep expansion moving, with the emphasis on low-cost housing.

While public current expenditure on goods and services in the coming months is likely to advance more slowly than it did between the fourth quarter of 1964 and January-March 1965, the trend of private consumers' expenditure should speed up appreciably in the second half of the year after a probable quieter spell during the June quarter. The total number of hours worked will most likely go up again, and per capita income in the private sector will rise sharply because of the extra general pay award expected about halfway through the year in the form of a single payment for 1965 and because of the wage and income tax cut to take effect on 1 July. In addition, there will be renewals of wage agreements in certain major industries, presumably accompanied by a further appreciable wage drift, in view of the continuing strain on labour markets.

These developments in overall demand make it certain that domestic production will keep rising. The trend of industrial production will vary between a slower increase in capital goods and more rapid expansion in consumer goods—where available capacity and manpower make this possible. On the whole the growth rate of industrial production could be about the same as in the first quarter. Output in building and in the services sector should show further progress.

Everything points towards continuing overstrain on the labour market as a whole, though the situation may well be easier in some industries or trades.

The movement of imports is unlikely to be held back much longer by the caution with which businessmen are stocking imported raw materials and semi-manufactures. Moreover, the disappearance of certain special factors active in the first quarter, and, in particular, the expected acceleration in the expansion of consumer spending, will result in higher demand for imported goods. How strongly imports increase will depend largely on the decision to be taken regarding a further general wage increase.

In any case it can be assumed as a working hypothesis that the balance of trade will tend to deteriorate, although the terms of trade might still improve for the Netherlands. It seems almost certain that there will be no surplus on current account: it may even close with a deficit—how big a deficit depending on the extent of wage increases.

This will of course help in some measure to contain the rise in prices, which might tend to be aggravated—particularly in the consumer sector—through the pressure of demand and in general because of the further increases in wage costs. It is also likely that the Government will continue its policy of direct price intervention. However,

there will be further inevitable increases in charges for public services, resulting from previous costs inflation, and possibly some adjustment of farm prices under the common agricultural policy. On the whole, the upward price trend will remain fairly strong, though it may be sometimes concealed by seasonal factors.

By and large these prospects up to the end of the year, together with the development already recorded, confirm the forecasts made in the last Quarterly Survey of changes in the volume of the major aggregates of goods and services supplied and utilized for the full year 1965 compared with 1964. The increase in the gross national product in real terms might be rather more rapid—4.5 % rather than 4 %.

The prospects for the Dutch economy in 1966 already indicate considerable expansion of public investment, of building and construction demand in general—with housing once again to the fore—and of private consumers' expenditure. Exports, on the other hand, and especially investment in plant and equipment by private concerns, will perhaps not impart as much stimulus to the economy as hitherto. In the Commission's view, real GNP could increase by 4 to 5 %. It is not at all certain whether economic expansion will be accompanied by stabilization of prices and a satisfactory balance of payments, particularly if this growth rate is exceeded as a result, among other things, of a sharper rise in public expenditure.

It is obvious that the objectives of stabilization policy will not be achieved by the end of 1965, and perhaps not in 1966 either, unless the authorities responsible for short-term economic policy adhere more closely to the EEC Council recommendation of 14 April 1964 and envisage only a reasonable expansion of domestic demand in monetary terms for 1966 too. If the aims of short-term stabilization policy are neglected in favour of the speediest possible attainment of medium- or long-term aims (perhaps by giving a strong fillip to spending in the public and semi-public sector and by extra outlay on housing) there would be a possibility of fairly vigorous real economic growth in the short term; at the same time, however, sizeable price increases would still have to be accepted, and the current account would not show the desired surpluses.

It is possible to go some way in asserting that there need be no real contradiction between the more rapid pursuit of medium- and long-term infrastructure and social objectives on the one hand, and the requirements of internal and external equilibrium in economic expansion on the other. But to this end the overall expansion of private consumers' expenditure must be kept within the requisite bounds—whether by means of budgetary policy or through incomes policy.

As far as budgetary policy is concerned, the increase in expenditure, which in 1964 was already considerably higher than the ceiling set by the Council (even allowing for

all permissible additions), will again go beyond the limit in 1965, though not to quite the same extent. In 1966, a further speed-up in government spending is not to be excluded. Moreover, direct taxes have been cut with effect from 1 July 1965, and there is a firm political commitment to make a second cut no later than the beginning of 1967.

If public expenditure is not kept within the prescribed limits, some counterbalance should at least be provided on the revenue side. In this connection, an appreciable increase in the charges for public services and in indirect taxes could well provide a solution.

If budgetary policy does not make a sufficiently effective contribution to stabilization, then it can hardly be expected that the requisite moderation in wages policy will be achieved either.

Moreover, there is a tendency to match general wage policy exclusively with the requirements of the balance of payments rather than with those of domestic equilibrium, i.e. the aim of stabilizing prices, even when the balance of payments has been affected by chance factors, such as movements of stocks, improvements in the terms of trade, deficits in the United Kingdom or net capital inflows. What is more, the limits agreed by the central bodies representing labour and management seem to be regarded as minimum figures, and on the whole they are not respected in collective bargaining agreements. Lastly, there has recently been a trend to include in longer-term wage agreements clauses making possible some degree of compensation for price increases. The Council's recommendation on this point should be borne in mind: the increase in average nominal earnings per head should not exceed that of real national product per head.

It would also be to the advantage of the Netherlands if the net capital inflows in fact stopped and the danger of a recurrence of excessive inflows were reduced. Recent action by the United States authorities in particular holds out hope of improvement. A reduction of net capital imports would reduce the balance-of-payments surplus, which in turn might have a damping effect on wages and tend to cut down investment demand. Still more important, credit policy would thus become more effective.

Where budgetary policy and wage policy do not help to limit the expansion of domestic expenditure sufficiently, or even speed it up, credit policy would have to apply the brakes more firmly, and in the circumstances just described this could be done with greater effect than hitherto. Already interest rates on the capital markets show that there is more demand for capital from the public sector and also (because of the restrictions on profit margins) from enterprises. At the same time, the flow of capital from abroad may no longer be increasing the supply on the markets, as it had hitherto done. Borrowers should therefore resist the temptation to have recourse to inflationary financing through bank loans, which inevitably arises when the capital market is strained. In this respect

a recent agreement between the Central Bank and the commercial banks to limit the hitherto very rapid expansion of medium-term bank loans is already a step in the right direction.

The primary impact of these restrictive measures—like that of direct state prices controls, moreover—is on investment by enterprises, which is the very element that is most important in the longer run for the maintenance of speedy economic growth in real terms. But if the alternative solution of limiting the expansion of other components of domestic demand is not adopted, this drawback simply has to be accepted.

E. B.L.E.U.

Belgium

Economic activity was still expanding in the first quarter and also, according to the data available so far, in the spring. The growth rate of production, however, again slowed down somewhat because of the less rapid advance of domestic demand.

Exports, on the other hand, tended to rise at an even faster pace, despite the influence of certain fortuitous factors, such as the dockers' strikes in the United States and Antwerp. In the first quarter, visible exports were 15 % higher in value than in the same period of 1964.

On the other hand, although remaining high—apart from seasonal and fortuitous fluctuations—expenditure on gross fixed asset formation advanced only very slightly. Investment by enterprises in plant and equipment very probably continued to grow: in housing the increase in expenditure probably continued, but it must have been very limited; the drop in public investment seems to have been appreciably larger than is usual at this time of year. Investment in stocks, especially in raw materials and semi-finished products, was decidedly weak.

The trend of private consumers' expenditure remained fairly dynamic, but the rate of increase seems to have slowed down somewhat in the last few months. The expansion of wages has slackened off a little, mainly because price increases became more moderate and, therefore, set the sliding wage scale machinery in motion less often. Another factor was the more stable level of employment, which was mainly due to structural difficulties in certain sectors, such as the collieries and textiles.

The slower growth rate of overall demand was reflected in the trend of domestic production. Industrial production, at any rate, adjusted for seasonal and fortuitous variations, made very little progress between the fourth quarter of 1964 and the March quarter of 1965. Nevertheless, according to the INS Index, the year-to-year growth rate was still as much as 4 % despite the effect of certain exceptional factors, such as the less favourable weather than in January/March 1964.

The underlying expansion of construction as a whole was very small, mainly because of the weakening trend in the public works sector. The labour market eased in certain regions and occupations, but on the whole no noteworthy increase in available manpower reserves can be reported.

The slower growth rate of overall demand affected the trend of imports more appreciably than production. In addition, the exceptional factors already mentioned in connection with exports had even stronger repercussions on imports. In the first quarter, the value of visible imports was only 1 % higher than in the same period of 1964.

The trade account and the overall balance of current payments closed with very heavy surpluses. However, gold and foreign exchange reserves of the National Bank of Belgium fell by Bfrs. 1 500 million between the end of December and the end of March owing to a deficit on capital account and an improvement in the banks' net foreign currency position.

The underlying upward trend of the price of finished industrial products was rather more moderate, but the impact of this factor on consumer prices was offset in May by some exceptional movements, mainly affecting the prices of certain foodstuffs. In the services sector the rising trend was moreover still relatively strong because of the persistent increase in costs. In the aggregate, the retail price index was again 5.1 % higher in May than a year previously.

In the coming months hardly any substantial change is to be expected in economic trends in Belgium. The growth of domestic production is likely to continue but will remain fairly modest. Imports should show some recovery after their particularly low first-quarter level, but this does not mean that any very clear-cut tendency towards expansion is to be counted on.

Consequently, there is at present no reason to make appreciable changes in previous forecasts of the results for 1965 as a whole in relation to 1964. The growth of the national product in real terms might exceed 3.5 %.

After the end of 1965 there could be some recovery in the growth of investment; the present easing of the policy of restricting public and business investment should help to buoy up such expenditure, although certain financing difficulties are to be expected. The expansion of consumption is likely to persist. At present the Commission estimates, as a first working hypothesis, that the gross national product at constant prices may rise from 3.5 to 4 % between 1965 and 1966.

There still remains the problem of improving the economic trend from the angle of domestic equilibrium, that is of stabilizing the price level. While undue

demand pressure has been eliminated in a number of sectors, there are others where it persists and, on the whole, the cost pressure arising from the general imbalance has not yet been removed. Consequently stability can be attained only by continuing to apply a policy of guiding overall nominal demand in such a way that its expansion is limited. The looser rein on investment should therefore be sufficiently counter-balanced by limitations in other directions.

1. Recent developments

The lively expansion of exports of goods and services was maintained in early 1965. Customs returns show that this was true at any rate of visible exports, where the pace of expansion—apart from seasonal variations—even accelerated further between the fourth quarter of 1964 and the first quarter of 1965. In the latter quarter, they were up 15 % in value on the level of the same period of 1964 despite certain exceptional obstacles, such as a strike in the port of Antwerp.

Exports to the member countries developed very vigorously, the main contribution being made by sales to the Federal Republic of Germany. But there was also very lively expansion in exports to non-member countries, especially of steel products. This was mainly due to stockbuilding in anticipation of a possible steel strike in the United States.

The expansion of domestic demand, on the other hand, showed signs of slackening. The (adjusted) growth of expenditure on gross fixed asset formation was very moderate. True, fixed investment by enterprises doubtless rose, although investment in industry probably expanded rather more slowly. Expenditure on housing may well have grown, but the increase can only have been a slight one. Public investment seems to have fallen off in the first quarter more than is usual for the time of year.

The hesitant trend of investment by enterprises is probably due in part to the smaller margin for self-financing, since cost increases cannot be entirely passed on to prices. Meanwhile, possibilities of outside financing have been limited by restrictive measures under the stabilization policy, particularly as regards credit. Finally, businessmen's expectations for the future expansion of demand are probably less optimistic than they were.

For these reasons it seems that the fixed investment of enterprises, while remaining at the high level reached early in the year, will no longer expand appreciably. This hypothesis does not necessarily contradict the results of the National Bank's half-yearly survey of investment projects in manufacturing and building, according to which the heads of enterprises in these sectors expect to step up their investments quite appreciably over the 1964 average in the first half of 1965. In the first place, part of this increase had already occurred by the end of 1964. Secondly, experience shows that hitherto businessmen have always proved to be over-optimistic in their forecasts for the first half of the year by comparison with the results actually obtained.

The slackness of public investment in the first quarter seems due not only to bad weather but also to a trough in the placing of new orders, which is a delayed effect of certain decisions taken in early 1964 under the policy of limiting public expenditure.

Investment in stocks of raw materials and semi-finished products may have shown fairly distinct tendencies to slow down.

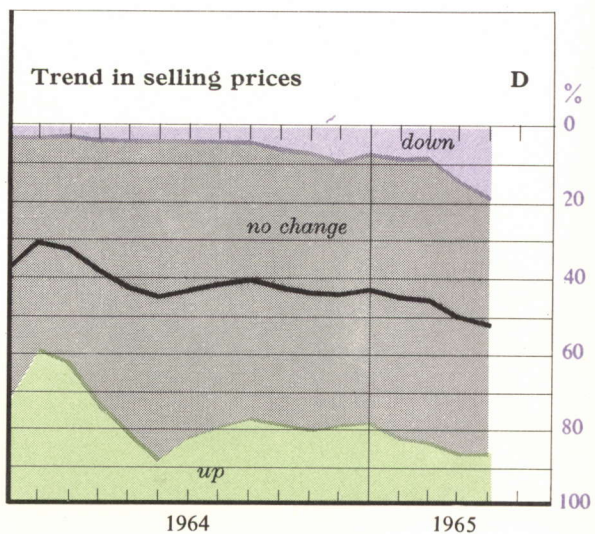
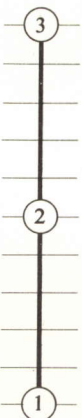
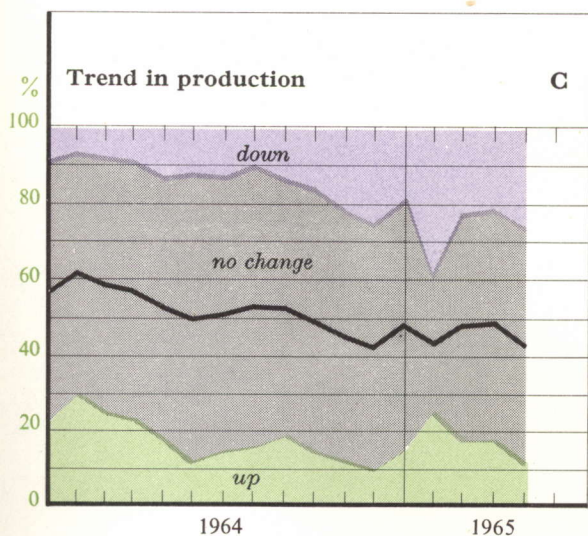
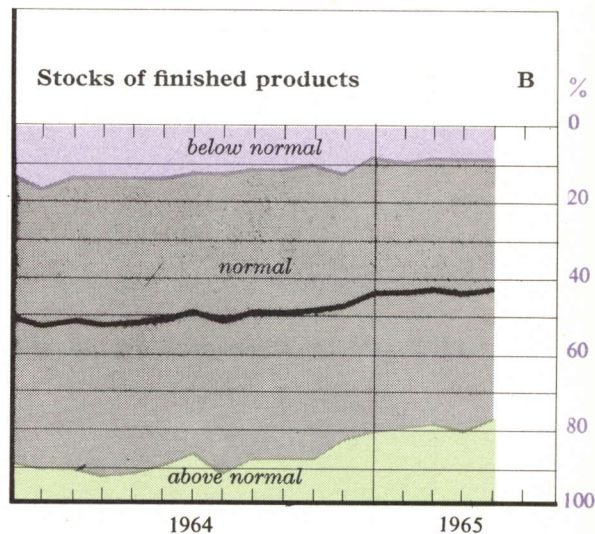
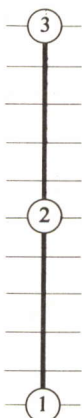
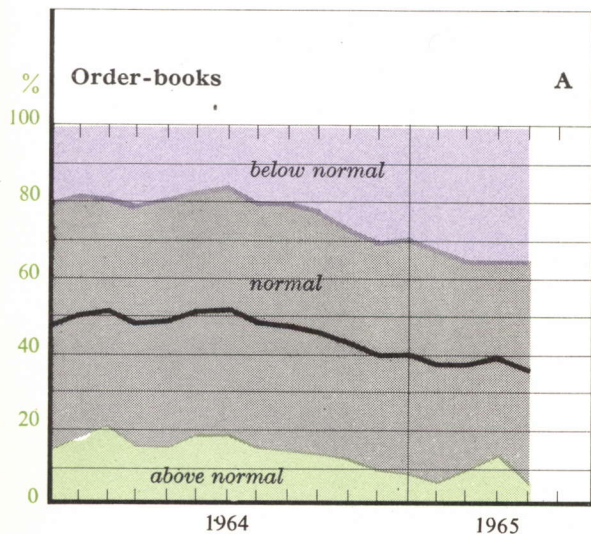
Public current expenditure on goods and services seems to have tended to expand quite vigorously in the first quarter, mainly on account of pay increases for civil servants. However, private consumers' expenditure was the most important element sustaining domestic demand, although its underlying growth seems to have been somewhat weaker.

The disposable income of households may in fact have grown more slowly than before, mainly because the upward movement of wage incomes as a whole has lost some of its vigour. It seems that the level of employment (total number of hours worked) has practically ceased to increase and that the rise of agreed wages in trade and industry has slackened somewhat by comparison with the very rapid pace of growth in the fourth quarter of 1964. The fact that the sliding wage scale was less in evidence played a part here.

These tendencies were not completely offset by the advance, already referred to, of wages and salaries in the public sector and the increases in transfer income, which are paid mainly out of the State budget. Furthermore, the propensity of households to spend perhaps diminished slightly, and this could be connected with certain symptoms of an easing in the economic situation and with structural difficulties which appeared in some sectors.

In accordance with this trend of overall demand, the expansion of overall supply slackened. Between the fourth quarter of 1964 and the first quarter of 1965, industrial production made a slight advance but the pace became very appreciably slower. However

BUSINESSMEN'S VIEWS ON THE INDUSTRIAL SITUATION



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

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

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

according to the unadjusted INS Index it was 4 % higher in the first quarter than a year previously.

The trend of production still differed from sector to sector. The weakening tendency in the coalmines, and in certain branches of mechanical engineering, and in the paper and cardboard industry largely offset the persistent underlying progress made in other sectors. However the crisis in textiles seems at least not to have become any worse, thanks mainly to a recovery in exports. In the construction sector there were signs of stabilization.

Imports of goods and services seem to have been influenced rather by the slower expansion of demand than by the trend of domestic supply mainly because of a slowdown in the stockbuilding of raw materials and semi finished products. At any rate according to customs returns, visible imports no longer seemed to show any underlying tendencies towards expansion from the fourth quarter of 1964 to the first quarter of 1965. If, however, actual imports were nearly 1 % higher in value than in the first quarter of 1964, this was partly due to fortuitous factors which are, in the main, the same as influenced exports. The January and February results were affected in particular; the March figures were again higher.

Imports of goods from non-member countries tended to slacken while those from Community countries still showed some vigour.

Conditions on the labour market continued to ease slightly. The number of workers registered as wholly unemployed seems to have gone up slightly, at least until May, if allowance is made for seasonal movements. In that month it rose to 29 500, which is 6 400 more than in May 1964. The figure, however, represents only 1.3 % of employed persons covered by social security and the percentage drops to 0.7 % for workers qualifying for benefits but fully able to work. These data seem to confirm that, on the whole, the labour situation has not eased so much as to cause concern. Indeed there is still a shortage of manpower in a number of regions and occupations, as is clear from the appreciable increase in the number of foreign workers migrating.

The number of short-time workers again fell, until May at any rate, after increasing sharply until February, mainly for seasonal reasons but also following the appearance of signs of weakness, particularly of structural origin, in certain industrial branches. The May figure was 15 900, which is 3 200 more than a year previously.

The tendency for prices to rise became somewhat less marked in the early months of 1965. A great number of wholesale prices seem to have become more stable. The

prices of finished products, however, again increased slightly, while those of raw materials and semi-manufactures flagged on the whole. Consumer prices continued to rise. The retail price index, however, went up by only 0.8 % between December and April, and this was accounted for mainly by increases, due to higher wages, in the services sector. In May the upward movement accelerated somewhat; the level was 1.3 % higher than the previous month and 5.1 % above May 1964, but this was largely due to difficulties in beef supplies and a very appreciable rise in the price of potatoes.

According to customs returns, the trade balance improved further and to a very appreciable degree. The surplus, which rose to Bfrs. 5 400 million—as against a deficit of Bfrs. 1 300 million in the fourth quarter and Bfrs. 4 400 million in the first quarter of 1964—was a ten-year record for this quarter. However, some exceptional factors, such as the strikes in the port of Antwerp—already referred to in connection with imports and exports—influenced foreign trade and affected imports much more strongly than exports. The improvement in the trade account may, however, also be ascribed in part to the favourable trend of the terms of trade, which is mainly the result of lower prices for imported raw materials.

This trend of the trade account was also the main reason for a heavy surplus amounting to Bfrs. 4 100 million in the balance of current payments in the first quarter. Chiefly on account of foreign exchange operations by the public authorities, the capital account seems to have shown a deficit which was slightly less than the surplus on current payments. Consequently, the overall balance was slightly in surplus, whereas it had shown a surplus of Bfrs. 7 900 million the previous quarter. The net gold and foreign exchange reserves of the National Bank of Belgium fell between December and March by Bfrs. 1 500 million; the net foreign exchange position of the commercial banks probably improved to an extent slightly above this figure.

The money and capital markets showed quite a strong degree of liquidity in the first quarter, and this was reflected in a tendency for interest rates to fall. This tendency affected short-term more than long-term borrowing. On the one hand, the effect of the large balance-of-payments surpluses in the fourth quarter was still being felt. On the other, the expansion of bank advances tended to slacken slightly, with demand for loans by enterprises less pressing; lastly, cash transactions by the public authorities seem, in the main, also to have helped to increase liquidity. On the capital market demand by borrowers became appreciably firmer, mainly as a consequence of the considerable calls again made on the market by semi-public establishments and local authorities, and despite the fact that the public sector covered only a part of its gross financing needs from domestic long-term capital. In the spring, the tendency for interest rates to dip gradually disappeared and seems to have given way to a fresh upturn.

2. Outlook

The latest available data confirm that business activity in Belgium is experiencing something of a lull.

In the months to come, it will clearly be external demand that will provide the most lively stimulus for economic activity. However, in view of the most recent trend in orders, any possibility of a further underlying acceleration in the expansion of exports must be ruled out.

True, exports are still encouraged by certain favourable factors : for example, as regards sales to the other member countries, by the business trend in Germany and the recovery of demand in Italy, and, as regards the general development of exports, by the standard reduction of turnover tax lately allowed for certain goods exported ⁽¹⁾. On the other hand there are important factors of uncertainty affecting in particular the future trend of sales to non member countries. For example, if both sides of the American steel industry should reach a speedy agreement, Belgian exports of steel products might slow down. Nor does it seem that sales to the United Kingdom will continue to be as vigorous as in early 1965.

Although the policy of curbing business activity has been relaxed to some extent since the beginning of 1965, expenditure on gross fixed asset formation is not likely to vary appreciably in the coming months. The propensity of enterprises to invest might be influenced unfavourably by the existence of unused production capacity, by the continual shrinking of profit margins in several leading sectors of the economy, or, finally, by the relatively pessimistic forecasts concerning the future expansion of overall demand. However, incentives will be provided by rationalization investment which firms carry out to cope with the shortage of skilled workers and to limit the upward movement of unit wage costs; the influence of the latter factor will be felt even more since, for some time past, the relative cost of capital goods has been going down by comparison with that of labour. The trend of orders received from the domestic market by the capital goods industries seems to confirm these forecasts.

The available data for housing, and in particular the trend of the number of new starts, indicate that expenditure will make no more than a moderate advance in the months to come. Finally, it would seem that public investments are not likely to provide further appreciable incentives for economic activity for a good while to come.

⁽¹⁾ The Ministerial Decree of 16 April 1965 gives the list of export items to which the standard reduction of turnover tax applies. They are mainly leather articles, certain textiles, building materials, aluminium products and machinery for the textile industry.

Private consumers' expenditure will certainly continue to rise, but at a somewhat slower pace, and in the aggregate disposable incomes of households may increase further. However, their annual growth rate must be expected to flag, because the tendency for the level of employment to stagnate, due to the reduction in the number of overtime hours worked, will doubtless persist and, furthermore, the rate of expansion of agreed wages will probably no longer be quite as rapid as a year previously. Nevertheless, further wage increases are to be expected as a result of the operation of the sliding scale. The expansion of transfer incomes will certainly continue, but there is no possibility of it still being as vigorous between now and the end of the year as in the last few months.

The outlook for the trend of overall demand outlined here will determine the broad lines of the expansion of supply.

There seems to be every likelihood that the growth rates of domestic production will be relatively weak. The expansion of industrial production in particular will not improve on the slow pace of the first quarter. The average period of activity ensured by order books in industry has not varied since November 1964. Likewise there will hardly be any appreciable acceleration in the construction sector, at least in the next few months.

Since imports are more sensitive than production to variations in overall demand their expansion is likely to be rather limited. It may be expected, however, that the weakness of the first quarter, which was largely due to exceptional factors, will be followed by a recovery. This being so, and if seasonal influences are disregarded, the trade account will cease to improve.

The underlying trend for the price rise to slow down will probably continue: industrial producer prices, for example, are not likely to vary considerably in the coming months. Even the possibility of a slight downward movement of the price of raw materials and semi finished products is not to be excluded. But consumer prices might continue to rise at the same pace as in recent months, under the influence of the higher costs of services and of certain imported finished products and of particular fluctuations affecting the prices of some foodstuffs. In the construction sector likewise prices will continue to tend upwards.

In general these forecasts, like the 1965 trend up to the present, confirm the estimates published in the last Quarterly Survey regarding the foreseeable variations, for the whole of 1965, in the principal aggregates reflecting the trend in volume of the supply and utilization of goods and services. However, the external surplus will no doubt be larger than had been foreseen initially, mainly because of the progress made by exports in the first few months of the year. The growth rate of the gross national product at constant prices might easily top the 3.5 % mark.

Supply and utilization of goods and services

	1962 ⁽²⁾	1963 ⁽²⁾	1964 ⁽³⁾	1965 ⁽⁴⁾
	At current prices (in Bfrs. '000 million)	% change by volume on preceding year		
Gross national product	646.2	+ 3.6	+ 5.5	+ 3.5
Imports ⁽¹⁾	230.3	+ 9.2	+ 11	+ 7
Private consumption	435.4	+ 4.6	+ 5	+ 4
Public current expenditure	78.0	+ 6.7	+ 2.5	+ 2
Gross fixed asset formation	128.7	+ 1.6	+ 10.5	+ 2.5
Exports ⁽¹⁾	232.8	+ 7.9	+ 10	+ 8.5

⁽¹⁾ Goods, services and factor income.

⁽²⁾ General Statistical Bulletin 1964, No. 11, Statistical Office of the European Communities.

⁽³⁾ Commission estimates.

⁽⁴⁾ Commission forecasts.

Note :

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

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

Various pointers regarding the trend of the Belgian economy in 1966 lead to the conclusion that expansion will be maintained and that a slight acceleration is not out of the question. Firstly, the outlook in respect of the other member countries of the Community and of the world business situation is that a persistent increase in external demand is likely, but at a slower rate perhaps than in 1965. Secondly, investments might prove to be more vigorous in the course of the year, mainly because of a recovery in public investment and also—after some relaxing of restrictive credit policy—of a further expansion of investment spending by enterprises, though certain financing difficulties could arise. Even if wage increases do not exceed the somewhat slower pace which seems to be setting in, the incentives emanating from private consumption might again become slightly stronger, chiefly because the slower upward movement of prices will permit an expansion in the volume of consumption comparable to that of 1965. Given these conditions, it may be expected, as a preliminary working hypothesis—for there are still a number of gaps to be filled in—that the growth rate of the gross national product from 1965 to 1966 at constant prices will be somewhere between 3.5 and 4 %.

This hypothesis, which seems rather optimistic, in particular from the angle of the conditions of equilibrium, can however be vindicated only if the right short term economic policy is adopted. The EEC Council's recommendation of 8 April 1965 indicates the line to be followed. For Belgium it recommends a cautious relaxing of the measures taken in 1963 and 1964 to limit the expansion of certain public investments, of investment by enterprises and of construction activity. It does not, however, dispense this country from applying in 1965 a general budgetary policy modelled as a whole on the rules contained in the Council's recommendation of 14 April 1964, to which the new recommendation makes specific reference.

Certain measures have already been taken to relax the restrictions on expansion of investment.

In the sphere of extraordinary budgetary expenditure—mainly on public works—commitments for the first half of the year were fixed at a sum which is practically half of the total of Bfrs. 33 000 million set aside in the budget for the whole year. This implies a partial release of the 10 % "tranche conjoncturelle", included in the total amount of Bfrs. 33 000 million, which would have remained frozen if a restrictive policy had continued to be applied. Allowance must be made, however, for the usual time lag between appropriation and actual spending.

The special subsidies to coalmines and the advantageous warrant system planned for financing pithead stocks are to be explained less in terms of short term economic policy than by structural factors and general policy considerations.

It seems, furthermore, that there are both new, and old but persistent, tendencies to increase public transfer and consumption expenditure. It can only be stressed once more that a general policy under which public spending expands as much as at present cannot be recommended, for the trend of prices and costs is still climbing too sharply. It must also be remembered that in 1965 State revenues are unlikely to exceed budgetary forecasts to the same extent as in recent years; on the contrary, up to a certain point the slackening of expansion could lead to the reverse situation and financing requirements might well increase. In order to satisfy these needs by non-inflationary means, that is by domestic saving, it will perhaps be necessary to overcome difficulties even greater than the present ones. A limit on the expansion of public consumption and transfer expenditure to offset increasing burdens arising from investment promotion measures is therefore strongly to be recommended.

The credit policy measures taken conform with the Council's recommendations. The banks are still requested to limit the expansion of their loans to 10 % annually. At mid-1965 this expansion should not exceed 15.5 % of lendings at the end of 1963. However, the National Bank has decided that some categories of bank loans granted

after 15 April should not be taken into consideration in calculating the growth rate. They embrace certain capital development loans and commercial credits and also short-term working capital in Belgian francs loaned to enterprises established in Belgium to replace dollar credits when dollars are actually transferred back to the United States.

The policy of credit control is also maintained in respect of public credit institutions, private savings banks and insurance companies, again except for certain capital development loans.

Furthermore, the decision requiring the maintenance of a 1 % minimum reserve has been extended to mid-July 1965. Lastly, other measures concerning the working of the capital market have been taken as part of a long-term reform: in April stamp duty on Belgian and foreign securities was abolished, and the system of taxation on capital contributions to companies has been adjusted. Finally, new provisions concerning the activity of the Société nationale d'investissement aim at increasing and diversifying financial aid for enterprises provided by this company.

Grand Duchy of Luxembourg

In the early months of 1965 there were signs that economic expansion in Luxembourg was losing momentum.

It is true that exports, apart from seasonal variations, probably increased slightly, but investment declined, despite the relatively heavy sums spent on new housing. Investments by enterprises contracted and public investment ceased to expand. The growth of private consumers' expenditure slowed down, probably in the main because the 1964 spurt in the growth of the disposable income of households has by now worked itself out and the trend has reverted to normal.

In view of the state of demand, supply did not grow to any appreciable extent. Imports in particular were hesitant, but production—at any rate industrial production—continued to make moderate progress. The year-to-year increase in the industrial production index for the first quarter was 5 %.

Strains eased slightly on the labour market, and until April prices were tending to settle down. May, however, once again saw a sharper rise in consumer prices, mainly because certain foodstuffs became dearer.

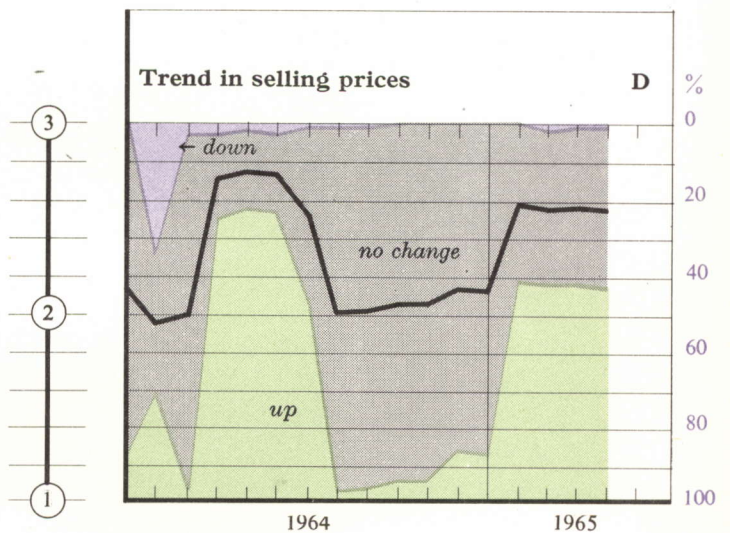
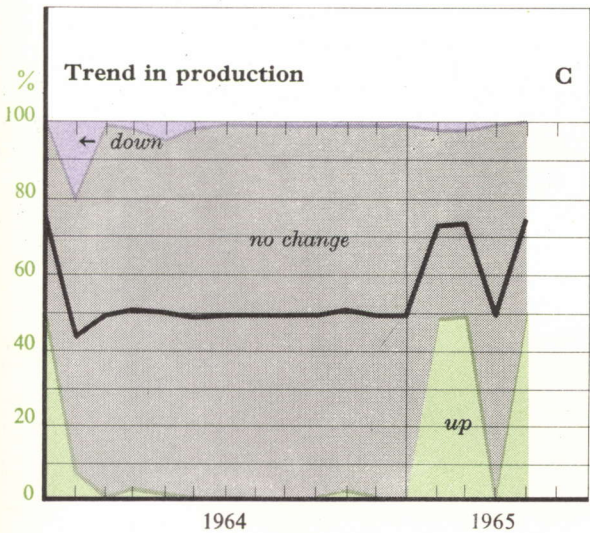
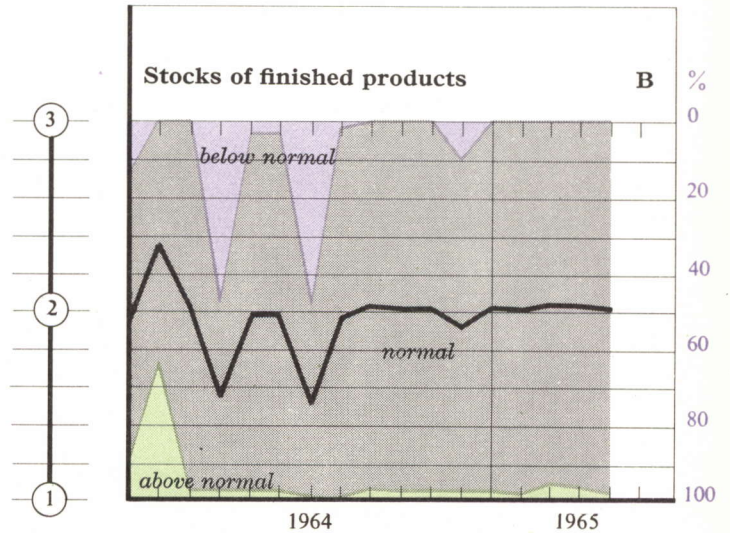
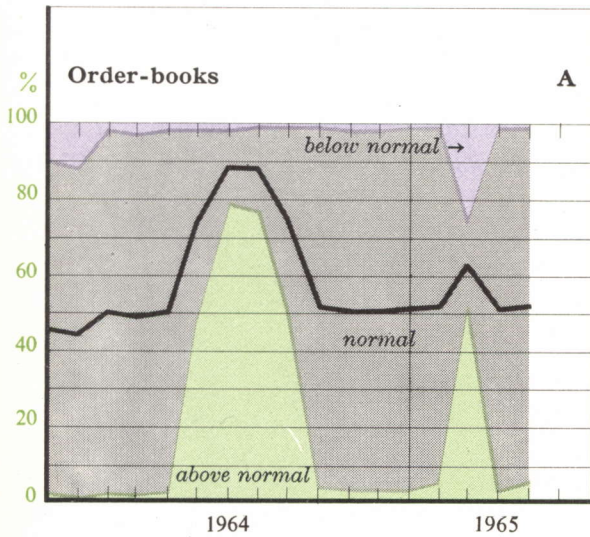
There is no reason to expect any appreciable change in the trend pattern in the coming months. Economic growth is likely to remain modest. The outlook for exports in the second half of the year is clouded by a number of unpredictable factors, and the expansion of domestic demand will again be cramped by the decline in investment and the relatively modest expansion of consumption.

1. Recent developments

Disregarding seasonal variations, exports of goods and services may well have expanded slightly in the first months of 1965. This is true, at any rate, of visible exports, the value of which was up appreciably in the first quarter on the figure for the same period of the preceding year.

Between the fourth quarter of 1964 and the first quarter of 1965 iron and steel exports to non-member countries and sales to the rest of the Community developed on

BUSINESSMEN'S VIEWS ON THE INDUSTRIAL SITUATION



Answers to the questions of the EEC business survey, carried out in Grand Duchy of Luxembourg by STATEC.
 GRAPHS A, B, C and D : The three colours (green, grey and violet) show the percentages of the three different answers. The black curves, the scale for which is given between the graphs, show the figures obtained by adding together the percentages weighted as follows :

- by 0.03 for the answer "above normal", or "up";
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- by 0.01 for the answer "below normal", or "down".

markedly divergent lines. Thanks mainly to speculative purchases, notably by firms in the United States, there was a very appreciable increase in sales outside EEC, whereas exports to the other Community countries slumped. However, the latest figures of orders received suggest that this disparity will become less marked.

The expansion of domestic demand on the other hand probably slowed down. Apart from seasonal variations, the underlying trend of gross fixed asset formation seems to have fallen back, although expenditure on housing showed an increase (but no substantial cyclical growth). There may well have actually been a fairly distinct decline in spending by enterprises on plant and equipment, and public investment certainly made no further progress.

Apart from seasonal variations, the growth of private consumers' expenditure has now lost momentum after exceptionally brisk expansion in 1964 : in recent months purchases of consumer durables by households have declined, and incomes are rising more and more slowly, mainly because the trend of wages and salaries in the public sector is now more normal. The stabilization of economic activity, notably in iron and steel, may also account in part for the new trend. It should be noted, however, that in the iron and steel industry and in mining and quarrying, the renewal of collective agreements has entailed an increase in wages and salaries retroactive to 1 January 1965.

Public consumption expenditure has probably increased hardly at all, either by volume or in value.

Industrial production, adjusted for seasonal variations, made a little progress in the first quarter. The year-to-year growth rate was admittedly lower than for the fourth quarter of 1964 (5 % instead of 9 %), but this reflects the vigorous spurt between the fourth quarter of 1963 and the first quarter of 1964.

With the fragmentary information available it is difficult to assess the recent trend of imports, but it would seem that growth has been rather slow in recent months : the rather hesitant demand for durable consumer goods and for plant and equipment and the trend of industrial production are signs that this is the case.

On the labour market, strains have eased to some extent. Save in respect of skilled workers, the labour shortage seems to have become less severe because of better opportunities for recruiting foreign workers. For several months now the overall level of employment has remained practically unchanged.

To judge from the cost-of-living index, the upward price movement clearly lost momentum in the early months of 1965. In April the index was up only 0.3 % on December and only 2.7 % on April 1964. However, it must not be forgotten in any assessment

of the relatively stable conditions prevailing since December, that these are due not only to some reduction of excess demand but also, and mainly, to official price control measures. Price strains seem to have persisted, on the other hand, in the construction sector.

2. Outlook

The trends sketched out above will almost certainly continue in the coming months. They indicate that the economy as a whole will expand at only a relatively moderate pace.

Exports are unlikely to make any further vigorous contribution to the expansion of the economy, at any rate not before certain new industries have begun production. Although the April business survey suggests that industrialists rule out any marked weakening of foreign demand for iron and steel products, at least in the near future, the situation on the world steel markets is always liable to deteriorate fairly rapidly. This could happen in the present instance if a slowdown of economic expansion in the United States coincided in the second half of the year with the end of the stock-purchasing prompted by fear of a steelworkers' strike.

The tendency for gross fixed capital asset formation to lose momentum must doubtless be expected to continue. Despite work on two big schemes (completion of the Mertert harbour installations and building of an aqueduct at the Esch-sur-Sûre dam), total investment by enterprises is again likely to decline for two reasons : lower investment in the iron and steel sector and the completion of investment programmes for new industries. Public investment will at best continue at the level already reached. Admittedly, expenditure on housing will grow, but the increment will doubtless no more than offset the increase of prices in this industry.

With household incomes growing more slowly, the expansion of private consumers' expenditure is likely to remain relatively weak. True, average wage rates will continue to rise, partly because of an automatic increase before the autumn due to the sliding wage scale, but the pace of increase should be markedly slower than in the two preceding years. Moreover, employment (number of hours worked) is unlikely to increase appreciably.

In view of this outlook for demand, there will be nothing very spectacular about the trend of production in the coming months. According to the adjusted national index, the figures for industrial production, in particular, are unlikely to be much above those for the first quarter.

Any repercussions of this hesitant trend of production on numbers employed will probably be offset by shorter working hours to the point that labour market strains will not ease again to any appreciable extent.

Consumer prices will almost certainly increase a little more rapidly in the coming months : imported manufactures will continue to become dearer, certain special trends in foodstuff prices are expected, partly as a result of official price decisions, and lastly freight rates will probably rise. In May already, after a period of relative stability in the early months of 1965, the cost-of-living index again rose and was 3.8 % above its level of May 1964.

In view of price trends and the danger of heavier cost pressure through the operation of the sliding wage scale, the authorities are still keeping a watchful eye on upward price movements. In addition to direct price control measures so far taken, a ministerial decree was promulgated on 29 April 1965 prohibiting retail profit margins for potatoes, vegetables and fruit in excess of 30 % of the supplier's invoiced price.

Supply and utilization of goods and services

	1963	1964 ⁽²⁾	1965 ⁽³⁾
	At current prices (in Lfrs. '000 million)	% change by volume on preceding year	
Gross national product	26 828	+ 6.5	+ 1.5
Imports ⁽¹⁾	23 389	+ 10	+ 2
Private consumption	16 121	+ 5.5	+ 3.5
Public current expenditure	3 433	+ 2.5	— 2
Gross fixed asset formation	8 809	0	— 10
Exports ⁽¹⁾	22 616	+ 11	+ 4.5

⁽¹⁾ Goods, services and factor income.

⁽²⁾ Estimates by the Commission's staff with the help of calculations made by STATEC as part of EEC work on economic budgets.

⁽³⁾ Commission forecasts.

Note :

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

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

In fact the authorities responsible for economic policy are in the difficult position of having to take certain measures which will force up the cost-of-living index while at the same time endeavouring to prevent these increases from exerting a cumulative effect on wage and price trends. If this last goal is to be achieved, it is very important that the expansion of domestic demand in money terms be kept within certain limits. The central budget for 1965, which by comparison with what actually happened in 1964, does apparently imply, in any case, that new expenditure will be kept within the 5 % limit laid down by the EEC Council, will probably contribute to the attainment of this objective. A precondition is that Treasury operations are not used—as in 1964—as a major adjunct to budget appropriations.

True, the Council's new recommendation of 8 April 1965 permits Luxembourg to relax its restrictive policy in favour of certain public investments and of investment by enterprises. But the aim here is merely to avoid any undue decline of these types of investment and not to provoke a new and appreciable expansion of expenditure, which could only be a further obstacle to the policy of stabilizing prices and costs. It is obvious that relaxation measures must give priority to those types of investment which, where possible, directly increase the elasticity of supply.

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The Council

**Council recommendation of 8 April 1965 to the Member States on the
economic policy to be followed till the end of 1965**

THE COUNCIL OF THE EUROPEAN ECONOMIC COMMUNITY,

Acting under Article 103 of the Treaty establishing the European Economic Community and,

on a proposal of the Commission,

Recommends to the Member States that, in view of recent developments in the economic situation and of the economic outlook, they should keep their economic policies for the remainder of 1965 on the lines laid down by the Council on 15 April 1964 in points 1 to 9 of its Recommendation for measures to be taken to restore the internal and external economic equilibrium of the Community.

The Council draws particular attention to the fact that prices and unit production costs are still rising even in Member States where excess of demand has been eliminated or is declining. If increases in money incomes are not kept within the bounds of increased productivity, tendencies towards stagnation or recession may persist or even become more pronounced.

The Council recommends however that the following changes be made :

1. For Italy, the Council approves the policy of reviving domestic demand defined by the Italian authorities in accordance with the conclusions reached by the Council at its session of 10 November 1964. Demand should be stimulated in a way which ensures a reduction in the pace at which unit production costs are rising. As regards budget policy for 1965, there might in Italy—but in no other Member State—be an increase of more than 5 % in those disbursements by public authorities which affect the domestic economy.

In expanding public demand and promoting the expansion of private demand, the authorities should ensure that emphasis is laid on expenditure for investment : they

should increase public expenditure on investment, should encourage—particularly by fiscal measures—investment by public and private enterprises, and should give support to low-cost housing and to building and construction in general. In the credit field, measures should also be introduced to make bank advances more readily available.

On the other hand, caution should still be exercised in expanding public current expenditure on goods and services and government transfer expenditure that stimulates private consumption; it is recommended that no decisions be taken to undertake new recurrent commitments or to increase present ones.

Both the budget deficit and the Treasury deficit should be financed by normal means without recourse to the central bank.

Measures to stimulate the economy should, however, be reviewed as soon as there is any threat of a renewed acceleration of the upward movement in prices and costs.

2. In France fiscal measures have been taken to encourage investment by private industry.

With the same end in view, limited measures of this kind could be taken in future in the field of credit policy.

3. In Belgium the restrictive measures adopted in 1963 and 1964 to throttle back certain public investments, investment by enterprises and activity in the building and construction sector might be cautiously relaxed.

4. In Luxembourg similar steps might be taken to ease restrictions on certain public investments and investment by enterprises.

5. In Germany the imbalance between the expansion of domestic demand and that of domestic supply is if anything becoming more pronounced. This country should therefore continue to comply with the Recommendation of 15 April 1964.

Done at Brussels, 8 April 1965
by the Council

President
M. COUVE DE MURVILLE.

Brussels, 25 March 1965

Reference to the Short-term Economic Policy Committee

1. At its session of 24 and 25 March 1965 the Short-term Economic Policy Committee discussed the economic prospects for the rest of 1965 and the policy pursued or contemplated by the Member States. It rendered an opinion on the draft recommendation to the Member States submitted by the Commission to the Council.

2. By and large the Committee shared the Commission's views on the co-ordinated short-term economic policy to be applied by the Member States. It stressed the hazardous nature of forecasts, particularly for France and Italy, in the present economic situation. In France the danger of the current stagnation of production persisting was not to be ruled out, and in Italy it was not clear whether a strong enough recovery had really begun. While in Italy measures to promote recovery had been taken as early as last autumn, in France only certain specific measures, mainly connected with company taxation, were being considered.

3. The Committee approved the cautious attitude of the authorities responsible for short-term economic policy in France. The authorities did not consider the trend towards stabilization sufficiently consolidated to be able to adopt more far-reaching measures to stimulate economic activity, for fear that prices and costs should again rise.

The Committee considered that steps can be taken in Italy to promote economic expansion. Measures of a short-term, not too heavy-handed and therefore reversible nature were needed to produce rapid effects. Consequently, as was suggested in the draft recommendation to the Council, stress should be placed on encouraging investment rather than on measures directly developing consumer demand. The Committee took note of the programme, recently decided upon by the Italian Government, to stimulate economic activity. The programme, which was to be accompanied by the necessary speeding-up of administrative machinery, could largely fulfil the requirements stated above. The Committee hoped that the measures to give a fillip to investment in the private sector would be sufficient. The evident difficulties involved in encouraging investment by tax adjustments showed, moreover, how much needed was a reform of the Italian taxation system in order to improve the instruments of trade-cycle policy.

4. In Germany and to a less extent in the Netherlands the situation was the reverse.

In Germany the pressure of demand had persisted. Furthermore the upward movement of unit wage costs again distinctly accelerated after the slower rise of late 1963 and the first half of 1964, for strains on the labour market were very great.

In the Netherlands the imbalance was clearly less marked than in the previous year, especially because the growth rate of private and public investment seemed to have slowed down somewhat. The strains on the labour market, which had hardly diminished, would in general mean that in 1965 wage costs would be appreciably higher than in 1964. Despite restrictive measures in the sphere of credit and budgetary policy, domestic demand was still expanding too strongly. Demand from abroad, especially from Germany, had also grown vigorously, at any rate up to that time. As a result the current improvement was still insufficient to stabilize unit costs and prices.

5. In these circumstances the Committee was of the opinion that short-term economic policy in Germany and in the Netherlands should continue to aim, even more firmly if possible, at restraining the growth of those elements of domestic demand which, in view of the need to stabilize prices, were expanding too vigorously.

6. In Germany it was the Committee's impression that the expansion of demand, which for some time already had been attributable to domestic factors, was not yet being kept sufficiently in check. Greater efforts should therefore be made to moderate demand by means of budgetary policy, but at the same time a restrictive credit policy should be maintained. These points remained valid even if it should turn out that by reason of the sharp increase in imports the upward tendency of prices was not so strong as at first feared. Though in the longer term a deficit on current account was scarcely admissible for such a highly industrialized country as Germany, the present slight deficit represented no immediate danger either for Germany itself—on account of its balance-of-payments position and foreign exchange reserves—or for the other member countries, with the exception of the Netherlands, since the Community's internal economy was at the moment quite capable of coping with growth incentives coming from Germany.

7. In Belgium and Luxembourg the expansion of demand seemed to be easing, mainly on account of a slower growth of investment expenditure and its secondary effects; furthermore, foreign demand for products of the Luxembourg iron and steel industry was static. At the same time, however, wages and consumption continued to go up more or less steadily in Belgium, and also in Luxembourg, but more slowly; unit wage costs were still mounting. The Committee therefore considered that a cautious budgetary policy was still called for, especially in the sphere of expenditure on consumption and transfers. In the matter of public investment expenditure, some easing of restrictions was possible only where credit had been kept severely in check. The promotion of private investment, which had been limited for some time, could again be stepped up somewhat if the waning tendency of investment persisted.

8. On the whole the Committee advised caution in applying incentives in those branches which revealed structural weaknesses. Such weaknesses were temporarily masked by inflation, but came to light with stabilization. If support measures were to be taken in this area, the aim should be to facilitate the process of adjustment rather than to preserve structural weaknesses, which in the long run led to higher prices.

9. The Committee thought that in 1965 wage increases in all the Member States would in all probability outstrip the growth of productivity. The considerable rise in production costs throughout the Community in recent years would continue; among the factors making for higher costs, wage increases still loomed large. In particular the Committee pointed out that cost-push inflation tended to persist even in those member countries where excess demand had been eliminated or was diminishing. As long as wage increases were not held within the limits of advances in productivity, tendencies towards stagnation or recession might persist or even be aggravated.

The Committee therefore felt obliged to draw attention once more to the fundamental importance for all the member countries of working out and putting into effect an incomes policy.

