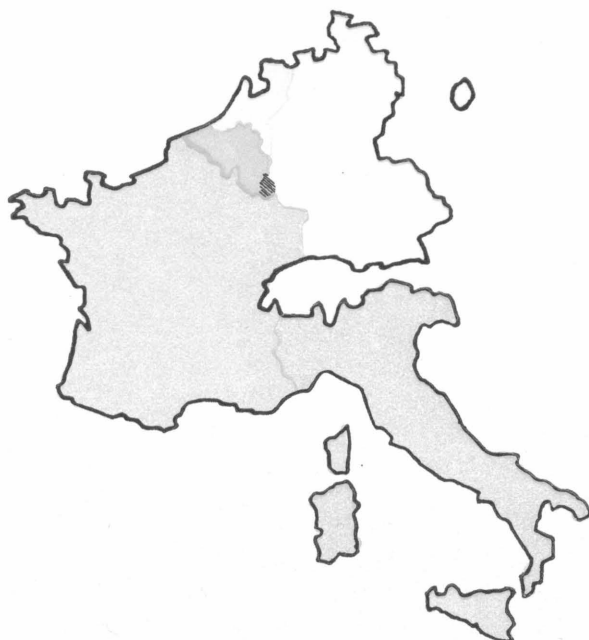


EUROPEAN
ECONOMIC
COMMUNITY

COMMISSION



DIRECTORATE-
GENERAL
FOR ECONOMIC
AND FINANCIAL
AFFAIRS

**THE ECONOMIC SITUATION
IN THE COMMUNITY**

1

MARCH

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

MARCH 1965

Contents

	<i>Page</i>
I. The overall situation	3
A. <i>Recent developments</i>	7
1. Demand	7
2. Production	10
3. The balance of the markets	12
B. <i>Outlook</i>	20
II. The situation in each of the Community countries	29
A. <i>Federal Republic of Germany</i>	31
1. Recent developments	32
2. Outlook	37
3. The economic situation in West Berlin	41
B. <i>France</i>	43
1. Recent developments	44
2. Outlook	50
C. <i>Italy</i>	54
1. Recent developments	55
2. Outlook	61
D. <i>Netherlands</i>	66
1. Recent developments	67
2. Outlook	73
E. <i>B.L.E.U.</i>	77
Belgium	77
1. Recent developments	78
2. Outlook	82
Grand Duchy of Luxembourg	87
1. Recent developments	87
2. Outlook	88

Graphs

1. The balance of trade between each member country and its partners	13
2. Community trade	13
3. Economic indicators :	
a) Federal Republic of Germany	33
b) France	45
c) Italy	57
d) Netherlands	69
e) Belgium	79
ANNEX — Trends of wages, productivity and labour costs in industry	91

Note :

For technical reasons it was not possible to include in this survey economic developments occurring after mid-March 1965. More recent data can be found in "Graphs and notes on the economic situation in the Community" No. 3-1965.

I. THE OVERALL SITUATION

While economic activity in the Community continued to grow before and after the year, the rate of expansion, which had begun to decline about the middle of 1964, continued to weaken.

Partly thanks to the favourable conditions encountered on world markets, exports to non-member countries made considerable further progress: for the fourth quarter the value of the Community's visible exports was no less than 13.5 % higher than a year earlier.

On the other hand, the growth of internal demand in money terms again declined a little. In particular, there was a slowdown in the expansion of investment in capital goods by enterprises, for the boom in this sector in Germany could not offset its persistent weakness in Italy and the hesitant trend in France. With building investment, too, tending to contract in Italy, total investment in this industry also contributed less than before to the growth of demand. Public consumption, however, was increasing for a time at a faster tempo in several countries, and the growth of private consumers' expenditure lost little pace, if any.

The growth of internal supply, too, once again slowed down a little; according to the Index of the Statistical Office of the European Communities industrial production in the fourth quarter was only about 4 % above the corresponding 1963 figure. Trends varied however from country to country: as before, there was vigorous growth in Germany and—to a lesser extent—in the Netherlands, and some recovery in Italy; but in Belgium expansion was less rapid and in France there was even a slight decline of output.

In the last few months the situation on the labour markets in France and, less markedly, in Belgium has eased somewhat; in Italy unemployment has been rising distinctly; in Germany, on the other hand, strains on the labour market have again become severer and in the Netherlands the difficult situation has continued with practically no change.

The slower expansion of internal demand also affected the trend of the Community's imports from non-member countries. The year-to-year increase in the value of visible imports for the fourth quarter of 1964 was only 7 %.

The slowdown of imports and—more important—the dynamic expansion of exports led to a further improvement on the Community's trade balance in the fourth quarter; the unadjusted external trade returns showed a deficit of 311 million units of account ⁽¹⁾, that is 338 million units of account less than for the fourth quarter of 1963. On capital transactions, too, there was once again a considerable surplus due in part to the movements of capital stemming from the sterling crisis. The official gold and foreign exchange reserves of the monetary authorities swelled in the last three months of 1964 by 944 million units of account. Over the same period the net foreign exchange position of the commercial banks deteriorated—mainly in connection with seasonal movements—but the decline was not as great as the growth in official reserves.

For the Community as a whole the upward movement of prices lost more of its momentum. In France and in the Netherlands consumer prices, on average, remained practically stable. In Italy the upward movement slowed down but was still considerable. In Belgium and Luxembourg, too, upward price trends continued practically unabated, and in the Federal Republic of Germany they actually gathered speed.

The outlook for economic development in the rest of 1965 has, for the Community as a whole, hardly changed from that already described in Quarterly Survey 4/1964; it appears that economic expansion will go on but that the tempo of expansion will be decidedly slow.

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

External demand will again make an important contribution to the economic activity of the Community; as the year wears on, however, this contribution might prove less effective than in the past, for three main reasons: economic expansion in the United States is expected to lose momentum, import restrictions are in force in the United Kingdom, and the first effects of the drain on foreign exchange available to the developing countries will be making themselves felt.

Although predictions as to the expansion of gross fixed asset formation suffer from the uncertainties of the situation—it is quite possible that economic policy measures may still affect the trend here—it seems safe to say that by and large there will be a further increase under this heading. In particular, the rapid upward movement in the Federal Republic of Germany is expected to continue; in Italy a recovery in the course of the year is not to be ruled out, and in France investment by private industry may also revive somewhat.

Private consumers' expenditure may well continue to mount slowly in the coming months. While private spending of this type will probably soar in the Federal Republic of Germany and its expansion gather speed again in the Netherlands, in France—and at least to begin with, in Italy—its expansion is likely to remain no more than marginal.

Internal supply will probably grow again, but the growth rate in the course of the year, even given some degree of recovery in Italy and in France, may well remain decidedly slow—if only because physical obstacles to growth in the Federal Republic of Germany will probably pose a more serious problem than hitherto. For the full year 1965 the growth of the gross Community product in real terms is estimated at some 3.5 %; the increase in the index of industrial production should be in the region of 4 %.

The trend in the expansion of imports from non-member countries will also probably remain relatively modest. Since however, as already pointed out, the speed at which exports are growing is also expected to decline in the course of the year, the tendency for the Community's trade balance to improve must be expected to weaken.

The upward price movement should again lose momentum in a number of countries (Italy and Belgium in particular), although it is likely to remain quite perceptible. The trend in France will probably be steady, with the exception of certain overdue adjustments still to be made in public service charges and certain increases in food prices resulting from the Government's farm policy measures. The upward price movement will probably gain some further strength in the Netherlands and in the Federal Republic of Germany continue to be faster than in 1964.

In view of all this, it would be unwise to allow any substantial general relaxation of the stabilization drive. On the contrary, in the Federal Republic of Germany and in the Netherlands—where the danger of overall imbalance either still exists or has not been brought sufficiently under control—the proper course would be to follow more closely the recommendation issued by the Council of Ministers in April 1964. In Belgium and in Luxembourg there is one measure, however, that might prove expedient, namely a prudent relaxation of certain measures designed to curb investments, without however allowing any considerable stimulating forces to be brought to bear on the economy in general through the budget. In France measures for the cautious stimulation of investment by private enterprises would now be safe, provided that a stringent policy was maintained with regard to public expenditure. Only in Italy should energetic measures now be taken to spur on domestic demand, particularly by promoting and expanding investment.

A. Recent developments

1. Demand

With internal demand expanding less briskly than hitherto, the growth of overall demand in the Community lost a little momentum in the new year.

The seasonally adjusted trend of external demand—defined as actual exports of goods and services to non-member countries—again indicated very vigorous growth in the fourth quarter of 1964 and early in 1965. In the fourth quarter the value of visible exports (as shown in customs returns) was no less than 13.5 % higher than the corresponding 1963 figure—following year-to-year growth rates of 9 % and 9.5 % for the second and third quarters respectively.

Economic expansion in most industrial countries continued at a rapid pace, and this favoured the export trend in the Community. Another factor was that the developing countries, where the availability of foreign exchange had been rising until the middle of 1964, began to increase their purchases from the Community more rapidly. A third factor was that the stabilization drive in the Community was bound to help expand the flow of exports.

In the United States, admittedly, the upswing in economic activity lost a little momentum towards the end of the year. After seasonal adjustment, the real gross national product gained only 0.5 % from the third to the fourth quarter of 1964, where the increase from the second to the third quarters had been 1.2 %. However this slowdown was hardly a reflection of the true state of business; among the separate components of demand, investment in plant and equipment was particularly dynamic, and investment in stocks strengthened: the slower growth of production was, in fact, mainly due to a strike in the automobile industry. At any rate, such information as is now available covering the first quarter of 1965 suggests that the tempo of production is picking up again. With the expansion of production came an appreciable decline in the number of unemployed; in January the unemployment rate (seasonally adjusted and expressed as a percentage of the labour force) reached—at 4.8 %—its lowest point for 7 years. The Community's visible exports to the United States were not affected by the temporary easing in the pace of that country's economic expansion, but continued their rapid rise in the fourth quarter. In the new year, however, a dock strike led to a serious cutback in deliveries.

In the United Kingdom economic expansion picked up again—as expected—towards the end of the year. Apart from seasonal variations, industrial production rose by as much as 4.5 % from September to December, though it should be remembered that the stability of the seasonally adjusted production index in the first nine months was the result of a statistical understatement of what was really happening. The demand

for plant and equipment continued to expand vigorously, the growth of private consumers' expenditure gathered momentum, and exports showed a distinct if temporary rise; by the new year, however, the export trend had already lost a little of its new vigour. Imports, which had previously been expanding, began to lose ground slightly in the last months of 1964. This was largely due to cyclical stock movements; however, it may also have been due in part to the first effects of the measures adopted in the autumn—in particular the introduction of a 15 % surcharge on imports and the raising of Bank rate to 7 %. There was, in fact, a small improvement in the current balance of payments, but the deficit none the less remained very appreciable. As capital outflows were also considerable, there was again a very heavy deficit on overall payments; this was financed by a partial recourse to the extensive international assistance made available to the United Kingdom, much of it by the Member States of the Community. The upward trend that had marked the Community's visible exports to the United Kingdom from month to month faltered in the fourth quarter, but by that time they were running at 10 % (value) above the corresponding figure for 1963.

Visible exports to non-member countries ⁽¹⁾

(% change in values on preceding year)

Imports from	1963	1964				1964 full year
		1st quarter	2nd quarter	3rd quarter	4th quarter	
United States	+ 4.5	+ 17.5	+ 8	+ 9	+ 11	+ 11
EFTA	+ 6	+ 14	+ 10	+ 10.5	+ 11	+ 11
including : United Kingdom	+ 8.5	+ 25	+ 12.5	+ 14	+ 10	+ 15
Developing countries	+ 2.5	+ 12	+ 4.5	+ 4.5	+ 12	+ 8.5
including : Associated overseas countries and territories	+ 8	+ 9	+ 15	+ 2	+ 14.5	+ 7
Total non-member countries	+ 5	+ 15	+ 9	+ 9.5	+ 13.5	+ 11.5

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

Community deliveries to the developing countries had been making relatively slow progress in the first nine months of 1964 but have soared in recent months. For the fourth quarter the year-to-year growth rate was 12 % (value). A swift expansion of sales to the countries of Asia and a sharp fourth-quarter improvement in exports to the associated countries and territories were the main sources of growth.

Unlike external demand, internal demand in the Community again lost a little of its upward momentum at the beginning of the new year; the element which weakened most was gross fixed asset formation. The vigorous expansion of expenditure on plant and equipment by enterprises continued unabated in the Federal Republic of Germany; in Italy, however, investment by private enterprises again shrank, and in France too it appears to have made only a very hesitant advance in the fourth quarter though here investment expenditure by public undertakings continued to rise strongly. In Belgium and—to a lesser extent—in the Netherlands purchases of plant and equipment by enterprises grew more slowly than in the past.

The trend of public investment varied widely from country to country : in Italy, it looks as if there were in the fourth quarter some increase in the volume of public works being carried out; in France, there was a decided increase in public investment, while in the Benelux countries and to a certain extent in the Federal Republic of Germany as well the restrictive measures taken continued—or in the case of more recent measures began—to make themselves felt.

Since in most member countries expenditure on new housing again rose appreciably, since in the Federal Republic of Germany and once again in the Netherlands industrial and commercial building activity remained brisk, and since, in addition, building and construction benefited from good weather in certain countries, total investment in this sector showed a further increase. Manpower shortages again set limits, however, to growth in this industry. Italy is an exception to the general rule, for here the decline in overall building investment continued. In Belgium the number of new orders in the building industry probably increased more slowly, and the backlog would seem to have contracted in the final months of 1964.

Investment in stocks, generally speaking, made a less noteworthy contribution to economic activity than before. In several Community countries firms were showing some reluctance to build up stocks of raw materials and semi-manufactures; in the Federal Republic of Germany, however, stock-purchasing remained vigorous and in Italy the tendency, still discernible in the autumn, for firms to run down such stocks would seem to have faded out or even to have given way to a modest re-stocking movement. In France and Italy there were still signs in certain industries of an involuntary build-up of finished goods.

In the Community as a whole consumption expenditure continued to grow fairly rapidly. Public expenditure on goods and services increased, largely as a result of heavier expenditure on personnel in the Federal Republic of Germany, in the Netherlands and in Belgium, and also in Italy. In the Community as a whole private consumers' expenditure also grew in the last months of 1964 and early in 1965, the pace of growth remaining practically unchanged. Within this overall growth, however, the divergence of trends already discerned in previous quarters grew even wider: private consumers' expenditure in money terms in Italy and in France rose very slowly, while in the Federal Republic of Germany it expanded appreciably faster than before. In the Netherlands private consumers' expenditure seems to have continued growing fairly slowly, while in Belgium no important change was recorded in the fairly high rate of growth.

By and large the different trends in the evolution of private consumers' expenditure were paralleled by similar trends in the evolution of incomes—especially of mass incomes, which are a decisive factor for consumption. In France and Italy the total wage and salary bill probably grew only very slightly. Both countries reported a slowdown in the upward movement of wage rates and a decline in the total number of hours worked, the latter item being particularly marked in Italy; though wage rates in this country went up again, mainly because the sliding wage-scale came into operation again in November and February, the growth of actual earnings over the same period was certainly extremely weak. In the Netherlands hourly wages remained stable in the fourth quarter; on 1 January 1965 there were general wage increases of about 2 %, largely to offset the increases in workers' contributions to social insurance; and in several industries collective agreements have been concluded which provide for a further increase in wage rates averaging about 3.5 %. In the Federal Republic of Germany there were faster increases not only in agreed wage rates and even more in actual earnings, but transfer incomes too expanded more rapidly than before.

The demand for certain consumer durables proved rather weak, particularly in France and in Italy. Sales of private cars in the fourth quarter made noteworthy gains only in the Netherlands and in Luxembourg. In Italy and France the number of new registrations was below, in Germany and Belgium only very little above, the corresponding figures for the previous year. However, the decline of new registrations in France seems already to have stopped, and in Italy too there have of late been some signs of improvement. The demand for services remained a major economic force even in those countries where the upward trend of incomes was slowing down.

2. Production

In the fourth quarter of 1964 and in the early months of 1965 internal supply in the Community expanded only modestly, mainly because of the slower expansion of internal demand.

Agricultural production, however, continued by and large to expand at an appreciable rate, especially crop production although in the period under review it was naturally not large in absolute terms. Till at any rate January the favourable weather made it possible to produce a relatively abundant supply of vegetables, and farmers were also able to step up appreciably the supply of livestock products. However, here the divergences in trend were relatively wide: in the current phase of the pig cycle the output of pigmeat was mounting sharply; output of beef made virtually no progress because of the shortage of cattle, and for the same reason the increase in milk production was only modest.

Unlike agriculture, industry was advancing rather slowly over the turn of the year. According to the adjusted Index of the Statistical Office of the European Communities (excluding construction and food, beverages and tobacco industries), the increase in production from the third to the fourth quarter was—as in the previous quarter—less than 1 %. The unadjusted index was running in the last three months of 1964 on average about 4 % above the figure for the same quarter of 1963.

The divergences between the trends of production in the various countries were wider than before: in the Federal Republic of Germany expansion was again rapid; in the Netherlands, too, progress remained fairly substantial; growth in Belgium was also notable between the third quarter and the fourth, though it slowed down distinctly towards the end of the year; no further improvement was recorded in France, where on the contrary there was even a slight decline in production. In Italy there was a reversal of trend, with the seasonally adjusted figures for industrial production moving upward during the last quarter of 1964 and probably again in January 1965.

Analysis by industry shows that in most cases the output of consumer durables rose at a slower rate, and that in some there were actual production losses: for the Community as a whole the output of passenger cars and estate cars in the fourth quarter was 6 % below the corresponding 1963 figure. The backlog of orders in the textile industry had already been receding for some time, and the output now also declined appreciably (5 % below the corresponding figure for 1963). The contraction of activity in this industry was due not only to the general business climate and to accidental factors, but probably even more to structural difficulties.

In the capital goods industries as a whole there may also have been some loss of momentum. Output in mechanical and electrical engineering was a little lower in France. In Belgium and—to a lesser extent—in the Netherlands its growth slowed down. In the Federal Republic of Germany, on the other hand, expansion continued unabated.

The output of basic materials and semi-manufactures, on the other hand, remained fairly vigorous. In the iron and steel industry further increases were achieved, but this

was partly due to very heavy orders received from United States manufacturers in anticipation of a strike in the American steel industry. In Italy, the growth figures picked up again partly because a new steel plant began production. The output of chemicals continued to expand briskly, as did that of electricity and petroleum in several member countries. In general (Italy being the exception) the output of building and construction and of their ancillary industries advanced substantially.

Among services, commerce and transport showed signs of quieter expansion as a result of the calmer development of internal demand in various member countries. The demand for services in the private sector, however, again rose sharply.

For the Community as a whole there was only a very moderate increase in the number of persons in paid employment. This was due in part to the continued insufficiency of manpower supplies, in part also to the slowdown in the growth of production. The total number of hours worked declined slightly in Italy and—at any rate in industry—in France too.

Trends on the labour markets of the Community consequently differed widely : in the Federal Republic of Germany the difficulties became even more acute, while both the Netherlands and Luxembourg continued to suffer from severe, if slightly less pronounced, shortages of labour; but in the rest of the Community the labour situation became less difficult or even, in the case of Italy, showed signs of weakness. In Italy the seasonally adjusted number of unemployed rose distinctly, while in France and—to a lesser extent—in Belgium it also increased slightly.

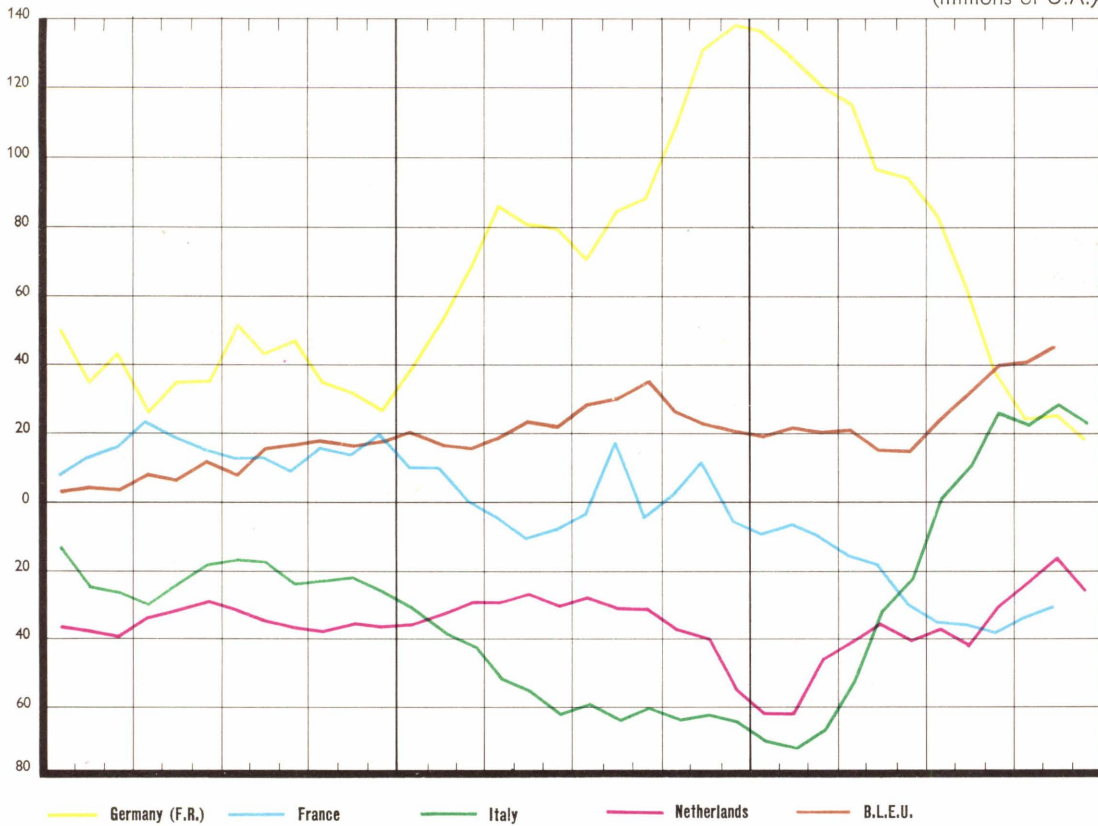
3. The balance of the markets

The slowdown in the expansion of internal demand also affected the trend of Community imports from non-member countries in the fourth quarter. After the decline in the third quarter, which was mainly an extension of the seasonal slackness of the summer, visible imports have grown only very little in recent months. For the fourth quarter of 1964 the seasonally adjusted figures showed hardly any improvement on that for the first quarter. The year-to-year increase (in value and based on customs returns) was 7 %—compared with 4 % for the third quarter, but 10 % for the second quarter.

Although in Italy imports picked up again a little towards the end of the year, the total remained well under the corresponding figure for 1963. In France the growth of imports in the fourth quarter was very slow and in the Belgo-Luxembourg Economic Union it lost momentum. On the other hand, Germany's purchases from non-member countries grew faster in response to the rapidly mounting demand which could not be met out of domestic supply because of its comparative inelasticity.

1. — THE BALANCE OF TRADE BETWEEN EACH MEMBER COUNTRY AND ITS PARTNERS

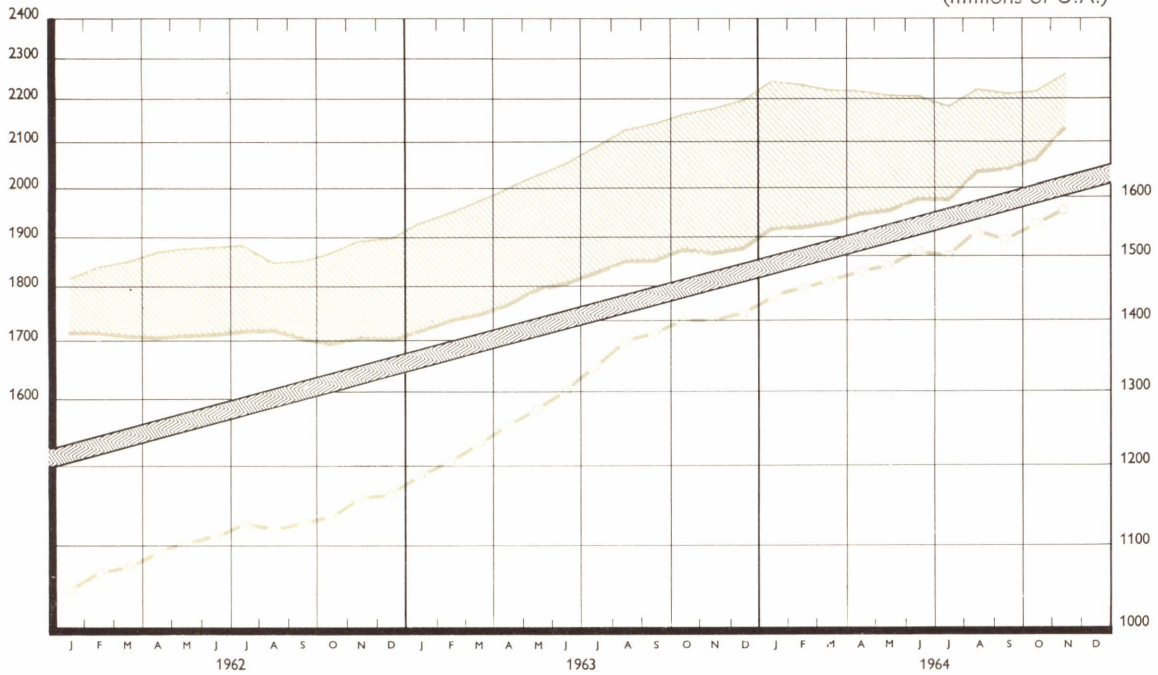
(millions of U.A.)



Note: Based on the customs statistics for imports and exports of each member country. Three-month moving average based on figures seasonally adjusted by SOEC.

2. — COMMUNITY TRADE

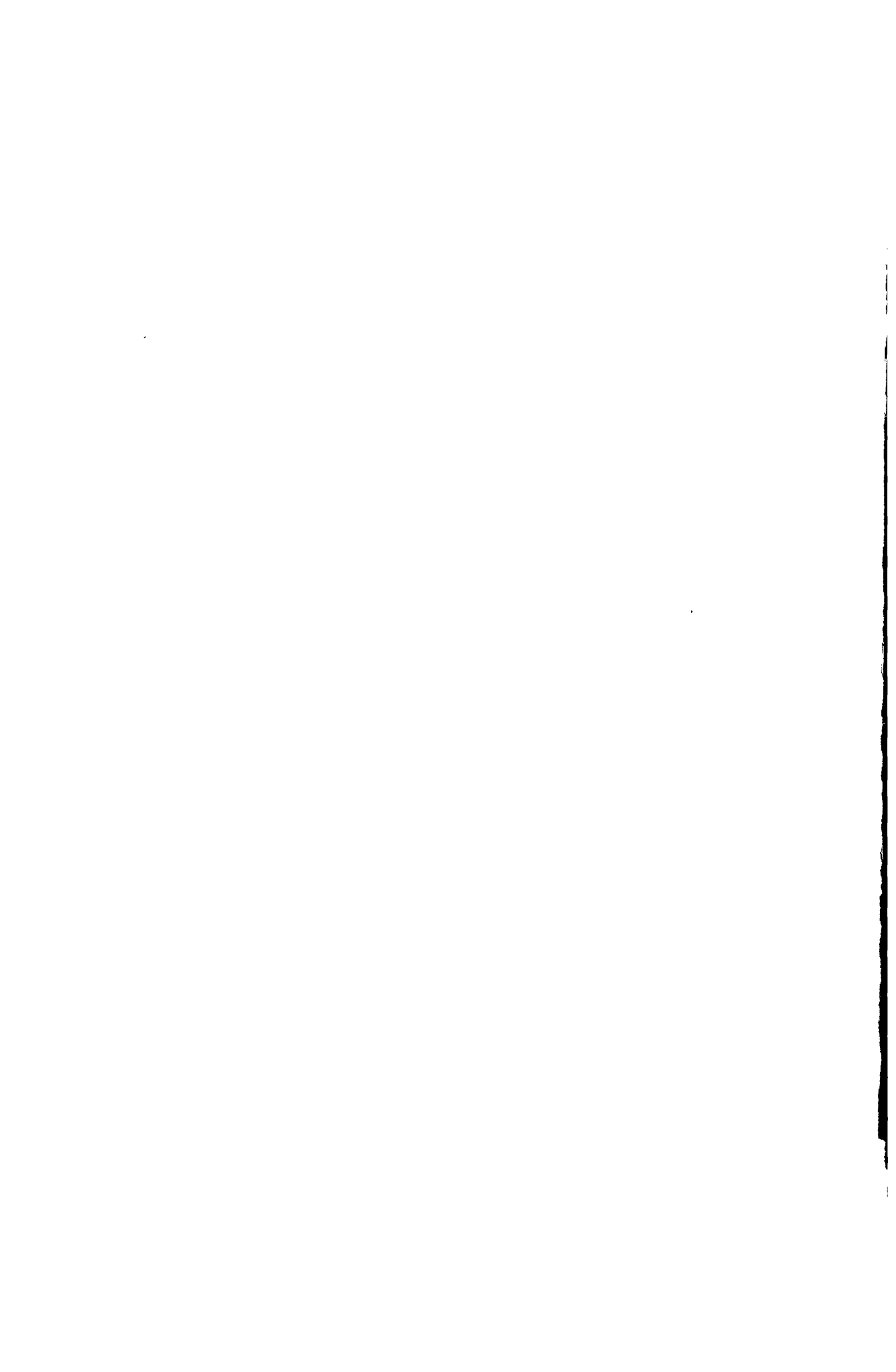
(millions of U.A.)



Key : — Exports to non-member countries.
 - - Imports from non-member countries.
 [shaded area] Intra-Community trade (based on import returns).

Note: Series adjusted by SOEC for seasonal and accidental variations. Exports fob, imports cif. One unit of account = 0.888671 gramme of fine gold.

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



The relative weakness in the growth of imports of consumer and capital goods affected in particular imports from EFTA, and an important element in this trend was the fact that purchases from the United Kingdom rose very little in the period under review. The reason for this was of course not only the trend of demand in the EEC but also—and more important—the domestic situation in Great Britain itself. Some other industrial countries succeeded in further increasing their exports to the Community, and Community purchases, especially those from the United States, reached a fairly high level. Major factors in this trend were not only the increased sales of farm produce, but also the relatively favourable competitive position of the United States, which enabled that country to maintain a fairly rapid increase in its sales to the Community of finished goods also.

Visible imports from non-member countries ⁽¹⁾

(% change in values on preceding year)

Imports from	1963	1964				1964 full year
		1st quarter	2nd quarter	3rd quarter	4th quarter	
United States	+ 13	+ 14	+ 4.5	+ 5.5	+ 7.5	+ 8
EFTA	+ 12	+ 14	+ 8	+ 1	+ 5.5	+ 7
including :						
United Kingdom	+ 17	+ 14	+ 9	- 2	+ 2	+ 5.5
Developing countries	+ 8	+ 16	+ 16	+ 5.5	+ 9.5	+ 11.5
including :						
Associated overseas countries and territories	+ 3	+ 6	+ 18	+ 5	+ 3.5	+ 8
Total non-member countries	+ 10.5	+ 16	+ 10	+ 4	+ 7	+ 9

⁽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 growth rate for purchases by the Community from the developing countries was fairly high in the fourth quarter, although, with enterprises tending to reduce the pace at which they were building up stocks of raw materials, expansion was no longer

as fast as in the first six months of 1964; in terms of value the slowdown in the expansion of imports became more pronounced at the turn of the year, when world commodity prices lost ground.

Intra-Community trade, which had been on the decline in the summer months, made a recovery from the third to the fourth quarter, when the year-to-year growth rate was 13 %. Italian imports from other Community countries ceased to decline and continued steady at their new level; imports into the Federal Republic of Germany again gathered momentum, the year-to-year increase in the fourth quarter being no less than 35 %. Although, on the other hand, French imports grew more slowly than before and Benelux imports developed at a relatively poor rate, these weaknesses were not enough to offset the expansionary trends elsewhere.

The more rapid growth of German imports had its counterpart, of course, in corresponding increases in the exports of the other member countries. Italy and the Benelux countries, in particular, achieved large increases in their exports to their EEC partners. Sales by France, too, picked up distinctly towards the end of the year. Deliveries by the Federal Republic of Germany itself ceased to decline.

The main feature of trends in the member countries' trade balances with their Community partners was the continued tendency towards greater equilibrium. Germany's surplus on trade had already declined in the second and third quarters, Italy's position was much improved, and now the French deficit, which in the third quarter had again been slightly heavier, was slightly lower. The Benelux countries succeeded in further improving their trade positions through a more rapid increase in exports, the decline of the Netherlands deficit, which in the first half of 1964 had been excessive, being particularly remarkable.

In the Community as a whole there is still a tendency for prices to drift upwards, though it has grown still weaker. In France and in the Netherlands the prices remained almost unchanged in the final quarter of the year; in Italy the weak trend of domestic demand, led to a distinct slowing down of price rises, but they were still fairly pronounced; in the Federal Republic of Germany and in Belgium their upward movement continued at a relatively modest rate, with signs in Germany of some increase in tempo.

Between January 1964 and January 1965 consumer prices rose 2.3 % in France and in the Federal Republic of Germany, 3.2 % in Luxembourg, 3.7 % in Belgium, about 3.5 % in the Netherlands and 5.5 % in Italy.

Apart from normal seasonal movements, the prices of food remained fairly stable towards the end of 1964 and in the early months of 1965 except in Italy and France, where the upward drift continued. The main reason for relative price stability was the decline in the price of pigmeat, due to the beginning of the upward swing in the pig cycle :

this served to offset higher prices for other livestock and for crop products. The prices of industrial finished goods continued to rise in several countries (Federal Republic of Germany, Belgium, and to a lesser extent in Italy) both at producer level and for the final consumer. In France and—doubtless only temporarily—in the Netherlands, prices were almost completely stable. Generally speaking, the upward price movement for services slackened towards the end of the year.

The Community's trade balance again improved from the third to the fourth quarter of 1964, and the improvement was fairly substantial. On the basis of external trade returns, the deficit was down to 311 million units of account, or 338 million units of account less than in the fourth quarter of 1963. Consequently the improvement in the current payments account of the Community should also have been maintained. Since in addition there was a net capital inflow—smaller, it is true, than in the third quarter—the Community's overall balance of payments showed a surplus in the fourth quarter and this may well have been larger than in the third quarter. At all events, the official gold and foreign exchange holdings of the member countries increased from the end of the third to the end of the fourth quarter by no less than 944 million units of account. Concurrently, however, the foreign exchange position of the commercial banks deteriorated appreciably, mainly because of the usual "window dressing" operations carried out at the end of the year. At the beginning of 1965 the pattern was correspondingly reversed—official reserves declined and the position of the banks improved. Because of the drawings on the IMF made by the United Kingdom, the position of the Community member countries with this institution improved in the fourth quarter by a total of about 400 million units of account.

In the fourth quarter, then, the trend of internal liquidity in the Community countries, with the exception of the Federal Republic of Germany, benefited appreciably from balance-of-payments trends. Mainly for seasonal reasons the cash transactions of the public authorities had a similar effect in most member countries, particularly in Germany, where the Federal Government had a heavy cash deficit. In Italy, too, there was a vigorous increase in public spending, and in Belgium large sums were injected into the economy from the same source; in France the contribution made to liquidity by cash transactions was smaller; and in the Netherlands they even tended to reduce liquidity, as public expenditure increased less sharply than in the first six months of the year, while revenue from taxation expanded very fast.

At the same time, the expansion of the demand for credit by commerce and industry slowed down a little in the Netherlands and in Belgium. In the former country the development of bank credit was less rapid than in the third quarter, and this meant a decline in the "penalty deposits" which must be made with the Central Bank when authorized credit limits are exceeded. In Belgium, too, signs of a slowdown in the expansion of credit were observed. Although in France bank advances, especially short-term advances to industry, continued to expand rapidly, the rate of expansion was

generally within the limits fixed by the monetary authorities; moreover, there have recently been signs in this country too of a slowdown in the growth of demand for credit in certain industries and in certain areas. In Italy the demand for credit by private commerce and industry was again slack, although the downward trend of bank advances ceased and showed if anything slight signs of recovering. The monetary authorities had some time ago reverted to an expansionary policy, but managements are apparently not yet inclined to increase their indebtedness very greatly; it is clear that one factor in this situation is the narrowing of profit margins.

Generally speaking, these trends, which are also exerting a growing influence on interest rates, reflect in varying degrees the slowdown in the growth of investment activity or its weakness in the various member countries: interest rates on the money and capital markets have of late tended to ease in Belgium, in the Netherlands, and, less markedly, in France. In Italy they have been falling slightly for some time.

Supply and utilization of goods and services (1)

	1962	1963	1964 (2)	1965 (3)
	At current prices (in '000 million u. a. (4))	% change by volume on preceding year		
Gross Community product	226.7	+ 3.9	+ 5.5	+ 3.5
Private consumption	138.1	+ 5.5	+ 4.5	+ 4
Public current expenditure	32.4	+ 5.7	+ 1.5	+ 3
Gross fixed asset formation	51.8	+ 3.9	+ 7	+ 3.5
Balance exports (5) less imports (5) (in \$'000 million, current prices)	+ 1.6	+ 0.5	+ 1.0	+ 2.0

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

(2) Commission estimates.

(3) Commission forecasts.

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

(5) Goods, services and factor income.

These observations also apply, but inversely, to the Federal Republic of Germany which, as far as general economic development and that of investment in particular are concerned, is for the moment out of step with the other Community countries. In this country the factors helping to expand internal liquidity were primarily domestic: there was a connection, for example, between the very high excess of public expenditure over public revenue in the last months of the year and the ending of the sharp contraction of bank liquidity. At the same time, the expansion of credit gathered pace. In view of the continuing strains on the domestic markets, the Bundesbank raised the cost of borrowing a little by increasing Bank rate in January to 3.5 %. The tendency for interest rates to rise was most marked on the capital market, despite a more plentiful supply of domestic savings; this was due not only to the heavy demand from the private sector, due in part to subsidization of interest rates, and from the public sector, but also to the effect which the withholding tax has been having on the flow of capital from abroad.

B. Outlook

Broadly speaking, the information now available on the latest trends confirms the forecasts for the full year 1965 made in the last Quarterly Survey (4/1964). Although the slowdown of economic development in the course of the year might prove greater than was initially to be expected, the difference will hardly be such as to warrant any very extensive adjustments in predictions.

The expansion of external demand (in terms of actual exports of goods and services) will perhaps be a little less rapid than was originally estimated. In particular, general world economic activity might well stimulate business in the Community less in the second half of the year.

For example, economic expansion in the United States—and consequently American demand for imports—may well slow down in the last six months of 1965. The increase in public spending provided for in the 1965/66 Federal budget is relatively small. While fixed asset formation by enterprises is still expanding markedly, its rate of growth will be slower than before. One factor affecting investment in stocks is that the stocks of iron and steel products built up as insurance against a steelworkers' strike will now be run down to normal. The major tax cut of 1964 will remain, it is true, a spur to the development of private consumers' expenditure, but the effects of the measure are steadily wearing off. How fully the decline of this stimulus will from the middle of the year onwards be offset by the planned reduction of indirect taxes—involving nearly \$1 000 million in a full year—remains to be seen.

In the United Kingdom domestic demand and production should continue to expand. For one thing the flow of orders received and the backlog of orders for capital goods suggest that fixed investment by enterprises, at least in the first half of the year, will develop further at a lively tempo—despite a higher Bank rate and the current pressure on the expansion of credit. At the same time private consumers' expenditure should grow at a faster rate because of the more expansive development of incomes. But these are merely the trends as they appear at present: they are still liable to be influenced by policy measures, notably in the 1965/66 budget. While it is already certain that public expenditure will again be expanded very sharply, it is not yet clear how far this will be offset by increased revenue or whether the budget will exert a restrictive effect on domestic demand. The same is true of credit policy, which could well be given a sharper edge. In view of the import surcharge, it is quite possible that imports from the Community may decline later in the year.

Similarly, certain other EFTA countries might find themselves impelled to pursue a more stringent deflationary policy, whether for balance-of-payments reasons or solely

to combat the upward drift of domestic prices. Such developments would certainly affect the Community's exports—although, by and large, there is every reason to expect that these will, in fact, continue to expand.

The Community's exports to the developing countries, will certainly again grow appreciably; it would however, seem that this trend is bound to involve a decline in the foreign exchange holdings of these countries which may eventually force them to cut back the rate at which their imports are expanding.

As for the components of internal demand, the prospects for the development of gross fixed asset formation in the Community as a whole suggest at present that expansion in this field will be relatively slow. This is however just the field in which the outturn may be favourably influenced by the policy measures that will have been taken in the first half of the year.

Available information on the flow of orders and the general economic climate suggests that investment in plant and equipment will continue its vigorous advance in the Federal Republic of Germany. In the Netherlands, this kind of investment will continue to grow but is expected to lose momentum later in the year. In Belgium, expansion might well cease altogether, and there could be an actual slight decline from what is, however, a high level of activity. In Italy and in France the only certainty is that investment by public undertakings will again expand; for the investment of private undertakings, on the other hand, the outlook in Italy is at the moment not clear, and in France it is not yet certain that the propensity to invest of private industry will recover much in the course of the year. Given the relative importance of Germany, however, there will probably be an improvement in the adjusted overall Community figure for investment in plant and equipment, though this improvement will be appreciably less than between 1963 and 1964.

Expenditure on building and construction, too, will on the whole continue to expand. In most member countries expenditure both on new housing and on public works should grow. In Belgium, however, the backlog of orders suggests some loss of momentum in future demand for building, and in Italy the outlook in this industry is for the moment decidedly poor; in the case of Italy, however, a drive is now under way to boost public works and the building of subsidized housing.

In view of the general economic trend and the movement of world commodity prices, investment in stocks is likely to make a more modest contribution than recently to economic activity in the Community. Exceptions will perhaps be Italy—given a recovery of economic expansion there—and the Federal Republic of Germany, where larger stocks of raw materials and semi-finished goods are needed to feed the vigorous expansion of production.

Generally speaking, there is unlikely to be any substantial decline in the rates at which consumption expenditure grows in the coming months. This applies particularly to public expenditure on goods and services, which will almost certainly gather pace in Italy and which should continue to grow at a fairly substantial pace in the Netherlands and to a lesser extent, in Belgium and the Federal Republic of Germany. Private consumers' expenditure will almost certainly grow at much the same rate as in recent months. In Italy and in France the expansion of the wage and salary bills and of consumption expenditure may continue to be slow; but a recovery as the year wears on is a distinct possibility in both countries, particularly in Italy, where measures of direct support to consumption, such as higher pensions, could be taken. In the Federal Republic of Germany the expansion of consumption expenditure by households should continue at a relatively fast rate—although probably not as fast as towards the end of 1964. In the Netherlands a fresh wage movement, which might well raise the total wage and salary bill 10 % above that of last year, is already under way; it is hardly to be expected that the expansion of consumption expenditure will fall appreciably. In the Belgo-Luxembourg Economic Union too there will, at least to begin with, be practically no reduction in the fairly rapid rate of growth of mass incomes and, consequently, of outlay on consumption. Since, for the Community on average, some loss of speed in the upward movement of consumer prices is to be expected, the real increase in private consumers' expenditure for 1965 will probably be hardly any lower than it was from 1963 to 1964.

The internal supply of the Community will, in all likelihood, continue to grow at the quiet pace recorded at the turn of the year. For one thing, the weakness experienced in France and the reduced rate of expansion prevailing in Italy could well continue for some time, but afterwards there should be a recovery or an increase in the pace at which production is growing. In the Netherlands however, and even more in Belgium, expansion may be slower than of late. In the Federal Republic of Germany the tempo of expansion is likely to continue very vigorous, but may level out somewhat as a result of the pressure of production factors.

In view of industrial production trends, of the growth rates for farm production (although the good harvests of 1964 will mean that the year-to-year rates are low), of the expected increase in building output and, lastly, of the relatively heavy growth in services which, as experience shows, usually goes with the slackening of industrial expansion, an increase in the real gross Community product of a good 3.5 % for the full year is to be expected. The growth of industrial production (as defined in the Index of the Statistical Office of the European Communities, i.e. excluding construction and the food, beverages and tobacco industries) may well reach 4 %.

Wide divergences between trends will continue, at least for some time, in employment and on the labour markets: there will be overemployment and severe labour shortages in the Federal Republic of Germany, a similar situation will persist in the Netherlands and in Luxembourg, strain will ease slightly in Belgium and more appreciably than hitherto in

France, though in this country shortages of manpower will continue in specific regions and occupations. The comparatively high level of unemployment registered in Italy recently will persist a while, particularly in building and construction, for here the recovery in output may at first result mainly in a restoration of the working hours that had been cut.

Community imports from the non-member countries are expected to go on growing in coming months. Imports by the Federal Republic of Germany should continue to expand very briskly and, in addition, the decline of Italy's imports has ceased; it is even quite possible that they may tend to rise again as the year goes on. Dutch imports, too, must be expected to grow more rapidly than in recent months. On the other hand, economic developments in France and—though to a lesser extent—in the Belgo-Luxembourg Economic Union will slow down the expansion of their imports.

None the less, the growth of visible imports may well prove so rapid that, in view of the slower expansion of exports, the Community's trade balance will no longer recover as fast as it did throughout most of 1964. The same will probably be true of the overall balance of current payments. When allowance is made for a probable slight improvement in the terms of trade, the current balance for 1965 may turn out to be distinctly larger than it was in 1964.

From country to country prices will be subject in varying degrees to the same stresses as those affecting the employment and labour market and the trend of the current payments balances.

The higher prices in the Federal Republic of Germany and the tendency for them to rise still faster are due primarily to demand pull; however, the situation in this country has already reached the stage where the upward movement of costs picks up speed, so that prices are no longer just drawn up by demand pull, but are also pushed up by rising costs. The situation is similar, though less acute, in the Netherlands, where not enough surplus demand has yet been drained off to relieve the labour markets sufficiently; this has led to wage agreements involving higher unit wage costs and increases in the level of prices.

The forces shaping prices in Italy and in France are not the same as those in the countries mentioned above. Here there can, on the whole, no longer be any question of inflationary excess demand. Although in Italy the tendency for prices to rise is still quite considerable, this is due solely to the upward movement of costs. The rate of increase will, moreover, continue to decline, and in this phase of the economic cycle the cost-of-living indices overstate the increase in the level of consumer prices. The rise is due in part to the after-effects of the wave of demand inflation, which was particularly pronounced in Italy, in part to the increasing influence of structural factors now coming more clearly to the fore—for example imperfect competition and the low elasticity of supply, notably in the distribution network.

The situation in France is similar in that here, too, the upward tendency still to be observed in prices, though appreciably less sharp than in Italy, is by now due to the pressure of costs alone, and this again is partly a consequence of the previous excess of demand and partly structural in character. The stability of the price level in the fourth quarter could well give way once more to an upward movement—although this would be fairly slow—as soon as direct price controls are lifted and certain adjustments are made in public service charges.

The situation in Belgium is a transitional one : here there are price increases due to both demand and costs, but the former factor has for some time been declining in importance and the latter is gaining strength.

For the Community as a whole, the result of all these trends will probably be a further slowdown of the upward movement of prices : relative stability in France, a smaller increase in prices than in 1964 in Italy, and a less marked slowdown in Belgium. In the Netherlands, too, the upward price movement will be slower than in 1964, but it will still be very considerable—possibly the most pronounced in the Community. Germany is the only member country in which a slowdown is not to be expected but in which there will, if anything, be acceleration of the upward movement; with both production and imports expanding sharply, however, the rise should remain within reasonable bounds.

The divergent trends that characterize the situation from country to country—the probable evolution of prices and the factors behind the differences in their evolution, the varying situations on the labour market and the outlook for each country's balance of current transactions—lead to the conclusion that the Community's short-term economic policy must now be tailored to fit specific cases more closely.

At the beginning of 1964, too, the business situation in the Community showed, it is true, certain divergences, but only in the intensity of an otherwise general inflationary pressure, not in the direction of the trend. So at that time it was perfectly logical that rules should be proposed which all Member States should apply in the same way as part of their economic policy during 1964. In the main, these were rules to limit the expansion of the various elements of demand, so compliance with them necessarily had different effects despite their uniformity: where the situation was very inflationary, the rules were sharply restrictive in their consequences; where the pressure of inflation was less or—as in the Federal Republic of Germany—hardly perceptible, the braking action was more gentle.

Some member countries are now witnessing a slowdown in economic growth, signs of stagnation, or even a situation in which the factors of production are not being fully utilized. This is not so much because of the stabilization policy itself (it could be ascribed to that source only in so far as the prescription was ill balanced), but rather because of the earlier inflationary thrust. Where inflation was strongest in 1963 and at the beginning of 1964, the economic situation is now weakest.

On the other hand, there are member countries in which the pressure of demand has increased or is only slightly abated. In Germany the measures needed to keep the investment boom in check have probably not been sufficient, nor has the expansion of public expenditure been slowed down sufficiently. Local authorities in particular, but recently the Federal Government too, have pushed expenditure beyond the limits recommended by the Council, and in addition taxes were cut at the beginning of 1965. In these circumstances it is obvious that the recommendations on incomes policy cannot be followed either.

The situation in the Netherlands is similar; here, too, it was not in 1964 possible to follow completely the Council's recommendation concerning the policy to be pursued by the public authorities on cash expenditure and revenue, partly because of decisions on wage policy which had been taken earlier and one of the effects of which was a sharp increase in public expenditure. For 1965 there is a risk that the rules approved by the Council will not be followed. Expenditure is, it is true, rising at a considerably lower rate than in 1964, but expansion is still relatively vigorous and a sizeable tax reduction has been decided on for the second half of 1965. In addition, the wage increases granted at the end of 1964 for 1965 will probably once again exceed the growth of productivity quite perceptibly, even if not by so much as in 1964. Although the rise in expenditure on investment by enterprises seems to be tailing off, the expansionary factors referred to above might prevent the Dutch economy from returning to the equilibrium signs of which were in the second half of 1964 to be discerned in the price situation and the balance of current payments.

Given these circumstances, there is certainly no reason to consider relaxing such restrictive measures as have been taken in Germany and the Netherlands; the authorities in these countries should ensure that their policies strictly follow the lines laid down in the Council's Recommendation—and this, as matters now stand, probably means that restrictions will have to be tightened. Action in the field of monetary and credit policy will have to be all the more rigorous if the public authorities themselves disregard the rules.

In Belgium and Luxembourg any *general* abandonment of restrictions on the expansion of internal demand would not appear to be politic. On the contrary, those parts of the Council's Recommendation of 15 April 1964 which concern public current expenditure on goods and services and transfer payments and, if possible, those which concern incomes policy should certainly still be followed. The more strictly the Recommendation is complied with, the sooner would it be possible in certain circumstances to introduce cautious relaxations of the restrictions on public investment policy and in the treatment accorded to building and to investment by enterprises.

In France, certain tax incentives could be introduced to encourage investment by private industry—and these are already being prepared. If in addition something were to be done in the sphere of credit policy, it would seem wise to restrict any relaxation in

this field to credits for productive investment by enterprises. Public expenditure should be kept within the limits laid down in the budget for 1965, and in encouraging house construction great care will be needed if price and cost increases are not to spread from the building industry to the rest of the economy.

Only in Italy is a definite policy of stimulating demand to be recommended. But here, too, stress should be laid on investment : expansion of actual investment expenditure by the public authorities and by public undertakings, further incentives to investment by private firms, promotion of low-cost and private house-building. On the other hand, the utmost moderation must be exercised in the expansion of public expenditure on goods and services and on transfer expenditure which contributes to private consumption; above all, new long-term commitments and increases in long-term expenditure should be avoided. Money and credit policy should continue to be expansionary, with an early cut in real interest rates.

Italy is the only member country for which an exception can now be made to the 5 % limit on the year-to-year growth rate of total government expenditure. However, an endeavour should be made to finance any budget deficit and the Treasury deficit by normal methods—i.e. without having recourse to the Central Bank. In view of the favourable liquidity situation, which is steadily improving because of balance-of-payments surpluses, the difficulties are not likely to be insurmountable.

All measures to stimulate the Italian economy should be such as will have a rapid but not too massive effect and should immediately be slowed down if the upward movement of prices and costs threatened to gather speed again. The immediate need is by no means the creation of "more money" but rather to ensure without loss of time that there shall be a sufficient increase in demand based on funds that for the most part are already available.

A final point at present of particular importance to Italy is that the trend of wages should keep in line with what the Council's Recommendation lays down on incomes policy; this means that wage increases in terms of money should in no case exceed the increase in productivity over the same period. There would otherwise be a risk of further stagnation coupled with considerable price increases.

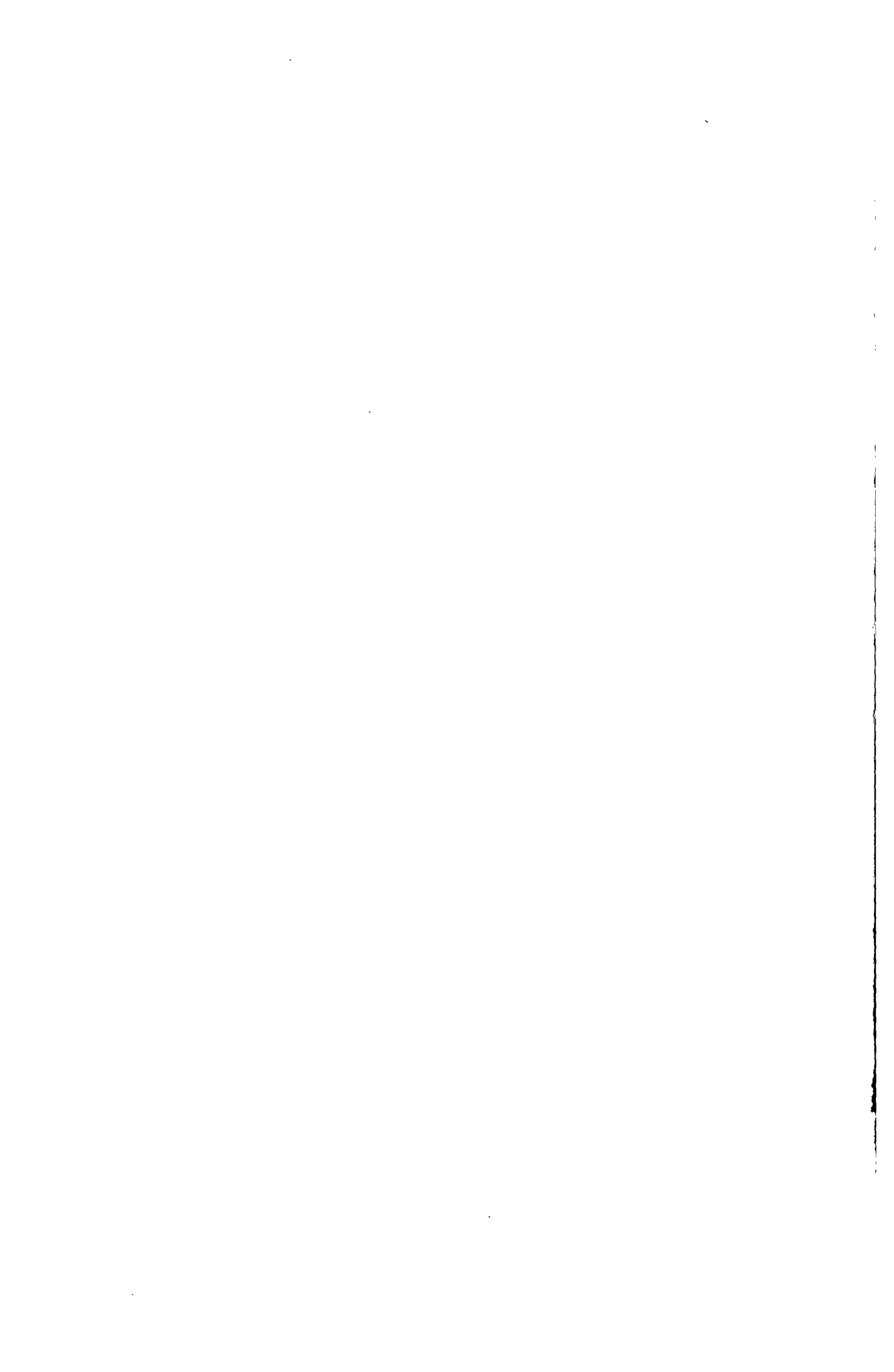
These, in the Commission's view, are the requirements of a co-ordinated economic policy in the Community for the coming months.

The Commission wishes to stress that the Community taken as a whole has entered a phase of stabilization and consolidation which is bound to last some time. For it is impossible to pass straight from such an inflationary situation as existed in some member countries in 1963 and early 1964 to a period of stable prices and stable unit costs and at the same time to maintain very high rates of real economic growth. If it is the Community's

will that stability in economic policy shall be maintained, then a period of slower growth must now be accepted. It should be remembered that the Council has, for the present at least, given top priority to the objective of stabilization.

There is absolutely no danger of a general recession in the Community: the expansion of demand in Germany in particular is much too strong, and it is having considerable stimulating effects on the other member countries; nor should it be forgotten that, mainly because of net capital inflows, the balances of payments of the Community and of most member countries are showing surpluses varying in size. These inflows and the risk that they might increase have for some considerable time been causing difficulties for the Community's short-term economic policy—especially money and credit policy; and they will continue to pose problems. They are a factor which tends to hamper the work of those responsible for economic and stabilization policies in the Community.

It is therefore fortunate that in the country with the biggest net capital outflows the restrictive measures already taken are being extended and supplemented by further efforts. It is also understandable that some Member States are themselves attempting to counteract inflows of capital. It would be useful if policy on this matter were harmonized at Community level.



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



A. Federal Republic of Germany

Economic activity continued to expand vigorously in the last quarter of 1964 and in the early months of 1965. Although a slightly faster rate of expansion of exports was recorded, the main feature of general economic development was the very stimulating business atmosphere at home. Investment expenditure—both on building and in particular on capital equipment—again rose appreciably, and the expansion of consumption expenditure gathered pace. This applies particularly to the consumption of households, but public expenditure, too, mounted faster than before.

Despite the serious and growing strain that beset the labour markets, domestic supply again rose appreciably. The year-to-year increase in industrial production was 7.6 % for the fourth quarter; high though the elasticity of production was, however, it was not high enough, and imports, which had already been rising sharply, gathered further pace. Evidently the additional supplies from abroad are one reason why there has so far been little increase in the upward trend of prices.

Although the surplus on goods and services was again a little higher, there was a small deficit on current account when transfer payments are included. Since, in addition, net capital exports were substantial, there was a deficit on overall payments of DM 1 400 million in the fourth quarter. At the end of the year the net gold and foreign exchange reserves of the banking system (Bundesbank and commercial banks) stood at much the same level as a year previously.

Demand is expected to go on expanding sharply throughout 1965. Although exports may well continue to grow, it is probable that domestic demand—industrial investment, housing and private consumers' expenditure—will be the main contributor to expansion.

Because of the serious labour shortage and because production capacity is fully extended at many points, the expansion of domestic supply is unlikely to keep up with the trend of demand. Industrial production will doubtless make further considerable gains, although it is expected to rise more slowly than of late. The expansion of imports will consequently remain fairly rapid, without repeating the very high growth rates recorded towards the end of 1964. There is a danger that the upward movement of prices may gather further momentum.

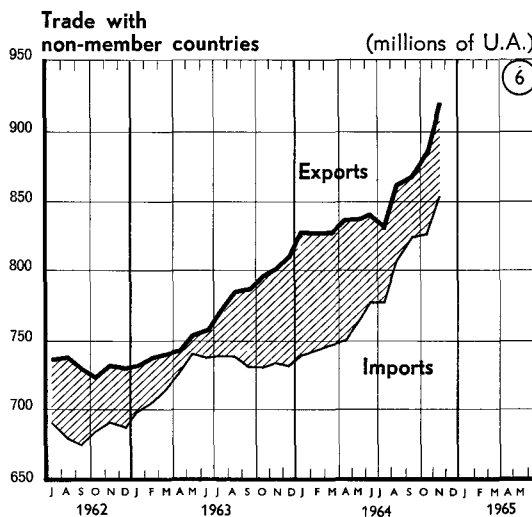
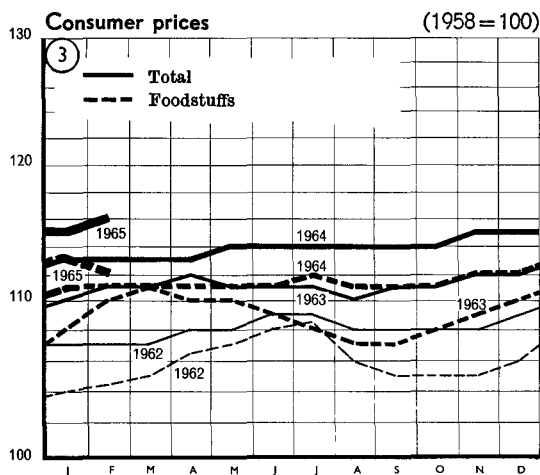
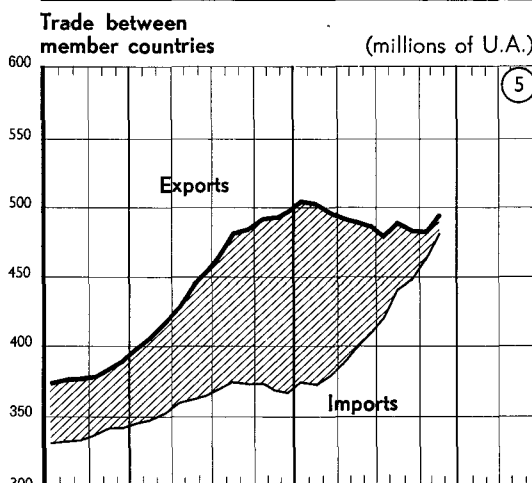
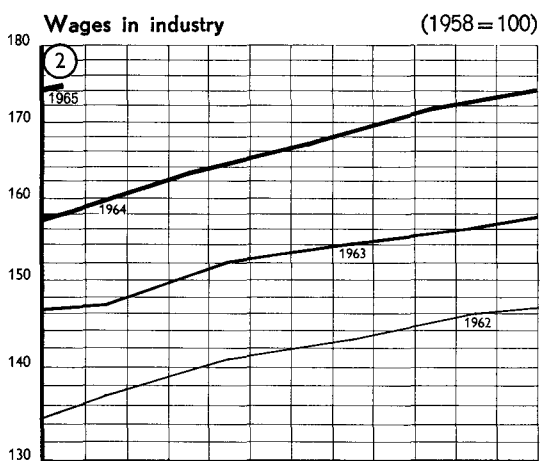
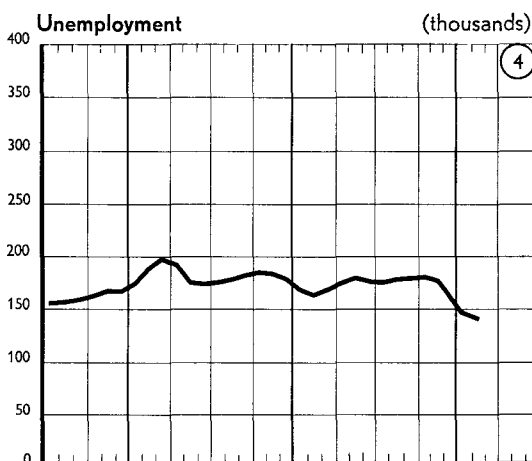
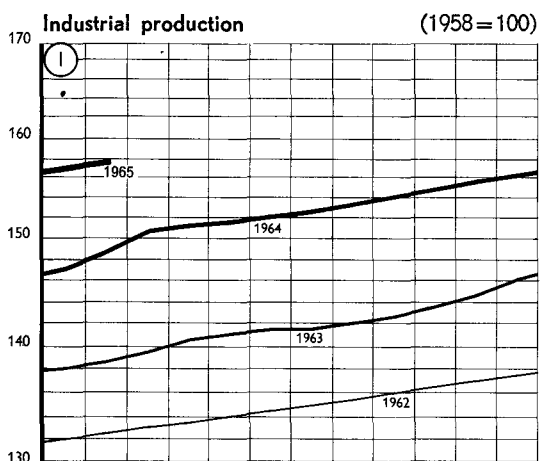
These prospects support the view that in the implementation of short-term economic policy in the Federal Republic of Germany even more emphasis should be laid on stabilization. However it would seem that precisely in the two most relevant fields—budgetary policy and policy on building—the authorities have actually moved away from the rules recommended by the Council on 14 April 1964 and again on 10 November. To the extent that the requirements of stabilization policy are not observed in the cash transactions of the public authorities, it will almost certainly prove necessary to stiffen the restrictive effect—as far as is feasible—of monetary and credit policy.

1. Recent developments

The growth of exports of goods and services has recovered somewhat after the slowdown recorded in the third quarter of 1964. According to the foreign trade returns, at any rate, visible exports were up 8.7 % in the fourth quarter and 10 % in January 1965 on the corresponding figures of a year earlier. Exports to the EFTA countries in particular grew faster; the year-to-year growth rate for the fourth quarter under this heading was more than 12 %. In December, however, the first effects of the United Kingdom surcharge seem to have made themselves felt: by then deliveries to this country were about 3 % up on the December 1963 figure, while the year-to-year growth rate for exports to the EFTA countries as a whole was as much as 16 %. In the last quarter the Federal Republic's exports to the other EEC countries showed virtually no change on the preceding months and only a very small advance on the figures for a year earlier. The main reason for this is the decline of exports to Italy, though in the fourth quarter this downward trend eased off; exports to France, too, were less impressive.

In recent months the most powerful forces making for economic expansion have derived from domestic demand. In particular, gross fixed asset formation has mounted appreciably. The increase in building investment was—with the exception of road-building—appreciably higher in the fourth quarter than in the preceding months. The growth of investment in capital equipment also gathered pace. For example, during the fourth quarter domestic sales in the mechanical engineering industry—the largest industry producing capital goods—were 11.6 % ahead of the corresponding 1963 figure. Imports of capital goods also rose faster.

ECONOMIC INDICATORS



NOTES :

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

Graph 1 : Estimated trends based on SOEC seasonally adjusted data. Excluding construction, food, beverages and tobacco.

Graph 2 : Index of average hourly gross earnings.

Graph 3 : Cost-of-living index for consumers in medium income groups.

Graph 4 : End-of-month figures, seasonally adjusted by Commission.

Graphs 5 & 6 : Series adjusted by SOEC for seasonal and accidental variations. Exports fob, imports cif. One unit of account = 0.888671 gramme of fine gold.

Investment in stocks generally remained brisk. The upward trend—first recorded some two years ago—in imports of raw materials and semi-finished products continued unabated, more than covering the amounts withdrawn for production; retail dealers also continued to increase their stocks, doubtless mainly because they expected consumers' expenditure to expand. The results of the EEC business survey suggest that over the same period manufacturers' stocks of finished goods continued to decline.

Consumption expenditure rose faster. In the public sector salaries were raised on 1 October 1964 and expenditure on military equipment also increased, causing public expenditure on goods and services to go up.

More important, the brisk business climate now seems to be stimulating private consumers' expenditure more and more. At any rate, retail sales are moving up at an increasingly rapid pace: in the fourth quarter of 1964 they were 8.4 % (5.9 % in volume) above the corresponding 1963 figure and the year-to-year growth rate for January 1965 was 4.8 % (volume, 2.3 %).

Though the proportion of savings taken from the disposable incomes of households—partly for seasonal reasons—again increased, income expansion was so massive that the growth of consumption expenditure gathered speed. The level of agreed wages, reckoned on a weekly basis, was in the fourth quarter 5.4 % higher than a year earlier. Actual earnings rose, on the whole, at an appreciably faster tempo, not only because of higher hourly rates but even more because of a sharp increase in other forms of money remuneration, such as bonuses, Christmas boxes, etc. All in all, disposable mass incomes in the fourth quarter—when the increase in employment, the increase in transfer incomes and the progressively heavier incidence of certain taxes are all considered—were 10.5 % up on the corresponding 1963 figure, compared with a year-to-year increase of 8 % for the third quarter. In addition, the amounts withdrawn from their businesses by the self-employed almost certainly increased faster as a result of improved profit trends in 1964.

One consequence of the vigorous upward movement in income from wages and salaries was that strains on the labour market increased even more. The usual seasonal increase in unemployment was appreciably smaller than in previous years. At the end of February the number of unemployed was only 291 200, compared with 304 700 a year before, and there were 608 500 unfilled vacancies on the books at labour exchanges, 22 600 more than in February 1964.

Despite the severe labour shortages, domestic supply remained fairly elastic. It is true that in the consumer goods industry, and to a lesser extent in the basic materials and capital goods industries, the growth of industrial production weakened a little towards the end of the year; none the less the Federal Statistical Office's index of production per working day shows that in the fourth quarter the year-to-year growth of output was 7.6 %, and in January 10.5 %.

The rapid expansion of imports of goods and services has gathered momentum in recent months. Visible imports, on the basis of customs returns, showed increases over the corresponding figures for the previous years of 24 % (value) and 22 % (volume) in the fourth quarter and of almost 24 % (value) in January too. While imports of military equipment have been expanding more rapidly, commercial imports of finished goods in the fourth quarter were as much as 30 % above the corresponding 1963 figure.

The generally vigorous increase in the supply of goods and services helped to limit the upward movement of prices despite the tendency for the growth of demand to gather pace and for costs to move upwards in various industries. While prices of agricultural produce stood at the same level in January as in January 1964, there was a year-to-year increase of 2.1 % in manufacturers' prices. The cost-of-living index has also continued to rise in recent months : by January it was 2.3 % up on the figure for January 1964.

Partly for seasonal reasons, the surplus on trade in goods and services has again increased somewhat in recent months; customs returns showed a surplus of DM 1 030 million in the fourth quarter of 1964, compared with DM 680 million in the previous quarter and DM 2 840 million in the fourth quarter of 1963. None the less the current account which, in addition to the items included in the trade and services balances, also covers transfer payments, again closed with a small deficit in the fourth quarter. Since, in addition, the balance of capital transactions (excluding any variation in the foreign exchange position of the commercial banks) showed net capital exports of DM 900 million and since there was a deficit of about DM 250 million (due to seasonal factors) on errors and omissions, the overall balance of payments closed in the fourth quarter with a deficit of DM 1 370 million. The foreign exchange holdings of the commercial banks declined by DM 1 670 million as a result of the repatriation of foreign assets normal at this period to cope with end-of-year settlements. Thanks to the refinancing facilities granted on a temporary basis by the Bundesbank, the amounts involved were, however, smaller than in 1963. On the other hand, the gold and foreign exchange reserves of the Bundesbank increased by DM 310 million. Thus the foreign exchange position of the Bundesbank and of the commercial banks at the end of 1964 was virtually the same as it had been a year previously.

The tightness on the money market which had prevailed throughout most of the year till October gave way for a time to easier conditions. An important factor in this connection was almost certainly the trend of Treasury transactions. In contrast with the relatively favourable results achieved in preceding quarters, the Federal Treasury's deficit totalled DM 2 450 million in the last quarter of 1964, thus exceeding slightly that of the fourth quarter of 1963. The expansion of bank liquidity in January was also connected with the fact that the banks stepped up vigorously their calls for accommodation from the Central Bank in the expectation that Bank rate would be raised. Bank rate was in fact raised on 22 January by one half per cent to 3.5 %.

The expansion of bank advances—particularly short-term advances—to commerce and industry gathered pace appreciably in the fourth quarter.

Supply and utilization of goods and services

	1962 ⁽²⁾	1963 ⁽²⁾	1964 ⁽²⁾	1965 ⁽³⁾
	At current prices (in DM '000 million)	% change by volume on preceding year		
Gross national product	354.5	+ 3.2	+ 6.5	+ 5.0
Imports ⁽¹⁾	65.3	+ 8.3	+ 11.2	+ 7.0
Private consumption	204.0	+ 2.8	+ 5.3	+ 5.0
Public current expenditure	53.1	+ 8.0	+ 0.1	+ 3.0
Gross fixed asset formation	90.2	+ 2.2	+ 11.0	+ 6.5
Exports ⁽¹⁾	69.0	+ 9.6	+ 10.1	+ 5.5

⁽¹⁾ Goods, services and factor income.

⁽²⁾ *Wirtschaft und Statistik*, January 1965.

⁽³⁾ Commission forecasts.

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

2. Outlook

Recent indicators confirm the forecasts made in Quarterly Survey 4/1964 that there would be lively economic expansion in 1965.

Although the basic trends in certain Community countries and the UK surcharge applied in the autumn of 1964 are factors that may vitiate any predictions as to the development of foreign demand, a further and appreciable increase in the Federal Republic's exports can be expected: the expansion of demand seems to have remained fairly brisk in many non-member countries and the competitive position of German enterprises should remain decidedly favourable despite higher export prices. Moreover, the further reduction in intra-Community tariffs on 1 January might well stimulate foreign demand. This

prospect is strengthened by the fact that the flow of orders from abroad again increased sharply in relation to the preceding months, that their year-to-year increase in the fourth quarter was 8.9 % on the already high figure of a year earlier, and that current sales abroad were also up 4.5 % on the final quarter of 1963.

Nevertheless, as compared with domestic demand, foreign demand must be expected to decline further in importance as a stimulant of expansion: the main feature of the economic situation will be a boom in domestic demand. Expenditure on gross fixed asset formation should again surge forward; as already mentioned in the last Quarterly Survey, public expenditure on road-building is expected to grow appreciably. But the number of licences granted in the other branches of the building industry also points to a vigorously upward trend in building investment: the estimated cost of public works for which licences were issued in the last quarter of 1964 totalled 13.7 % more than the corresponding 1963 figure. The rate of increase of expenditure planned for authorized new housing was as much as 20.6 % up on the corresponding 1963 figure. Commercial and industrial building was also expanding rapidly: in this field it was planned in the fourth quarter to spend 20.8 % more than a year previously.

Equipment investment should also continue to expand briskly. Strong evidence for this assumption is the vigorous upward trend in new orders for capital goods: in the fourth quarter, orders from the home market received by the mechanical engineering industry were 19 % up on the corresponding figure for the previous year. The results of the EEC investment survey carried out towards the end of 1964 suggest that investment expenditure in industry will rise by about 16 % in 1965.

On the other hand, the increase in public consumption expenditure should be relatively modest, mainly because the expenditure on national defence in the Federal budget for 1965 has been cut to offset in part the increase in overall spending which stems from the Bundestag's decisions to raise a number of transfer incomes (subsidies to agriculture, family allowances, etc.).

For reasons already set out in detail in the last Quarterly Survey, private consumers' expenditure will rise very sharply. In addition to an appreciable increase in transfer incomes, a large addition to wages and salaries is also to be expected. In view of the severe strain which still besets the labour market and of the favourable trend in profit margins, the workers have already increased their wage claims considerably. The latest collective agreements also confirm that the employers are ready for fairly extensive wage concessions, all the more since the market situation suggests that much of the cost increase can be passed on in the shape of higher prices.

In view of this trend in demand, the growth of production will almost certainly remain appreciable. In absolute terms, however, its elasticity will probably decline.

Despite the very high rate at which capacities are being used, the decline will be due more to the shortage of labour than to technical limits, since these are now being steadily extended thanks to the investment boom which began some time ago. The tightness of the labour market is, in fact, likely to increase further. None the less, what with rationalization measures and the further recruiting of foreign workers, industrial production will make substantial gains in spite of the slower rate of growth that appears likely.

Imports will also continue to expand rapidly, though here, too, the growth rate may be a little lower.

All in all, these predictions are in line with the annual forecasts made in the last Quarterly Survey (4/1964). The increase in gross fixed asset formation and in imports is likely to prove even a little higher than forecast.

This seems to confirm the impression that the West German economy is still suffering from the effects of an inflationary upsurge in demand, despite the stabilization drive and despite the fact that influence exerted for some time by the trend of trade with the other Community countries has if anything helped to counter inflation. The pressure exerted by demand would seem even to be gathering further strength, and since wage costs per unit of output are consequently beginning to move forward more rapidly once again, there is every reason to fear an acceleration in the upward movement of prices. It is true that the rapid expansion of imports—and the fact that the prices of imported raw materials have eased a little—are factors helping to curb the upward price movement; none the less the rate of increase is too rapid to be compatible with stabilization.

In addition, it would seem that this development is bound up with a tendency for the balance on current account to deteriorate; according to the latest forecasts the current account should, at best, balance out in 1965. But the Federal Republic of Germany is one of the Community member countries which must at least in the long term be in a position to accumulate surpluses on current account in order to offset net exports of capital, for—and this is a desirable development—there is now a deficit on the balance of capital transactions.

It goes without saying that in these conditions a moderating short-term economic policy is more necessary than ever—and equally clearly domestic demand is the element in economic activity against which these measures must be directed: for some time now the trend in foreign trade has ceased to be a source of inflationary pressures.

The short-term economic policy pursued by the authorities should keep closer to the recommendation made by the Community Council on 14 April 1964 (the Council decided on 10 November that its recommendation should continue to inspire economic

policy for 1965). Measures on these lines had already been taken; for example the Federal budget for 1965 had been kept, although only just, within the limits recommended by the Council. There is a danger that this will no longer be the case, at least from the economic angle, in view of the latest changes made to the budget. This being so, the tax cut made on 1 January, adding, as it does, additional pressure to demand, gains in importance.

Another relevant factor is that available information on the estimates of expenditure made by the communes and the Länder (in the case of the communes information is naturally far from complete) suggests that spending will on average be appreciably higher than was recommended by the Council for public spending as a whole.

In view of this trend in budgetary estimates the least that can be done is to take advantage of all administrative opportunities available to curtail expansion in those forms of public spending which affect the internal economy.

A special problem is that of official expenditure on construction, whether direct or indirect, and of interest subsidies for new housing; it is obvious that despite the Council's Recommendation, the authorities are not only no longer trying to slow down the building boom, but have actually resumed measures to encourage it. Strict limitation is all the more necessary since the unfortunate consequence of a failure to curb expansion firmly will be that the Government is openly nullifying the effects in this field of the stabilization drive conducted by the authorities responsible for credit policy.

The less the general and specific aspects of the budgetary policy pursued by the public authorities take account of the vital needs of short-term economic policy, the more the monetary and credit policy pursued by the Bundesbank will have to be restrictive. The Bundesbank will in any case have to strengthen restrictive measures if, as is likely, the present trends towards an unduly sharp expansion of private investment demand and of bank credit continue or, as is not impossible, actually gather momentum.

The small increase in Bank rate made in January reinforced the moderating policy already put in hand in the field of credit. More energetic measures may well prove necessary. Within certain limits they would, moreover, be perfectly feasible; the danger that the efforts made in this field might be offset by an inflow of foreign capital has declined sharply, mainly thanks to a number of measures designed to stem imports of capital, among them the recent law by which the Bundestag instituted a tax on income from securities held by non-residents. However, care must be taken to see that use of interest rebates by the public authorities does not artificially encourage upward trends in interest rates.

3. The economic situation in West Berlin

The vigorous economic upswing in the Federal Republic is also reflected in the lively expansion of the West Berlin economy.

Exports of goods and services have continued to expand very fast. In the fourth quarter of 1964 the value of visible exports was 21 % up on the last quarter of 1963, and this means that the average for the year was a shade under 14 % higher than for the preceding year. The trend in investment remained very healthy. Investment in the building sector and purchases of capital goods both rose appreciably. The expansion of private consumers' expenditure has gathered momentum in recent months. In terms of value, retail sales were up by 9 % in the fourth quarter on the corresponding figures for the previous year.

The strain on the labour market persisted although, thanks to net immigration, the numbers in paid employment again increased slightly. At the end of January the number of unemployed at 12 300 was 5 700 lower than at the same period of the previous year, while the number of vacancies unfilled had risen by 1 200 to 17 000.

The expansion of production has accelerated. According to the index of production per working day, industrial production in the fourth quarter showed a year-to-year increase of 9 %. All in all, the increase in 1964 as compared with 1963 was 6.3 %. Although the growth rate is thus lower than the average rate for the Federal Republic as a whole (about 8.5 %), this is almost wholly due to the situation of the electrical engineering industry in West Berlin, the output of which declined by more than 3 % in 1964. West Berlin's "GNP" at constant prices increased by about 5 %, compared with a corresponding growth rate of just on 3 % in 1963.

Both exports and imports made appreciable progress and the balance of visible trade with the Federal Republic closed in the fourth quarter of 1964 with a deficit of DM 142 million, as against DM 80 million for the fourth quarter of 1963. All in all, the deficit for 1964 (DM 133 million) was just as heavy as that for 1963.

The upward movement of consumer prices continued. In January the cost-of-living index was 3 % above the figure for January 1964.

The outlook for the rest of the year is one of vigorous expansion for Berlin's economy. In industry there is a marked tendency for the flow of orders to increase. In the fourth

quarter, new orders were 11 % up on the corresponding figure for 1963, and were running 7 % ahead of current sales. In the electrical engineering industry, the order situation has made a marked recovery after a lean period. Investment is likely to remain very lively. The number of building licences issued indicates that investment in the building sector will move ahead rapidly; moreover, purchases of equipment will increase considerably as enterprises endeavour to streamline operations and extend capacity. However, the growing shortage of suitable sites would seem to be discouraging the establishment of new industries.

B. France

The business situation has settled down further in the past few months.

True, demand from abroad grew decidedly brisker, but the chief features in the growth of domestic demand were a distinctly weak propensity to invest on the part of private industry, a cautious attitude on stocks and a very slow rise in private consumers' expenditure. On the other hand investment expenditure by the public authorities, by public enterprises and on housing again showed a strong increase.

In line with these developments, the rise in domestic production was very slight, and in industry it even tended to fall back a little. Imports too made scant progress.

As excess demand at home fell, there was a further improvement in the balance of external transactions. At the same time, the forces making for higher prices probably lost some of their strength; the rise in the level of consumer prices has been distinctly slower over the past few months.

The further outlook for 1965 is somewhat uncertain at this stage. For some time to come economic activity is almost certain to remain decidedly subdued; a marked general recession is however hardly a possibility to be reckoned with, and there is even a chance of some recovery in the pace of economic growth as the year wears on; but it is difficult to say when this will be and how far it will go.

Demand from abroad will be one of the main contributors to economic activity during the months ahead. An important factor in the development of domestic demand will be the extent to which private enterprises invest; there are, however, no immediate signs of any increase here, at any rate in private industry. Be that as it may, total expenditure on gross fixed asset formation will rise further, and quite a considerable part of the rise will be due to the expansionary programmes of the Government and of public enterprises. Even if businessmen's attitude to stockbuilding may for some time to come exert a restrictive influence on production and employment, the trend of wages should suffice to ensure a very slow but steady rise in private consumers' expenditure.

Although supply and demand are now tending towards balance, there are still, in addition to the further increases expected in the price of certain public services and the rise in producer prices for a number of farm products, a number of other latent factors which might force prices up. These stem mainly from the rise in costs, which has not yet been slowed down sufficiently.

In the circumstances, the policy of stabilizing prices and costs should certainly be maintained. There is no further need, however, to stiffen the general measures taken to curb demand; limited incentives to investment by private industry could be desirable if the elements of weakness in the investment field should continue. It should also be pointed out that lasting price stability cannot be achieved unless those responsible for economic policy do more than they have so far done to remove the structural obstacles to steady, long-term and, above all, balanced economic growth.

1. Recent developments

Exports of goods and services have again shown a clearly marked rise since the autumn of 1964. Customs returns indicate that visible exports in the fourth quarter were worth 11.7 % more than a year earlier. The inhibiting effects previously caused by falling Italian imports had gradually subsided, but the chief reason probably was that firms were seeking to offset growing difficulties at home by selling more abroad. Their task was made easier by a continued improvement in their competitiveness and by the continued buoyancy of the business situation in major purchaser countries such as the Federal Republic of Germany and the United States.

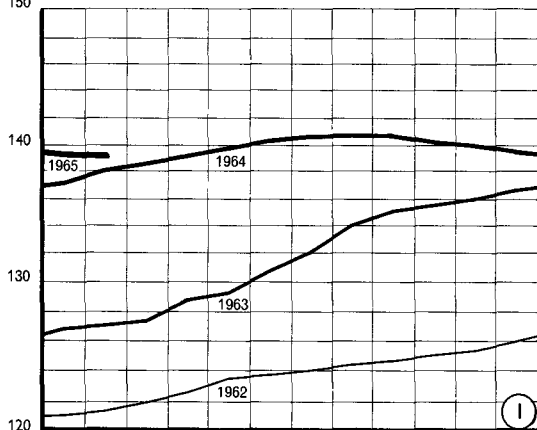
Domestic demand, on the other hand, seems to have been very quiet over the last few months, with private industry showing very little propensity to invest, businessmen cautious over stockbuilding and private consumers' expenditure rising appreciably more slowly.

The continued upward trend in gross fixed asset formation as a whole reflects primarily the steady and rapid rise in capital investment by the public authorities—particularly for building—and by public enterprises. Expenditure on housing, too, probably continued to rise quite vigorously. Private industry, on the other hand, was still extremely hesitant over investment. According to the INSEE survey made in November 1964, private industry's expenditure on building, plant and equipment for the full year may have been some 2 % lower than the 1963 figure.

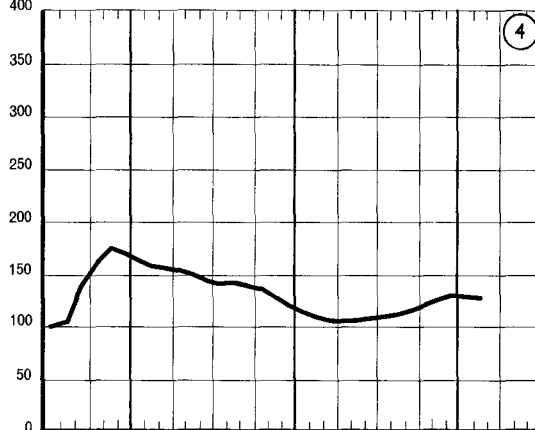
In recent months stockbuilding appears to have had a negative influence on the growth of production and employment. Stocks of finished goods at the factories and in

ECONOMIC INDICATORS

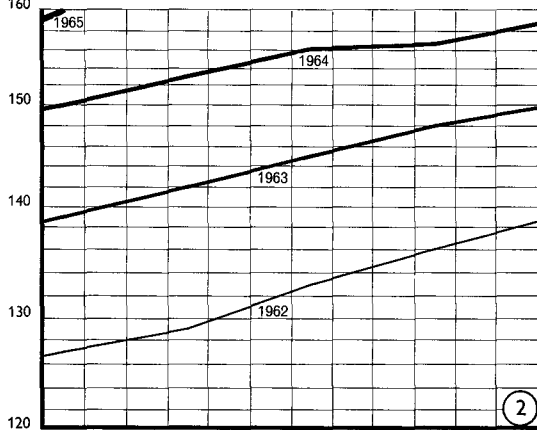
Industrial production (1958 = 100)



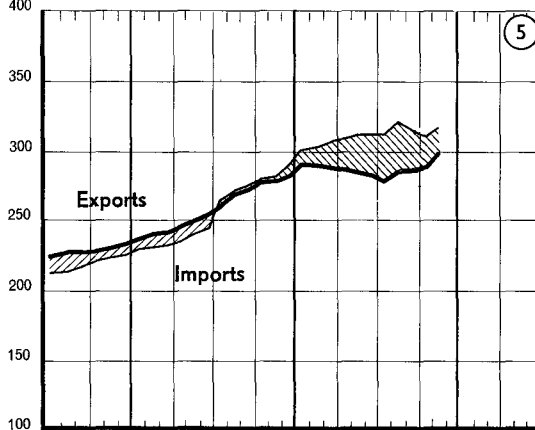
Unemployment (thousands)



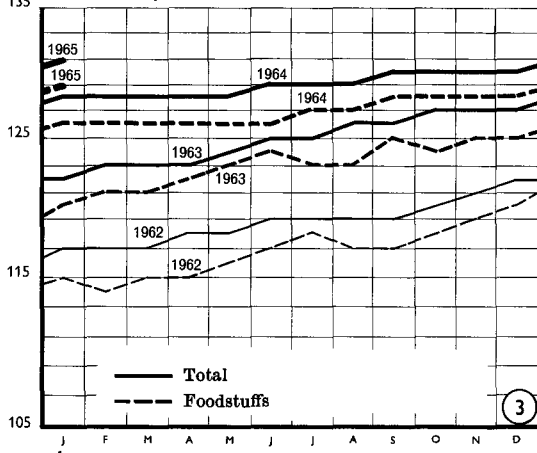
Wages in industry (1958 = 100)



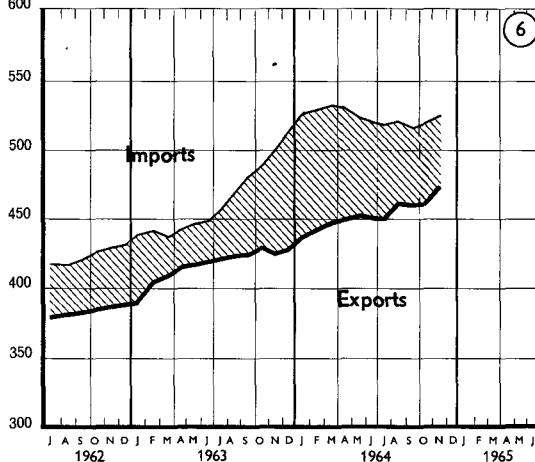
Trade between member countries (millions of U.A.)



Consumer prices (1958 = 100)



Trade with non-member countries (millions of U.A.)



NOTES :

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

Graph 1 : Estimated trends based on SOEC seasonally adjusted data. Excluding construction, food, beverages and tobacco.

Graph 2 : Index of hourly industrial wage rates, excluding mining and quarrying.

Graph 3 : Index of prices of 259 items.

Graph 4 : Number of persons seeking employment; end-of-month figures seasonally adjusted by Commission; including repatriates from Algeria from August 1962 onwards.

Graphs 5 & 6 : Series adjusted by SOEC for seasonal and accidental variations. Trade with non-member countries includes trade with rest of franc area. Exports fob, imports cif. One unit of account = 0.888671 gramme of fine gold.

the hands of dealers had been built up, even if involuntarily, till some time in the autumn, and had reached a high level, but it would seem that in some sectors a start has now been made with running stocks down again. Managements seem also to have been very reticent in their attitude to stocks of raw materials.

Public expenditure on goods and services continued to rise, though the pace of expansion was rather limited.

Private consumers' expenditure too has probably risen further, albeit at an extremely moderate rate; the accent may have shifted back a little from services, demand for which was particularly strong in the summer months, towards industrial consumer goods; at any rate, the fourth quarter's turnover figures for the Paris department stores showed a certain recovery. The decline in the number of new cars registered also appears to have come to a halt.

Whereas the reluctance with which consumers have been spending since late 1963 and early 1964 was at first due mainly to a greater propensity to save—chiefly in the form of investment in housing—the decisive factor in the last few months was probably the appreciably slower rise in wages and salaries. Hourly wage rates in industry and commerce during the second half of 1964 rose no more than 2.7 % as against a full 3.8 % during the first six months of the year; in addition, there was no increase in the numbers in paid employment; finally the weekly number of hours worked per person in paid employment even fell slightly in industry and commerce. As against this, there appears to have been no significant change in the trend of other household incomes.

Overall domestic production in the last few months was not only geared to the slower pace of demand, but was also influenced by the efforts to run down stocks. In addition to this, output was affected by absenteeism due to strikes.

This explains why industrial production (excluding construction) tended to fall off slightly in the fourth quarter of 1964; according to the seasonally adjusted INSEE index, the relatively high level reached in September was not maintained in the ensuing months. The year-to-year growth rate, which was 4.5 % in September, fell to barely 1 % in December. As in the past, however, the situation varied greatly from one industry to another. While the symptoms of recession on a number of markets in consumer goods such as cars and textiles began to spread more and more perceptibly from the final to the earlier stages of production, and growth in the capital goods industries, slightly brisker during the spring and summer months, faltered once more towards the end of the year, production trends in the basic materials industries (chemicals, metals, building materials)

continued to move upwards. Building output too again rose briskly, the year-to-year growth rate in December 1964 being more than 11.5 %.

The tendency for industrial activity to slacken had repercussions on the employment situation, affecting not so much the numbers in paid employment as the number of hours worked and the demand for additional manpower. The seasonally adjusted number of persons seeking employment rose but slightly, from 118 500 on 1 October 1964 to 127 600 on 1 February 1965. However, a decline in the percentage of women in or seeking employment and a lower rate of immigration may also have had something to do with this. The number of vacancies published during the same period fell considerably, the seasonally adjusted figure on 1 February 1965 being 28 000 as against 44 500 on 1 October 1964.

Imports of goods and services, like domestic production, have hardly risen any further in recent months. Customs returns show that the volume of visible imports in the fourth quarter of 1964 was only 2.5 % over last year's figure; raw materials and industrial consumer goods accounted for much of the slackening.

Prices were extremely quiet towards the end of the year; the INSEE index of industrial wholesale prices remained unchanged from September 1964 until January 1965. The index of consumer prices rose only 0.8 %. This was less than the rise recorded during the previous four months; and at the beginning of 1965 the increase over the figure of a year earlier was down to 2.3 %. This slowdown however partly reflected the incidence of fortuitious factors on food prices. Prices for industrial consumer goods, especially clothing and textiles, continued to rise steadily if slowly (0.5 % in four months). The cost of services—apart from rents—did not increase at quite the same speed as before, owing no doubt to a more favourable trend in wage costs and to the extension of a number of price-control measures to the services sector.

With exports making a distinct recovery and imports rising less strongly, the balance of trade has further improved. On a payments basis, visible trade may well have been showing surpluses again with countries outside the franc area, and the overall balance of transactions was again positive. Since there was at the same time a substantial net influx of capital from abroad, the balance of payments for the fourth quarter may have closed with an heavy surplus. In any event, official gold and currency reserves went up by FF 1 194 million in the fourth quarter of 1964 and a further 330 million in January 1965, compared with an increase of FF 784 million from October 1963 to January 1964.

Despite the stronger inflow of liquid resources from abroad, the money supply continued to show a very slow rate of increase. Between the end of September and the

end of December 1964, the total supply of money (notes and coin in circulation plus sight deposits) rose by just short of 4.3 %, compared with 4.6 % a year earlier. The annual growth rate for the full year was a mere 8 % as against 14.6 % in 1963. Public transactions exerted a particularly strong inhibiting influence; the Treasury made considerable further reductions in its indebtedness vis-à-vis the banks. Bank advances to industry and commerce were close to the maximum growth rate of 10 % per annum; in the fourth quarter, however, the increase at FF 9 100 million was sharper than the FF 7 900 million of a year earlier, short-term loans in particular having continued to rise with considerable speed.

Supply and utilization of goods and services

	1962 ⁽²⁾	1963 ⁽²⁾	1964 ⁽³⁾	1965 ⁽⁴⁾
	At current prices (in FF. '000 million)	% change by volume on preceding year		
Gross national product	356.1	+ 4.3	+ 5	+ 2.5
Imports ⁽¹⁾	48.6	+ 12	+ 10	+ 5
Private consumption	230.1	+ 6.2	+ 4.5	+ 3.5
Public current expenditure	47.9	+ 2.1	+ 2	+ 3
Gross fixed asset formation	70.0	+ 5.9	+ 8	+ 5
Exports ⁽¹⁾	51.1	+ 7.5	+ 7.5	+ 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 the figures for utilization is accounted for by changes in stocks.
- b) The estimates and forecasts are approximations based on particular hypotheses, generally mentioned in the Quarterly Surveys. They have been discussed with experts from the member countries but are established and published on the sole responsibility of the Commission.

2. Outlook

The economic situation is likely to remain quiet for some time, with the chance of a return to a slightly faster rate of growth later in the year.

Demand from abroad will undoubtedly provide a stimulus to expansion in the months ahead. Expectations of a rally in exports to the other EEC countries have already been confirmed. The tendency for the downward trend in deliveries to Italy to level out will probably make further headway, while exports to the Federal Republic of Germany, which account for roughly half of all French exports to other Community countries, will doubtless continue to expand in lively fashion. The outlook for a rise in exports to non-member countries generally is also promising. Disappointing as they were, the figures for January do not invalidate this view, but would seem rather to be a chance deviation from a basic upward trend. In February exports were once again well above the figure for February 1964.

It is difficult to say at this stage how domestic demand will develop. It seems fairly certain that expansion here will remain extremely slow or mark time, at any rate till the spring. There is little likelihood of the economy as a whole sliding into a pronounced recession; indeed, there may even be some acceleration in growth as the year wears on, but when this will occur cannot be predicted at this point.

An important factor in this connection is how the heads of private enterprises view the longer-term prospects for sales and profits. According to the survey made in November 1964, private industry was no less inclined than a year earlier to spend on fixed investment: managements plan to invest roughly as much in plant and equipment this year as they did in 1964. Although these plans are largely tentative, depending not least on whether and on what terms funds can be obtained—it is by no means out of the question that the very high propensity to invest among large enterprises—their programmes for 1965 provide for a substantial increase in investment expenditure over those for 1964—might later in the year work back through the economy, causing medium-sized and smaller firms to increase their investment outlay also. Fixed investment by the public authorities and public enterprises will in any case continue to make rapid advances. Finally, investment in housing can also be expected to go on rising. Building permits issued in the last few months again ran to a very high figure, in addition to which there was early in the year quite a substantial backlog of uncompleted dwellings from 1964. Reports from building contractors, at any rate, state that order books were fuller late in 1964 than a year before.

Public spending on goods and services will continue to expand at a rate which is likely to be once again due primarily to wage and salary increases, still pegged by the Government at 1 % per quarter. However, a recent government decision to expedite the

award of public contracts in order to support certain sectors of the economy might result in some additional expenditure later in the year.

The growth of exports and fixed asset formation (assuming that private industry shows at least the same propensity to invest as before) should affect incomes sufficiently to make a further rise in private consumers' expenditure possible; as long, however, as production and employment are affected by the attitude to stocks, this rise will be extremely slow—even on the assumption that any sharper deceleration in the upward wage movement is to some extent offset by a decline in the savings ratio.

If demand behaves as predicted above, the French economy as a whole will continue to expand, but at very slow pace. Furthermore, the rate of growth might at first vary widely from one sector to another. Industrial output, for instance, may well remain static, or even tend to decline slightly, as long as stocks, especially those in the hands of dealers, are considered too high and the flow of orders does not improve. The EEC business surveys show that industrialists at any rate anticipate that production will be slack in the months ahead. The situation in major consumer-goods industries, however, will scarcely continue to deteriorate to the same extent as hitherto; indeed, the decline in output in the car industry already seems to have come to a halt. On the other hand, a slowdown in the growth of several basic materials industries, particularly steel, cannot be ruled out. Sustained by brisk demand from households and the public authorities, building output will continue to show decidedly dynamic progress.

With weak trends on a number of domestic markets and the consequent keener competition from home industry, imports should rise only slightly.

For the same reasons, prices should remain relatively quiet in the months ahead. Further increases can be expected, however, in the charges for certain public services; rents, too, are likely to go up, and so are producer prices for a number of farm products as the common market in agriculture is gradually established. Furthermore, direct price controls on industrial products are now being gradually relaxed; this could mean a number of adjustments to allow for higher costs—such changes are even necessary to correct distortions in the price structure. The continuing upward movement in unit wage costs, too, is certainly another reason why prices may tend to rise: wage incomes per person employed will rise more slowly than in 1964, but still faster than production per head.

The prospects outlined above suggest that in the coming months there will be a further marked improvement in the balance of payments: the exchange of goods and services will doubtless continue to show appreciable surpluses.

On the whole, those prospects tend to confirm the forecasts for the whole of 1965 made in the last Quarterly Survey (4/1964), although the real increase in the gross national product should perhaps be put at a more cautious 2.5 %.

After a long period of excess demand and overemployment, the French economy has now entered a period of calm, of which advantage should be taken to achieve lasting price stability and secure the basis for a more permanently balanced growth. Before this can happen, both workers and managements will have to change their attitudes somewhat; this is a process which sets in only with a certain time-lag and only when the economic situation is quiet, as at present. Those responsible for short-term economic policy would therefore be ill advised to tackle the difficulties of adjustment and adaptation which are being felt quite keenly on a number of commodity and labour markets by immediately taking strong general measures to stimulate the economy. It should also be remembered that a good many of those difficulties are not cyclical but structural in origin and were previously masked by the general inflationary pressure; if any attempt were made to solve them by a policy of expansion, this inflationary pressure would have to be re-established throughout the economy, and in the long run it would be a danger not only to France, to its competitive position and its economic growth, but also to the Community and its inner cohesion. Structural problems must be solved by measures of structural policy kept within the bounds set by short-term economic policy.

France's internal economic balance is still too precarious and the threat of higher prices caused by past and current cost increases too great to dispense at this stage with the essential elements of the stabilization policy—a stringent budget policy and a cautious money and credit policy.

The growth of public spending should be kept within limits; there still seems to be a strong case for careful handling of all expenditure which has a direct or indirect influence on building markets. It is also still desirable to use credit policy to keep down the supply of money available. Here some elasticity may be entirely appropriate; the instruments of monetary and credit policy are in fact already being used with a considerable degree of flexibility.

There is however no further reason to advocate stiffer overall measures to curb demand. It would even be advisable to stimulate investment by private industry if activity in this field remains low and if there is a danger of any undue slackening of consumption. Any measures along those lines would however have to be carefully balanced and to be accompanied, if possible, by an incomes policy ensuring that the growth of costs and of consumers' earnings is kept within the requisite limits. Now that the business climate has changed, particularly on the labour markets, the conditions will perhaps be more favourable for an attempt of this kind than they have been in the past.

If a policy of expansion were adopted too soon and resulted in an upswing in business, circumstances might arise in which a resurgence of boom conditions would be almost bound to bring France back quite soon to a period of cost and price inflation, which would inevitably mean that after a while the country would once again suffer from a slackening of economic activity.

C. Italy

The business situation was still subdued in the closing months of 1964 and, as far as can be judged at present, at the beginning of 1965. The slight recession of industrial production, however, has been replaced by an incipient recovery.

Demand from abroad rapidly expanded further, though somewhat more slowly than in the third quarter. Visible exports in the fourth quarter stood almost 19 % in value above the level of a year earlier.

Gross fixed asset formation—building, plant and equipment—seems by and large to have continued weak. Investment in stocks, in the other hand, seems to have increased. In contrast to the probably brisk trend of public spending on goods and services, private consumers' expenditure may have continued to be slack.

From the supply angle there has been, as mentioned above, an increase in the seasonally adjusted index of industrial production. The index, however, was still distinctly lower—3.5 % in the fourth quarter—than a year previously. Visible imports also went up after declining sharply for a period, but they were considerably lower (some 17.5 %) than in the fourth quarter of 1963.

The slackness of demand led to an appreciable slowdown in the upward movement of prices; they still continued to rise distinctly, however, partly as an aftermath of inflation and in part owing to structural factors. Despite the slower pace, consumer prices in January 1965 were 5.5 % higher than a year before and the cost-of-living index was 5.7 % up.

The balance of payments again showed a considerable surplus (Lit. 303 000 million in the fourth quarter), with surpluses on both current and capital accounts. Official gold and currency reserves rose from September 1964 to January 1965 by Lit. 22 700 million.

There continued to be little demand for bank loans. On the stock market there was a recovery in the demand for fixed-interest securities.

The immediate prospects do not suggest that there will be any great expansion of business activity. If a suitable economic policy is applied, however, the present signs of recovery should in the course of the year turn into a more distinct resumption of economic growth.

The outlook for demand from abroad is still favourable, though there was less indication of expansion than in most of 1964. There may be a recovery of domestic demand as the year goes by, though it seems that private demand in the shape of investment in plant and equipment will continue to be slack in the immediate future. The prospects for demand from abroad, together with the lively expansion of investment expenditure by the public authorities and state-controlled companies, and also special government measures to promote investment, should all encourage the private sector's propensity to invest. Moreover the trend of stockbuilding appears to have improved again. Private consumption will presumably still grow only slowly for a while, but later it may expand more distinctly.

In view of this trend of demand, industrial production will very probably not make much headway. Building activity may even continue to be very slack for some while to come.

Costs and prices will probably continue for the time being to move upwards, but the trend may flatten out further, especially if production and productivity again begin to rise.

Current transactions and the overall balance of payments may still show a distinct surplus; this fact, together with the ample supply of credit and developments in public budgets, will contribute to domestic demand and so to the recovery of business activity in Italy.

But a return to a more marked expansion and, eventually, to a balanced development of Italy's economy depends largely on overall economic policy, and especially on short-term economic policy being pursued energetically, but with moderation and in such a manner that sufficient flexibility is ensured for the future. At the same time the stress should be on stronger measures in support of productive investment by enterprises.

1. Recent developments

Exports of goods and services continued to advance rapidly in the fourth quarter of 1964. The growth of visible exports slowed down somewhat, for according to foreign trade figures they were 18.8 % higher in value than a year previously, against 21.2 % in the third quarter, but here special factors, such as strikes, may have been mainly responsible. Exports to Federal Germany and the Netherlands expanded particularly

fast, with services, unlike visible exports, advancing perhaps even a little more rapidly than before.

Domestic demand was still weak, though there were some signs of recovery, especially in investment in stocks; on the whole expenditure on gross fixed asset formation was obviously still declining. Among capital goods, seasonally adjusted output—of machinery and equipment at least—seems to have grown somewhat in the fourth quarter; but this increase may be attributed to factors not connected with the business situation and, what is more, may be outweighed by an accompanying increase in corresponding net exports and in stocks of finished goods.

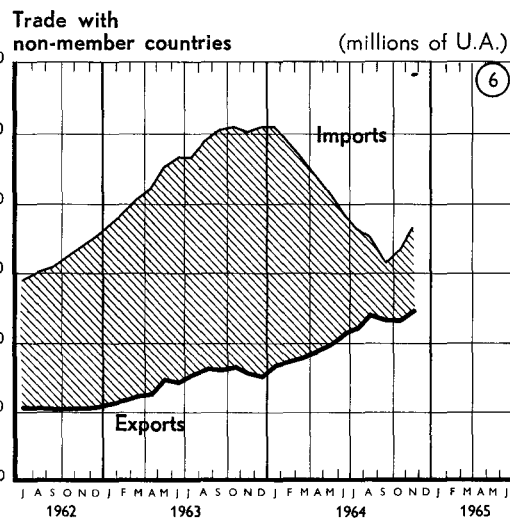
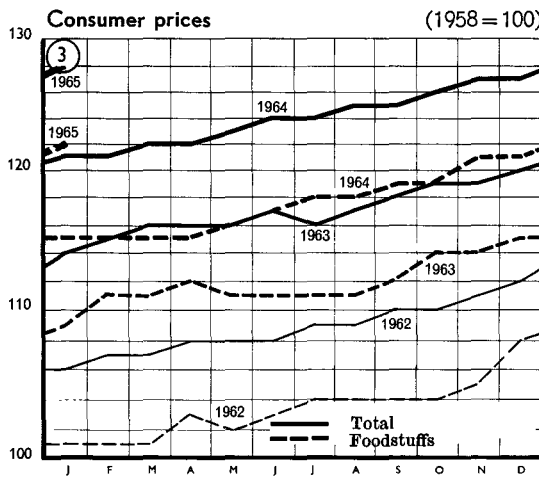
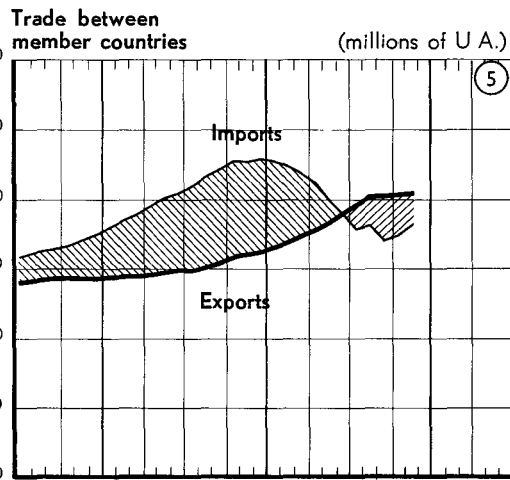
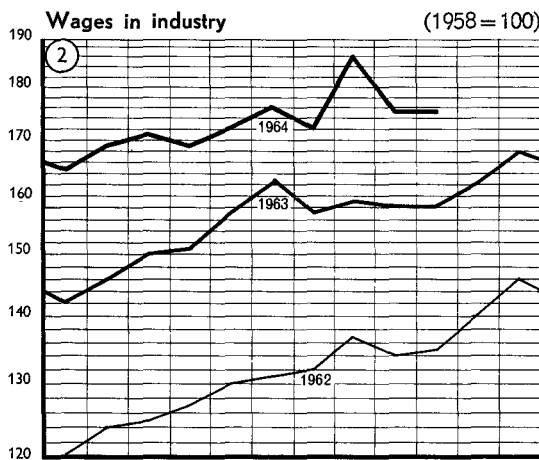
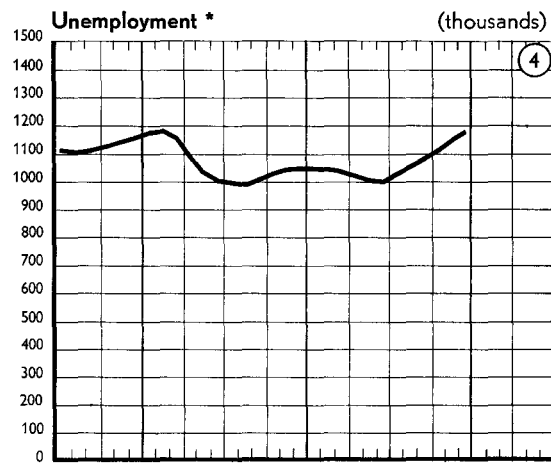
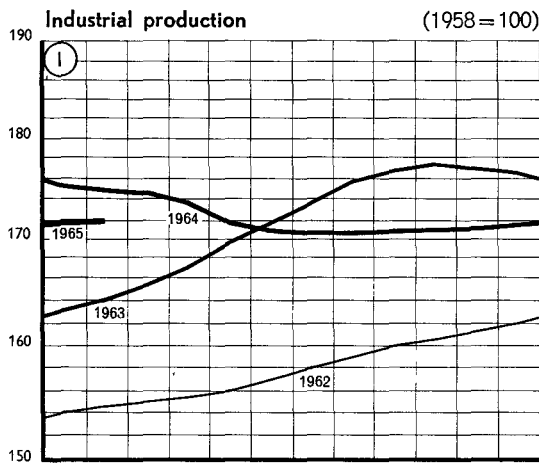
Building investment too was doubtless characterized by regressive tendencies, even if completions in October-November were again considerably more numerous than a year before, with dwellings (number of rooms) 11 % up and non-residential building (in cubic metres) some 67 %. But the number of new projects started remained low. Building projects for both dwellings and non-residential building were, as in the third quarter, almost one third lower than a year before. Building activity and expenditure on building investment, which is determined largely by the proportion of new projects to finished buildings, seem to have fallen off appreciably in these sectors. On the other hand, the acceleration of the growth rate which was evident in the sphere of public works (excluding dwellings), provided only a partial counterweight. The number of wage and salary earners in building and construction has therefore doubtless declined appreciably; according to the ISTAT quarterly sample surveys the number fell from July to October by 24 000, while the year before it had risen by 62 000 or 3.5 %.

Stockbuilding seems to have increased in late 1964, for there are signs that stocks of raw materials have been built up again to some extent, and at the same time there may have been an involuntary increase in stocks of finished goods.

Expenditure on consumption, however, may at most, have increased slightly. On the evidence of the Government's cash transactions, there was probably quite a distinct expansion of public spending on goods and services in October and November. But private consumers' expenditure as a whole probably continued to be slack, although there were signs of recovery, especially in expenditure on private cars; the total number of hours worked was probably still moving downwards, and though agreed hourly wages went up further, mainly because of the sliding wage-scale, the growth of actual wages was certainly considerably less marked than before.

From the supply angle, industrial production tended slightly upwards for the first time since early 1964. The ISTAT index, seasonally adjusted by ISCO, rose from the third to the fourth quarter by nearly 2 % and, according to provisional information, also from December to January. This left industrial production still distinctly below

ECONOMIC INDICATORS



NOTES :

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

Graph 1 : Estimated trends based on SOEC seasonally adjusted data. Excluding construction, food, beverages and tobacco.

Graph 2 : Index of minimum wage rates (Source : Italian Central Statistical Office).

* Graph 4 : Registered as unemployed at end of month. The effective number of unemployed is certainly lower. Data seasonally adjusted by Commission.

Graphs 5 & 6 : Series adjusted by SOEC for seasonal and accidental variations. Exports fob, imports cif. One unit of account = 0.888671 gramme of fine gold.

the level at which it had stood a year earlier, but the improvement deserves to be noted. It was probably due in part to the continued expansion of exports, in part to the build-up of stocks of materials held for further processing, and in smaller part to the opening of a modern steel works. At the same time, however, building activity was very slack, as has already been mentioned.

At the present juncture, the slowness with which statistics on the Italian labour market are produced greatly hampers analysis of the economic situation; when this report was drawn up, it was still not possible to ascertain whether or how much the pick-up of industrial production had effected the employment situation. From July to October, at any rate, the number of wage and salary earners dropped, according to ISTAT sample surveys, by 88 000 or nearly 1 %, whereas from July to October 1963 it had gone up by 24 000; in October it was consequently some 2.3 % below the comparable period of the year before.

The increase in the number of unemployed was smaller; from July to October it was 62 000 or 13 %. On the other hand, the distinct tendency for the average working week to be reduced was maintained : according to ISTAT surveys there were some 450 000 employed persons in October—that is a quarter more than in July—whose working week was down to 32 hours, or less.

Imports of goods and services may have risen somewhat, after they had still been dropping very sharply in the previous two quarters. The improvement was confined to visible imports. Under the influence of the same special factors which hindered the growth of exports, imports in the fourth quarter still stood some 17.5 % below the level of a year previously, when however it had been exceptionally high. As the improvement was confined entirely to imports of foodstuffs and—initially at any rate—semi-finished goods, it was mainly deliveries from the developing countries that rose. In contrast to the slight increase in visible imports, imports of services seem to have declined even further.

The slackness of demand led to an appreciable slowdown in the upward movement of prices. The reason why the movement of prices continued definitely upward is to be sought largely outside the trends that affect business. Structural deficiencies of the distribution network, for instance, no doubt played an important part in sending up costs and prices, especially as employment in this sector does not seem to have stopped rising. The raising last autumn of the general turnover tax (IGE) worked in the same direction, and the lower rate of utilization of industrial capacity may also have helped to increase costs and prices. At any rate the official indices, which do not take into account the liberal rebates allowed in the present situation, show that consumer prices again rose appreciably between September and December. But the rise of 1.6 % was considerably smaller than the 2.2 % increase of a year previously, when there was still

an excess of demand. Wholesale prices rose very little during the period, and in January they even fell slightly. In this month the wholesale price index was only 1.3 % higher than in January 1964; the corresponding increase in the consumer price index was 5.5 %, in the cost-of-living index 5.7 %.

The trade account remained more or less balanced in the fourth quarter. As there was a perceptible increase in net revenue from services (mainly on account of the recently improved trend of the tourist trade) and the capital account too showed a surplus once more, the balance of payments for the period again closed with a large surplus of Lit. 303 000 million, as compared with a surplus of Lit. 314 000 million in the previous quarter and a deficit of Lit. 283 000 million in the last quarter of 1963. For the first time for nine months, there was a small deficit—of Lit. 11 000 million—on the balance of payments in January 1965. This was probably due to special factors. Official gold and currency reserves rose from September to December by Lit. 206 000 million and in January 1965 by a further Lit. 21 000 million. Their level at the end of January (Lit. 2 174 000 million) represented the value of visible imports for some six months.

In the fourth quarter the balance of payments again made a vigorous contribution to domestic liquidity, which rose sharply by more than Lit. 300 000 million. The Treasury's cash operations had a similar effect and contributed some Lit. 302 000 million. Since effective demand from business customers for bank loans remained rather slack at least until November (in December it may have grown even more quickly than is usual at that time of the year), the banks once again used part of their surplus funds to reduce their indebtedness to the monetary authorities, and lowered their rediscount liability towards the Banca d'Italia from September to December by some Lit. 30 000 million. The banks' net liquidity in November was none the less as high as 6.7 % of deposits, and in December still as high as 5.5 % (September 1964, 5.8 %; December 1963, 4.8 %). Total deposits were themselves distinctly higher, the rise occurring not only in savings accounts but even more in current accounts, as businessmen were showing little propensity to invest.

There were very divergent trends on the securities market. The demand for shares, until late January at any rate, remained extremely weak; since then, however, there have been clear signs of an improvement in prices. Nevertheless, in the fourth quarter of 1964 and at the beginning of 1965 almost all the money—and the amount was apparently quite considerable—that flowed into the securities market went into fixed-interest securities. This market has experienced a distinct pick-up, which may have been assisted by the change in the regulations on the minimum reserves to be held by savings banks ⁽¹⁾. Several large issues of bonds state or state-controlled companies were quickly oversubscribed. In December the net rate of interest on long-term government securities dropped further to 5.6 % (July 6.0 %, September 5.7 %).

⁽¹⁾ See Quarterly Survey 4-1964, p. 83.

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	+ 2
Imports ⁽¹⁾	4 365	+ 20.7	— 5.9	+ 3
Private consumption	15 006	+ 9.7	+ 2.4	+ 2
Public current expenditure	3 645	+ 5.7	+ 3.9	+ 5
Gross fixed asset formation	5 846	+ 5.7	— 9.2	— 9
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 the figures for utilization is accounted for by changes in stocks.
- b) The estimates and forecasts are approximations based on particular hypotheses, generally mentioned in the Quarterly Surveys. They have been discussed with experts from the member countries but are established and published on the sole responsibility of the Commission.

2. Outlook

The prospects for the economy in the near future do not promise very rapid expansion; but if the right economic policy is applied, growth might well pick up appreciably later in the year.

Demand from abroad—in the shape of actual exports of goods and services—may continue to grow. One pointer is the outlook in important customer countries, in particular the Federal Republic of Germany. Another factor is that the expected trend of domestic demand may in the short term provide exporting firms with an incentive which is being reinforced by measures taken by the authorities. It must also be remembered, of course, that Italian exports have a competitive advantage because of their short delivery periods.

The Mondo Economico's "Forum" survey carried out in January 1965 and the EEC Business Survey both point to a distinctly rising export trend. But the growth rate of exports may become somewhat slower, not only because of the world business situation, which by and large is contributing less to activity than a year ago, and of the effects produced by the British measures in restraint of imports, but also because of a possible recovery of domestic demand later in the year. In such an event there would probably be a decline of those exports which are at present being exported at not very profitable prices in order to limit the build-up of stocks and to make fuller use of capacity.

Of the factors constituting domestic demand, expenditure on gross fixed asset formation is weak and its weakness may persist for a time, though this does not exclude possibility that some recovery from the present low level is already occurring. Nevertheless, according to the results of an inquiry on investment in manufacturing industry and mining, a further contraction seems to be envisaged from 1964 to 1965. Important sectors, however, such as oil and electricity, were not included in this inquiry; furthermore, accidental factors play a role, in particular the completion in 1964 of a large-scale investment project in the steel industry; a decline in the year-to-year comparison would not of itself mean that economic expansion will also show a corresponding decline later in the year; and lastly, account must be taken of psychological factors which, as is well known, change quickly and can lead to revision of plans. For example, the decision to make a large increase in public investment and expenditure on low-cost housing, the considerably wider investment by state-controlled enterprises and the effects of special government measures to promote private investment may between them offer sufficiently strong incentives to encourage a more general propensity to invest.

It is clear that, in the near future at any rate, this pattern of investment expenditure cannot provide very much stimulus for private consumers' expenditure. The rationalization measures that are being simply forced upon companies by continually rising costs—especially unit labour costs—will probably also affect mass incomes and, consequently, private consumption, but the Government will counteract these tendencies with measures to support employment and perhaps even with others that give direct encouragement to consumption. The expansion of public expenditure on goods and services and on transfer incomes may also make a contribution. If later in the year the considerable recovery expected in investment as a whole really occurs, the expansion of private consumption will receive further encouragement.

In view of these prospects for demand, industrial production may well expand again more appreciably later in the year. Building and construction, however, may be relatively slack for a longer period, at least as far as building is concerned, but, as already mentioned, there are certain factors which may tend to boost housing; civil engineering work, on the other hand, ought in 1965 to continue making distinct if uneven progress.

Imports, too, will probably make more lively progress in the coming months, mainly because stocks of raw materials and semi-finished products need to be replenished and because production is once again tending upwards. Later an even more distinct acceleration is quite conceivable.

It is possible that the rise in prices will continue for some time yet, though it will be slower than in most of 1964.

The trade account should gradually tend to deteriorate, but further considerable surpluses are to be expected both on current account and in the overall balance of payments.

These prospects are in keeping, by and large, with the picture drawn for 1965 as a whole in the last Quarterly Survey (No. 4/1964). If some of the figures are lower than was forecast, it is because the expected recovery of the economy, at the outset at any rate, has apparently been less vigorous than expected.

Naturally the outlook described in this Survey depends on how the psychological climate develops. It is quite possible that the trend will be more favourable if further improvement in this climate is achieved, because businessmen and savers look for a stable policy based on economic needs. Otherwise there would be at least the possibility of prolonged stagnation, and this threat would of course be aggravated by a wage policy bearing no relation to the economic situation.

Short-term economic policy must aim at promoting greater vigour in the growth of investment, in particular those forms of investment that directly reduce costs and so in turn improve the level of consumption and production too. The increased productivity thus achieved and a very cautious wages policy ought to bring about reduced unit costs, more stable prices and at the same time a recovery in profit margins, and this in turn would encourage the upward movement of investments and make possible a further general rise in incomes. Without the prospect of improved profits, business firms will scarcely make sufficient use of the funds which, as a result of credit policy and increased saving, are now available for borrowing.

In the present economic situation it nevertheless seems advisable not only to maintain an ample supply of credit, as has been done for some time, but also to take other measures which would reinforce the downward tendency of interest rates. In Italy the effective cost of borrowing has despite this downward trend remained very high, but reductions in interest rates are, in view of the country's balance-of-payments position, perfectly possible and even desirable.

Still more could perhaps be done, for instance through measures favouring investment, to reduce social burdens and taxes and so to improve the profit-earning capacity

of enterprises and promote the propensity to invest. Incidentally the fact that the possibilities in the tax sphere are relatively limited shows how urgent is the need, in the interest of economic policy as a whole, to reform taxation.

As can be seen from the prospects described above, it is of great importance that the promotion of housing and the intended expansion of those forms of public investment which have the main impact on employment should in fact be carried through within a reasonably short time.

The policy being pursued by the authorities is on the right lines. The special fund of some Lit. 100 000 million which was proposed as far back as last August and is meant to finance small and medium industrial companies, was established in January by decree law. At the same time the Government decided to take administrative measures to speed up the implementation of the programmes of investment in public works, state-controlled companies and agriculture; at the end of January it proposed to make available from budget resources some Lit. 90 000 million to proceed with public works that had been interrupted for financial reasons.

In all attempts to expand demand, however, care must be taken that such measures are short-term in character; nothing must be done which involves fresh long-term expenditure or long-term increases in expenditure in the public sector or, conversely, to make long-term inroads on revenue, with the result that a structural deficit occurred again. This would have an inflationary effect once full employment were achieved. The tendency of overall expenditure by the public authorities to expand must still be held in check, although for the time being it will no longer be necessary to follow strictly the 5 % rule recommended again for 1965 by the Community's Council of Ministers.

The same applies by analogy to monetary and credit policy; here the authorities must ensure that they are in a position to keep the upward movement of bank loans, as soon as it gets under way again, under continuous and careful control. Otherwise there is a danger that the developments of 1962 to 1964—inflation, with inevitable deterioration of the business situation—will be repeated.

It now seems even more advisable than ever to intensify action to deal with the structural factors which force prices up, especially those besetting the whole sector of domestic distribution: transport and, in particular, wholesalers, middlemen and retailers.

On 16 March, after the preparation of this report had been completed, a series of measures designed to revive the Italian economy were brought into force by a decree law. These can be summarized as follows :

1. Until the end of 1965 public works projects are to be speeded up through the simplification of certain administrative procedures. The Cassa Depositi e Prestiti, which is a department of the Treasury, and the Public Works Credit Consortium have

been empowered to grant construction loans for low-cost housing, schools, clinics and hospitals, and motorways. One of the sources of the necessary funds will be loans—totalling Lit. 250 000 million—issued by the Credit Consortium, if necessary on foreign capital markets. Both operations are guaranteed by the State.

2. Supplementary budget appropriations, totalling Lit. 50 000 million, have been earmarked for investment in agriculture.

3. The acquisition of machinery by small and medium-sized enterprises is to be facilitated. Loans offered to these enterprises have been increased and will be partially guaranteed by a state-controlled bank.

4. Until the end of March 1966 the State will defray part (3 %) of the cost of the employers' contributions to pension funds. A proportion of the Lit. 127 000 million required for this purpose will be obtained from the issue of long-term Government bonds in 1965 and 1966.

5. The construction of housing will be encouraged by means of tax reliefs (exemption for 25 years from the buildings tax for housing completed in 1964 to 1967; reduction of registration tax and of the purchase tax on building materials, provided certain time-limits are complied with).

6. The unemployed will now be entitled to claim family allowances.

An assessment of these measures in the light of the short-term economic policy of the Community cannot be given till the next Quarterly Survey.

D. Netherlands

The expansion of economic activity during the closing months of 1964 and at the beginning of 1965 was considerable. The growth of demand was due to a particularly rapid expansion of exports, while considerable increases in production and productivity contributed to the growth of supply.

Exports of goods expanded vigorously from the third to the fourth quarter; over the last three months of 1964 they were on average more than 21 % higher in value than in the corresponding quarter of 1963. Gross fixed asset formation again increased—mainly because of a further rise in expenditure on housing—but there was a clear tendency for the expansion of spending by enterprises on plant and equipment to slow down, and public investment declined somewhat.

Owing to the continuing rise of incomes, consumer expenditure grew at much the same rate as before; as a result of the stability of prices since the summer, growth in terms of volume was even a little faster than before.

The labour market showed only slight signs of easing. Although the unemployment figures, adjusted for seasonal variations, tended slightly upwards in the autumn for the first time since the beginning of 1963, the number of unfilled vacancies remained practically unchanged at a much higher level than the number of unemployed.

The growth of industrial production speeded up somewhat from the third to the fourth quarter. The national index showed an 8.1 % rise from the last quarter of 1963 to the last quarter of 1964.

Despite a decline in purchases of plant and equipment, the slowdown of imports gave way to a rather more positive trend.

Though consumer prices, as reflected in the retail price index, have remained steady since the middle of 1964, the index was in December 5.5 % higher than in December 1963. The better trend in the trade balance continued, and as there was also a surplus on current transfer payments, the balance of current payments in the fourth quarter will have shown a considerable surplus. In addition, there was a sizeable net inflow of capital, with the result that in the fourth quarter the Netherlands had a noteworthy surplus on the overall balance of payments.

In the coming months business is likely to expand further. Foreign demand will doubtless be once again the most expansionary element in total demand. Although the slowdown in the growth of fixed asset formation may become more marked, domestic demand will probably expand quite rapidly again. Private consumer expenditure will again increase perceptibly as a result of agreed wage and salary increases, the rise in old-age pensions and the tax cut which is to become effective halfway through the year.

Production, particularly industrial production and new housing, will probably again register a distinct advance. However, it is not impossible that the rate of expansion—notably of industrial production—will slow down slightly. Imports are likely to go up again.

Nevertheless, the upward movement of consumer prices, which have probably risen again since January 1965, should persist; labour costs per unit of output are still rising, though more slowly, and the expansion of total demand is likely still to exceed that of internal supply. The balance of current payments may again show slight deficits.

Despite measures taken so far, progress towards less strained business conditions and stabilization of prices and costs is not entirely satisfactory, and there is no prospect at all that these objectives will soon be attained. Short-term economic policy must therefore again be anti-inflationary. A stricter line should be taken on public expenditure in particular.

1. Recent developments

Exports of goods and services still seem to have been rising satisfactorily—and probably even at a quicker pace. In the fourth quarter of 1964, customs returns show that visible exports were 21.4 % in value and 19.7 % by volume higher than a year before. In January 1965, however, as a result of certain special factors, their value was only 5.6 % higher than a year earlier.

Both manufactures (chemicals, metal goods, transport equipment, machinery) and farm products (particularly dairy products) shared in the increase. The marked expansion of exports can be ascribed not only to a very rapid growth of deliveries to member countries, particularly the Federal Republic of Germany but also to vigorous demand from outside the Community.

The continuing rise in foreign demand and the trend of prices and wages in major importing countries also made it possible to pass on some of the increase in production costs: export prices for finished products were 5 % higher in the fourth quarter of 1964 than a year before.

Domestic demand also expanded, though the rise in expenditure on gross fixed asset formation was a little less vigorous than hitherto. Investment by enterprises went up again, but slightly less than in the preceding months. The growth of expenditure on industrial and commercial building and even more on plant and equipment has probably slowed down.

Considerable progress was again made in housing: the number of completions in the last quarter of 1964 was 25 % higher than in the fourth quarter of 1963. Public investment, on the other hand, showed a tendency to decline, probably because of the implementation of certain measures adopted under the stabilization policy and intended to ease the strain in the building sector; none the less, investment remained higher than in the corresponding period of 1963.

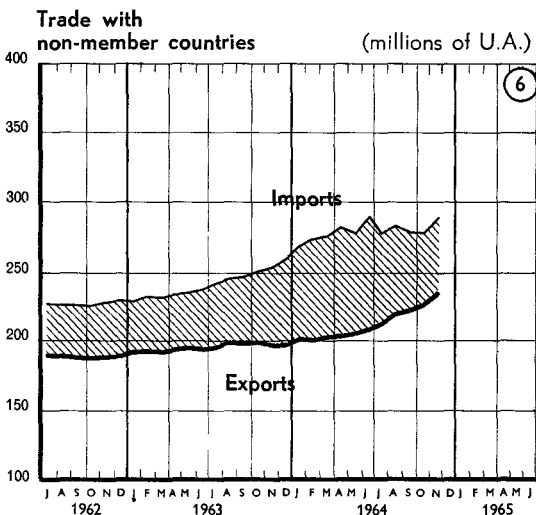
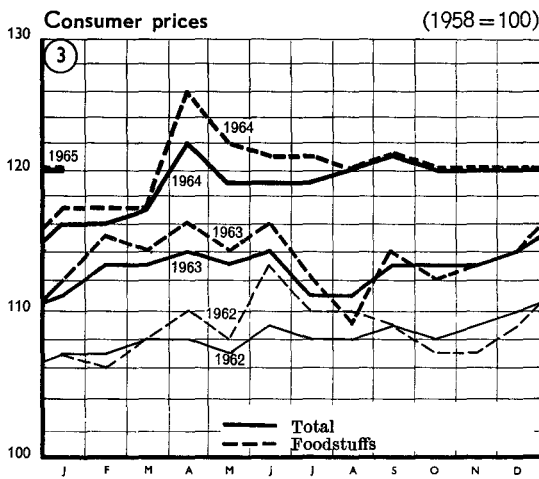
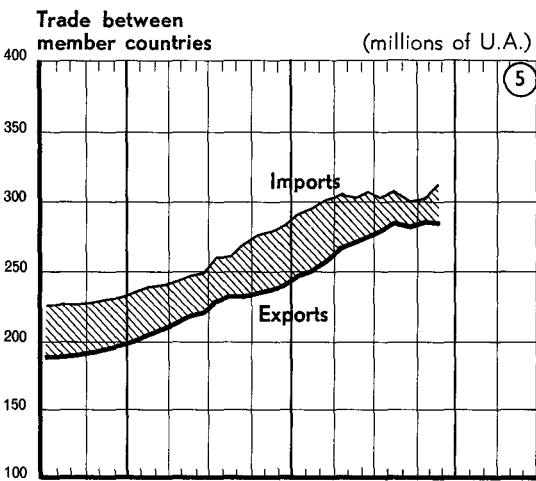
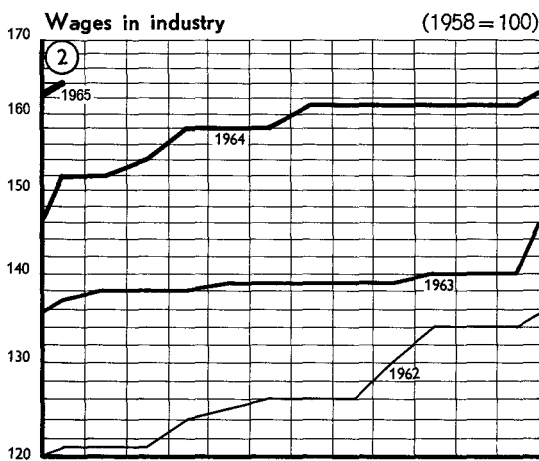
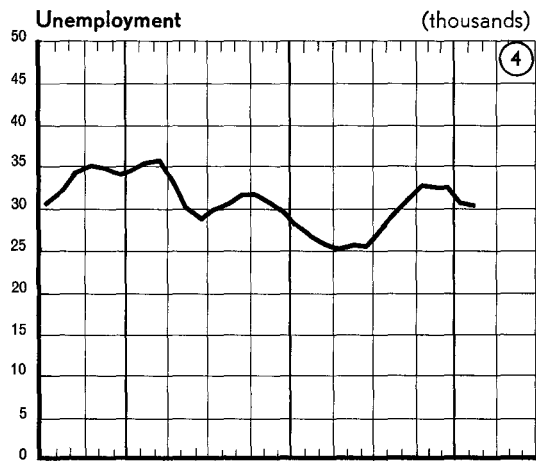
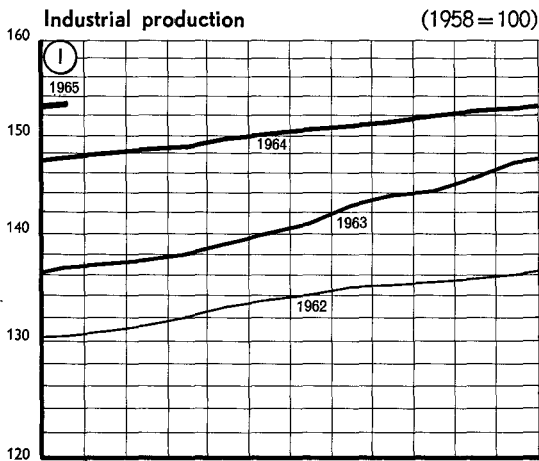
Investment in stocks probably declined after the rapid expansion recorded up to the middle of the year.

In contrast to the trend of investment, consumption kept on rising at a rapid pace, with public current expenditure on goods and services again tending to expand considerably and private consumer expenditure showing a distinct increase. As prices remained remarkably stable, the growth of private consumption in terms of volume was even more rapid than before. This seems to have been mainly due to heavier spending on consumer durables, including electrical household appliances, and this in turn is doubtless connected with the large number of houses completed.

The expansion of consumption was determined by the continuing increase in the disposable income of households. Agreed wages remained practically stable until the end of the year—apart from a slight increase in some women's wages and a backdated 3.5 % rise in civil service salaries—but wage drift continued, and there was a further increase in some non-wage incomes.

Total supply has expanded very vigorously in recent months—even rather more than in the third quarter. Industrial production went up a little more rapidly in the fourth quarter—8.1 % up on the last quarter of 1963 according to the CBS unadjusted index, as against a year-to-year increase of 5.1 % for the third quarter. The growth of production can again be ascribed for the most part to greater productivity—itself a result of the high level of investment.

ECONOMIC INDICATORS



NOTES :

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

Graph 1 : Estimated trends based on SOEC seasonally adjusted data. Calculation of the trend in the Netherlands encountered certain difficulties which it will not be possible to eliminate till the new Dutch index is available; this amended index is expected shortly. Excluding construction, food, beverages and tobacco.

Graph 2 : Index of wage rates, excluding construction, mining and quarrying.

Graph 3 : Cost-of-living index for wage-earners and employees.

Graph 4 : End-of-month figures, seasonally adjusted by Commission.

Graphs 5 & 6 : Series adjusted by SOEC for seasonal and accidental variations. Exports fob, imports cif. One unit of account = 0.888671 gramme of fine gold.

Numbers in paid employment increased only slightly, and the seasonally adjusted figure of persons seeking work even tended to rise, however slightly. From October the number of unemployed was a little higher than in the corresponding period of the previous year the first time since 1959—apart from the extremely cold winter of 1962/63; in February 1965 the number was 47 900. Notification of vacancies showed no further rise, though at 117 000 it was still 3 % higher than a year earlier. As a consequence, severe labour shortages persisted in practically all sectors. The slight increase in manpower reserves is probably due mainly to the inability of some marginal firms to meet the sharp rise of wage costs from 1963 to 1964.

The falling trend of imports since the middle of 1964 seems already to have come to a stop. At any rate, imports of goods—which customs returns show to be 10.5 % by volume and 12.1 % in value higher in the fourth quarter than in the corresponding period of 1963—may have risen somewhat. Imports of consumer goods increased rapidly, while imports of capital goods slowed down perceptibly. Imports from member countries expanded more than those from non-member countries. In January 1965, however, the total value of visible imports was 6 % lower than a year before, but this figure too has been affected by the special factors already mentioned in relation to exports.

The retail price index has been remarkably steady since the summer. A number of special factors (excellent harvests, lower meat prices, effect of direct price controls) were partly responsible, but an important part was doubtless also played by the increase in turnover and the vigorous advance in productivity, as these limited the effects which rising wage costs had on prices. The price index at the end of 1964 was none the less 5.5 % higher than at the end of 1963. Wholesale prices for finished goods have remained steady since September, but for food and raw materials they again went up.

As exports rose more vigorously than imports, the balance of trade showed a further improvement, though by no means as spectacular as from the second to the third quarter. The fourth-quarter deficit was Fl. 837 million, as against Fl. 883 million in the third quarter and Fl. 1 141 million in the last three months of 1963. If these figures are adjusted for purely seasonal variations, a still more favourable picture results.

As the balance of invisibles also showed a distinct improvement, with increased surpluses on factor incomes in particular, the current account (seasonally adjusted) is sure to have closed with a surplus, after the slight deficit recorded in the previous quarter. There were also net inflows of short- and long-term capital. The overall balance of payments will therefore have a sizeable surplus. The gold and foreign currency reserves of the monetary authorities—excluding IMF transactions—rose by about Fl. 540 million from the end of September to the end of December 1964, and the banks' holdings of foreign currency rose for the first since the third quarter of 1963.

For 1964 as a whole, then, the current account (on a transactions basis) closed with a deficit of some Fl. 650 million; as a result of a surplus on capital account, the overall balance of payments (excluding IMF transactions) was more or less in equilibrium.

Transactions with abroad thus had a considerable expansionary effect on domestic liquidity during the fourth quarter. Treasury transactions, on the other hand, contributed if anything to a tightening of liquidity, particularly because of the taxes which fell due in this period and because operations to consolidate the national debt were also carried through. The liquidity ratio (liquidity as a percentage of national income) did not fall any further, although the expansion of bank loans in the private sector tapered off slightly.

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
Imports ⁽¹⁾	23.67	+ 9.6	+ 14	+ 6
Private consumption	27.98	+ 7.1	+ 6	+ 5
Public current expenditure	7.19	+ 2.8	+ 0	+ 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 the figures for utilization is accounted for by changes in stocks.

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

2. Outlook

A feature of the economic trend in the coming months will be the continuing expansion of overall demand, though the growth rate of some of the components of overall demand will be decidedly slow.

Demand from abroad will certainly provide further stimulus. Towards the end of 1964, however, the flow of foreign orders was rather less firm; as a consequence, the increase in exports may well be less vigorous than during the closing months of 1964.

Nevertheless, because of the expected slowdown in the expansion of domestic demand, businessmen will be making greater efforts to find new outlets on foreign markets—a tendency that could be furthered by the extreme adaptability of some industries. The latest export returns show that competitiveness has not yet suffered very much, but wage costs per unit of output must be expected to go up again in the course of 1965. The fact that the economic trend in certain member countries has become more uncertain or more hesitant is offset by more optimistic forecasts for exports to the Federal Republic of Germany. Deliveries to non-member countries should also expand fairly dynamically in the coming months.

The trend of gross fixed asset formation will vary; on the whole the growth rate will probably be lower than it has been. Capital expenditure by enterprises may well go up at first, but the propensity to invest may slacken off again. The tendency noted since the middle of 1964 for the growth of new orders for plant and equipment to slow down is an indication that in this field restrictive measures and the considerable increase in wage costs are having an effect on profits per unit of output.

In absolute terms, however, profits are still quite satisfactory. Moreover, increased activity in the building sector and the longer-term economic outlook should encourage investment. Lastly, the continuing shortage of labour will make businessmen carry on with their rationalization efforts. A definite decline in investment by enterprises is therefore hardly to be expected.

Effective demand for expenditure on building and construction will probably show a further vigorous rise. Industrial building will again expand, though more and more slowly. Demand for housing will remain heavy; expenditure in this field may well be the most dynamic component of domestic demand. Public expenditure on investment, particularly by local authorities, will go up at a more moderate rate than in recent months, however, since in this field the effects of the stabilization measures are beginning to be more clearly felt.

Once again, private consumers' expenditure is likely to show a considerable increase, though until the middle of the year the pace may be quiet. The total number of hours worked will again rise. Moreover, the expansion of disposable incomes will be

encouraged by the newly negotiated wage increases of about 3.5 % and the increase at the beginning of the year in old-age pensions and other social security benefits. The income tax cut to take effect from the middle of 1965 will also have an appreciably stimulating effect on consumer spending. Whether there will be a further advance in the expansion of this element of demand depends on the results of another round of collective bargaining about the middle of the year. In fact a further speed-up in the wage drift before then is also possible, if the strains caused by the present situation should persist.

It should be noted in this connection that the prospects for a far-reaching relaxation of strain on the labour markets are not much better than a year ago. The shortage of manpower is likely to persist, though the (seasonally adjusted) figures for unemployment might, as a result of keener competition and some slowdown in the expansion of overall demand, settle down at the rather higher level recorded in January/February 1965.

The expansion of domestic supply will continue, though certainly rather more slowly than in recent months. Industrial production will go up significantly again—mainly as a result of advances in productivity. In some industries, however, the decline in the expansion of demand might result in a lower utilization of productive capacity, for the build-up of stocks which occurred in the first half of 1964 will hardly be repeated, while a further increase in domestic productive capacity is to be expected.

Imports, especially of consumer goods, will probably also rise, but the growth rate is likely to be relatively slow.

Although the authorities will continue to pursue the policy of direct control of prices, it is hardly to be expected that the level of consumer prices can be kept as steady as since the second quarter of 1964. Account must be taken of the consequences of domestic price increases in 1964, higher import prices, certain measures taken in connection with the common agricultural policy, and further rises likely to be made in charges for public transport and public utilities. In addition, it might after all prove necessary to pass on in the form of higher prices at least part of any further increases in wage costs per unit of output in some industries. This applies in particular, of course, to the price of services, which will in any case continue to rise. The ban on vertical price fixing, however, could have a stabilizing effect on the prices charged for consumer durables.

The trade balance is not likely to show any significant improvement on recent months; it may perhaps even relapse slightly. Over the year as a whole, then, there will presumably still be a deficit on current account. In spite of the forecast trend of current transactions with abroad, the overall balance of payments may possibly have an expansionary effect on domestic liquidity—particularly as a result of further net inflows of capital from abroad. In view of the other factors affecting liquidity and the gradual decline in the propensity to invest of Dutch businessmen, interest rates are unlikely to exceed the exceptionally high level obtaining at the end of 1964.

The latest information available and the current outlook indicate that few changes need be made in the forecasts for the full year 1965 presented in the last Quarterly Survey (4/1964), and these point to a rather more vigorous expansion of nearly all aggregates.

Although consumer prices have not gone up as much as was expected and the balance of payments in 1964 did not deteriorate as seriously, these developments provide no ground for any relaxation of short-term economic policy; nor would the prospects outlined above warrant such a move. There still seems to be too much strain on the labour market; wages are increasing faster than productivity, though by no means as seriously as in the previous year; prices will go up again, and although this means a reduction in the real expansion of demand, and particularly of private consumption, there may still be deficits on current payments.

This being so, an effort must be made, in line with the unanimous Recommendation put forward by the EEC Council in April 1964, to stabilize prices (in the longer run this should be possible without administrative controls), to halt the rise in unit costs and to restore the surpluses on current account to a level that might be considered appropriate for the Netherlands.

Stabilization policy must therefore continue along the lines of the Recommendation. As regards monetary and credit policy it was, in fact, decided at the beginning of 1965 to maintain the quantitative limit on the expansion of bank loans for another four months (the permitted expansion is 4 % of the average level for the first six months of 1963).

Furthermore, the increase in domestic liquidity ought to be combated by opening the Dutch money and capital market to foreign borrowers, especially if the balance of payments should show a surplus again as a result of net capital inflows. Steps in this direction have apparently already been taken. What would however appear to be still very necessary in connection with budgetary policy is that an unswerving and in some directions stricter line should be enforced. The same applies to the policy intended to promote the construction of housing, inasmuch as in this sector there has been an evident lack of success in bringing supply closely enough into line with effective demand. Moreover, it would perhaps be advisable to aim at a change in the pattern of finance for residential housing which would give greater facilities for property-owning. The restrictive measures on investment by local authorities were extended for twelve months in October 1964, but the permitted nominal rate of increase was fixed at 10 %. There is also an impression that in public current expenditure on goods and services and on transfers there could well have been a greater measure of restraint.

Once again, the 5 % rule laid down by the Council will apparently not be complied with in 1965, though it will be exceeded by a much smaller margin than in 1964.

In addition, considerable importance attaches to the negotiations at national level between the two sides of industry on possible further wage increases in 1965, to be held about the middle of the year; unfortunately, the economic situation is unlikely to have eased sufficiently by the time the negotiations take place. Experience shows that in such circumstances there is a risk that the agreements reached will not be such as to moderate the economic trend or prevent further price increases but, on the contrary, will in the end lead—directly or indirectly, though perhaps only temporarily—to an increase in economic strains and that they can in any case keep prices rising because of the push of costs. These negotiations could produce a situation in which the authorities responsible for short-term economic policy had no option but to stiffen the overall restrictive measures, even if in the circumstances this resulted temporarily in further reducing the pace of growth.

E. B.L.E.U.

Belgium

The expansion of economic activity continued from the third quarter of 1964 to the fourth; towards the end of the year, however, and early in 1965 there were increasingly obvious signs that expansion was losing momentum.

Exports of goods and services increased considerably. In the field of domestic demand, the increase in expenditure on gross fixed asset formation seems to have slowed down appreciably, and for a time the growth of public expenditure on goods and services ceased altogether. Private consumers' expenditure probably continued to expand rapidly.

From the third quarter to the fourth, activity in building and construction made no gains of note, but industrial production increased appreciably once again; according to the INS Index it was, in the last three months of 1964, on average 7 % higher than a year earlier. However, a tendency for the seasonally adjusted growth rate to slow down began to emerge in the fourth quarter and the beginning of 1965. The manpower situation showed some slight signs of improvement.

Apart from seasonal and fortuitous factors, import would seem to have levelled off for a time. Although a slight loss in momentum in the upward price movement was recorded, the machinery of the sliding wage scale again came into play in most industries towards the end of 1964 or early in the new year. In February, the retail price index was 4.1 % up on the February 1964 figure.

In the last months of 1964 and in the new year, the balance of current payments showed a distinct tendency to improve: in the fourth quarter there was, for the first time since early in 1963, a heavy surplus on current account. In the same period net official gold and foreign exchange reserves increased by Bfrs 7 600 million.

In the coming months the expansion of demand and of production could well lose a little momentum.

Exports will make further progress, though probably at a slower rate. Investment expenditure might well show signs of levelling out. The expansion of private consumers' expenditure will probably be affected to some extent by the development of other components of demand; it will nevertheless continue at a relatively brisk rate.

In these circumstances, the pace of growth of domestic production is likely to be no more than modest. Mainly owing to the stock cycle, the expansion of imports will be slow. Employment will probably remain stable and strains will ease a little more on the labour market—although this trend will not curtail sufficiently the expansion of costs. Consumer prices will tend to rise further.

With the outlook as it is at present, there are no grounds yet for any very substantial relaxation of the stabilization drive.

1. Recent developments

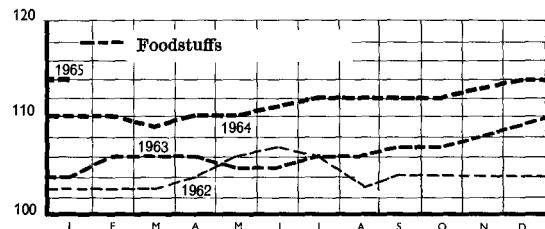
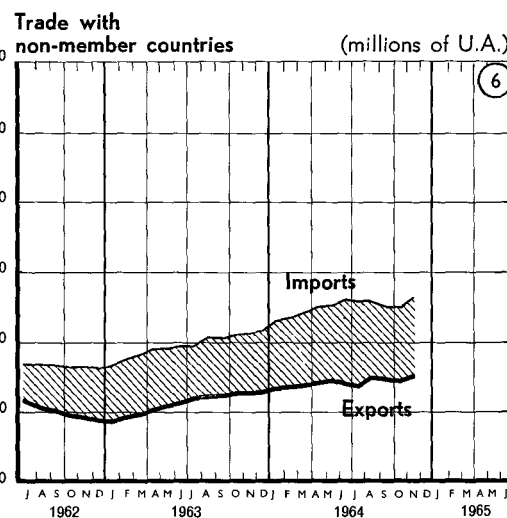
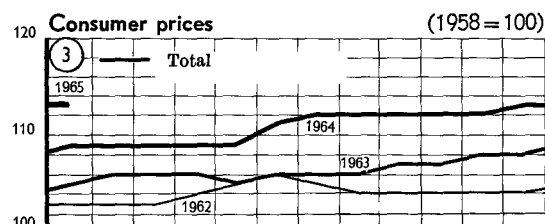
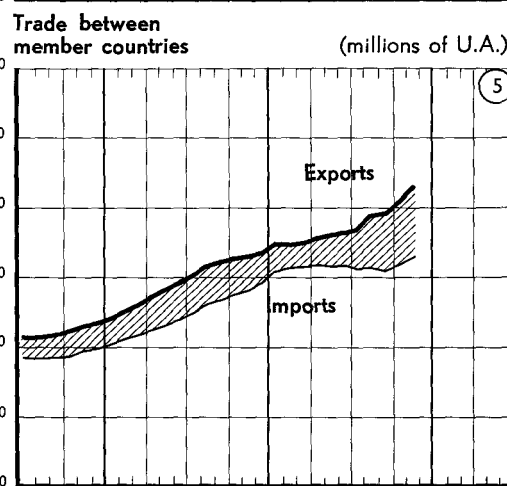
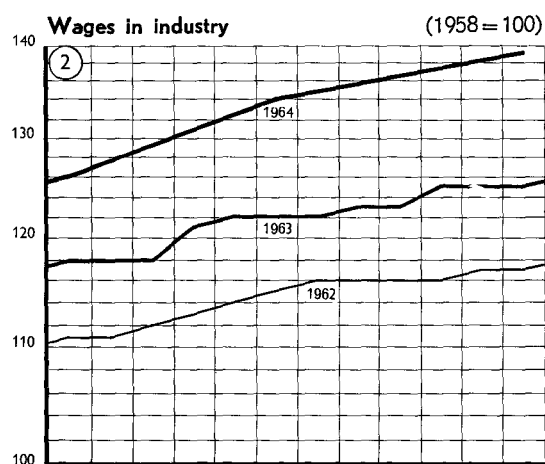
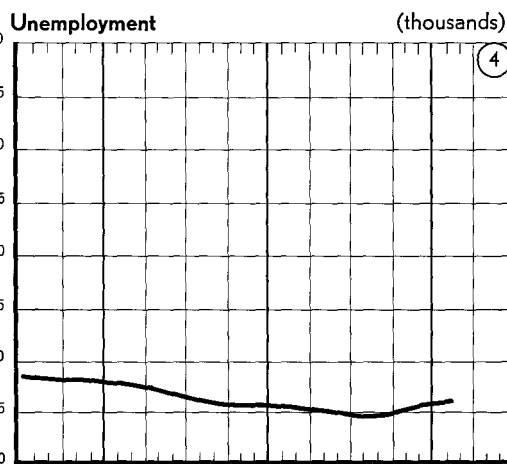
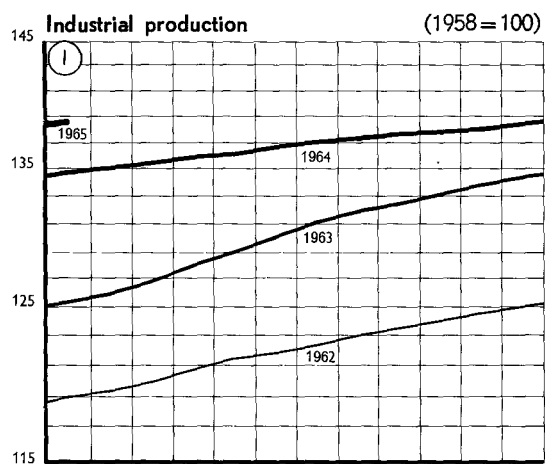
Exports of goods and services, which since the winter of 1963/64 had been tending to level off, have apparently begun to climb again during the last months of 1964 and at the beginning of 1965. Customs returns show, for example, that visible exports have gathered more momentum: in the fourth quarter their value was 14.1 % higher than a year earlier. In January, because of certain fortuitous factors, the corresponding increase was however only 11.2 %.

The trend in the fourth quarter probably owed much to the fact that in several industries investment had strengthened the elasticity of supply considerably while at the same time the expansion of domestic demand was losing momentum. It is also quite possible that certain orders that would normally have been despatched earlier were not delivered until the last quarter because of the longer paid holidays in the summer. The increase in exports to Germany and non-Community European countries (taken as a whole) was particularly marked.

The pressure of domestic demand eased towards the end of 1964 and in the new year, mainly because of an appreciable loss of momentum in the rate of growth of investment demand.

Since September the progress of gross fixed asset formation (apart from seasonal and fortuitous variations) has probably slowed down appreciably. All the main components of this section of demand contributed, though to differing degrees to this development: expenditure by enterprises on plant and equipment was certainly the least affected, because of the persistent efforts to rationalize undertaken in those industries hardest hit by rising production costs; on the other hand, the information at present available

ECONOMIC INDICATORS



NOTES :

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

Graph 1 : Estimated trends based on SOEC seasonally adjusted data. Excluding construction, food, beverages and tobacco.

Graph 2 : Index of wage rates.

Graph 3 : Index of consumer prices, excluding rents.

Graph 4 : Monthly average of day-to-day figures. From February 1962 onwards certain groups of only partially employable workers have been excluded. Data seasonally adjusted by Commission.

Graphs 5 & 6 : Foreign trade of Belgo-Luxembourg Economic Union. Series adjusted by SOEC for seasonal and accidental variations. Exports fob, imports cif. One unit of account = 0.888671 gramme of fine gold.

suggests that of late expansion in the construction of industrial and commercial buildings has weakened, and there have been unmistakable signs of a slowdown in the housing sector, where until the summer activity had been relatively brisk.

The slowdown in the growth of public expenditure seems to have affected investment by local authorities more than investment by the central government.

Although, apart from seasonal variations, public expenditure on goods and services has ceased to expand, private consumers' spending has continued to grow relatively rapidly. The increase in agreed wages has been as sharp as in the third quarter. The increase in the total wage bill may have been slowed down by certain developments pointing to renewed stability of employment (as reflected in the total number of hours worked), but this factor will have had no more than a slight impact on consumption expenditure; in the fourth quarter, at any rate, the rise in retail sales generally was greater than in the preceding months.

The growth of domestic supply continued. Industrial production made fairly pronounced gains from the third quarter to the fourth, but differences between the trends for specific industries were wider than before, and the advance from one month to the next during the fourth quarter and at the beginning of 1965 was strictly limited. Even so, the INS Index (1958 = 100), indicates that on a year-to-year basis the growth rate in the fourth quarter was about 7 %, compared with 2 % in the third; the year-to-year rate for January appears to have been very small. The adjusted output of the building industry would seem to have levelled off of late.

Signs that conditions on the labour market are easing have become stronger since the autumn. The number of unfilled vacancies has continued to decline, and manpower reserves (adjusted) have tended to build up. The number of workers wholly unemployed was 39 200 in February 1965 (compared with 33 500 at the same period of the preceding year). The figure for partial and "accidental" unemployment was 84 500 in February as against 29 300 a year previously, but this change probably owed much to the difference between the relatively good weather conditions of February 1964 and those of February 1965.

The backlog of orders has been steadily contracting and the vigorous build-up of stocks of raw materials and semi-manufactures has come to an end, so that visible imports have tended to level off. Purchases from non-member countries may even have declined slightly. Customs returns show that the year-to-year growth rate for visible imports which had been 12.4 % in the third quarter was 10.5 % in the fourth (value—figures for volume are not yet available).

The upward price movement has weakened slightly. At wholesale level, the increase in the prices of semi-manufactures and finished industrial products slowed down

in the fourth quarter; raw materials were even slightly cheaper. Prices for farm produce rose substantially, though less than in the corresponding periods of the three preceding years. In the building industry, there are signs that the upward movement in labour costs is losing a little momentum, but the cost of building materials has been rising sharply.

The official retail price index continued to mount though, at least for a time, the upward movement was rather slower. From December to February, the average increase each month was 0.2 %, compared with 0.3 % from September to December. The policy of direct intervention, designed to slow down the upward movement, has been maintained, and for certain items (butter, rice, etc.) maximum prices were imposed.

The improvement in the trade balance which had become discernible in the third quarter gathered further strength in the fourth. Since, in addition, the development of net income from services was very favourable, the balance of current payments closed with a heavy surplus for the first time since the first quarter of 1963. Capital transactions also yielded a surplus, partly thanks to inflows of speculative capital, so that the overall gold and foreign exchange reserves of the banking system increased appreciably. The net holdings of the National Bank of Belgium increased by Bfrs 9 600 million between September and December, but the foreign exchange position of the commercial banks deteriorated by Bfrs 2 000 million.

The surplus deriving from transactions with abroad and the means chosen to finance the government deficit led to an increase of liquidity on the money and capital markets in the fourth quarter. Unlike the Treasury, which was forced to increase its borrowing from the National Bank, commercial banks therefore required less and less assistance, especially since the expansion of short-term bank advances fell a little short of what is usual for the season, partly because of the credit squeeze.

Interest rates reached a peak in December; thereafter they tended to ease. The success of a government loan floated towards the end of January and the beginning of February 1965 on much the same conditions as in October 1964 is additional evidence of the abundance of domestic liquidity.

2. Outlook

Some caution is required in assessing the contribution foreign demand will make to economic activity in Belgium in the coming months: the economic outlook in certain countries which are among Belgium's leading customers and the relative trends of prices and costs are factors pointing to some loss of momentum in the rate of growth of exports. At the end of 1964, however, there was some recovery in orders from abroad; the backlog of orders has since contracted because manufacturers have stepped up the tempo of their deliveries.

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	+ 7

⁽¹⁾ Goods, services and factor income.

⁽²⁾ General Statistical Bulletin 1964, No. 7-8, Statistical Office of the European Communities.

⁽³⁾ Commission estimates.

⁽⁴⁾ Commission forecasts.

Note :

- a) The difference between the figures for supply and the figures for utilization is accounted for by changes in stocks.
- b) The estimates and forecasts are approximations based on particular 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.

None the less there is every reason to believe that once again business activity in the Community will provide a sharp stimulus to Belgian exports; in particular, prospects for sales to the Federal Republic of Germany are excellent. On the other hand, exports to the non-member countries might lose some of their vigour, though the effects of this development should make themselves felt only gradually, mainly because of increasing purchases of iron and steel products by American manufacturers anxious to guard against the repercussions of a possible strike in their own iron and steel industry. Lastly, for visible exports as a whole, it is reasonable to expect that a decline in sales of military equipment will be offset by deliveries of agricultural produce worth more than in 1964 and by the effects of the standard-rate turnover tax refunds from which exports have recently begun to benefit. Lastly, the rapid expansion of domestic demand is likely to slow down, and this too may well encourage an increase in exports.

The growth in gross fixed asset formation will almost certainly be very modest in the coming months, or it may level off entirely; in view of the outlook for overall demand, which is not particularly favourable, and of the persistent pressure of costs on profit margins, the propensity to invest is likely to weaken in several industries. This is already confirmed by the flow in orders for plant and equipment from the domestic market. The restrictive economic policy at present pursued might also work in the same direction, particularly where it seeks to cut back the benefits provided for by the laws passed in 1959 to promote economic recovery. Expenditure on the construction of housing will in all likelihood run at approximately its present level. In the field of public investment estimates are less certain—some degree of expansion should not be ruled out here.

Private consumers' expenditure will almost certainly continue to grow fairly rapidly, but expansion will be slower than hitherto. Since the upward price movement will probably lose momentum, the expansion of this demand component in terms of volume should remain relatively steady.

Although as yet there is no sign that the stabilization drive is directly slowing down the growth of personal incomes per head, these will advance slightly more slowly for two reasons: the overheating of the economy had given the wage-earner certain advantages which will be trimmed down now that economic expansion is not so rapid, and the amount of overtime worked will probably decline in a number of industries. This slowdown in the growth of personal incomes will, however, be limited by factors such as collective wage agreements, which in various industries cover a period of two years, the appreciable increases recently agreed in certain industries, and the possibility that after the middle of the year the sliding scale may come into operation. Two other relevant considerations are the tax reductions granted early in the year and the pension increases accorded of late in both the private and public sectors—as a result of which transfer incomes will increase still more rapidly than in 1964.

The trend of production in industry, and even more in building, will show moderate progress. This will stem solely from improvements in productivity, since the number of persons in paid employment should remain practically unchanged. According to the latest business surveys the volume of outstanding orders in industry, measured by the time it would take to complete them, declined steadily until the end of 1964 and flattened out in early 1965 at the lowest level recorded for four years.

Imports may be expected to show a further increase. None the less, the deficit on trade should be smaller than in the first nine months of 1964, during which it had however been exceptionally heavy.

The general price climates will probably improve only slightly: towards the end of 1964 the number of heads of enterprises who forecast a further increase in the sales prices of industrial products remained high. The retail price index, which is the basis of calculation

for the adaptation of wages and of most social security benefits to the cost of living, will almost certainly mount further, especially since the upward movement of costs will probably persist, notably in the services sector.

The present outlook for the development of the Belgian economy confirms the forecasts made in Quarterly Survey No. 4/1964 for the full year 1965; a possible reservation is that the (volume) growth rates for gross fixed asset formation might be a little lower than was thought likely at the end of 1964.

In general, the stabilization drive has been maintained since the autumn, though some changes have been introduced.

In the field of monetary and credit policy, the net expansion of short-term bank loans in the first quarter of 1965 should not be more than 2.75 % of the level which had been reached at the end of 1963, and the limitations imposed on the expansion of building loans have been maintained with the exception of loans for publicly-assisted housing. On the other hand, the general restrictions on rediscounting instituted in July 1964 have been relaxed for credits to textiles. The 1 % minimum reserve rate (coefficient de réserve monétaire) is to be retained, but will now be subject to review every two months instead of every quarter.

In the field of budgetary policy the authorities have allowed a number of exceptions to the restrictions in force in the field of public investment, notably the release of certain appropriations for the financing of public works which had been frozen. These were part of the 10 % tranche in the 1965 budget, the spending of which was to be timed in the light of the economic situation. In addition, extraordinary subsidies will be granted to the coalmines, and the government will doubtless assist in financing the higher pensions to be paid in the private sector.

Signs that the rate of growth of demand is slackening do not mean that the stabilization policy should be dropped or even substantially relaxed—particularly if the structural weaknesses until now masked by the inflationary upsurge were to be brought out into the open by the new trend. As long as the easing of conditions, notably on the labour markets, is not marked enough to inhibit appreciably the upward movement of costs, the aim of policy with regard to domestic demand must be to keep its expansion within narrow limits.

Manifestly, the stabilization drive must be continued in the field of credit policy. Given the present tendency to make supplementary additions in expenditure and to grant tax reductions, the public authorities must adhere even more closely to the restrictive budgetary policy laid down: it looks as if the expansion of government expenditure has already exceeded, although to only a slight extent, the 5 % margin fixed by the Council of Ministers. But in curbing the growth of their expenditure, the authorities should avoid singling out one item for attention while ignoring the rest: a recent heavy

cutback in public works appropriations contrasted with spending policy in other fields, where expansion remained just as rapid as before. Indeed, the time may well be ripe for some relaxation of the policy of restricting public investment—provided always that the growth of public consumption and of transfer payments (the bulk of which helps to strengthen consumption demand) are kept adequately in check.

In view of current trends it would perhaps be desirable, if it should be found that investment by enterprises was dropping sharply, to revert in the coming months to a policy that was less restrictive in the treatment accorded—under the 1959 laws and under other arrangements—to the productive investment of enterprises. But for the moment, it is not yet certain that this will prove necessary: according to the information now available, more investments financed by foreign capital are to be expected and, if they are on a large enough scale, these might well engender further strain for a time at certain points in the economy, notably on the employment market.

It is important, too, that policy with regard to wages and social contributions should be framed with due consideration for the competitiveness of industry. In Belgium, a country heavily dependent on external trade, this question may prove of even more crucial importance than in other Community countries (save the Netherlands), not only as a factor in the stabilization of prices but also, and to a growing extent, as an element in the maintenance of satisfactory economic growth.

Grand Duchy of Luxembourg

In the last few months decidedly divergent trends have been apparent in the various elements of total demand. While exports and gross fixed asset formation showed a steadily falling rate of expansion and seemed to be settling down at the high level recorded over the last few months, private consumption doubtless continued to rise vigorously. Presumably in response to these developments in total demand, the expansion of domestic supply was decidedly weak.

Employment and prices have so far shown no signs of any significant change.

The tendencies shown by exports in recent months will probably continue in the near future. Fixed asset formation might decline markedly. Since incomes will probably continue to rise, private consumers' expenditure is also likely to go up, though less rapidly than in 1964.

Although in the coming months total demand will probably expand more slowly, considerable upward pressure on prices will persist; combating this remains one of the major tasks of short-term economic policy.

1. Recent developments

Supported by firm demand for steel abroad, Luxembourg's exports (seasonally adjusted) in recent months stayed at the very high level achieved in the third quarter of 1964. The backlog of orders from abroad, however, again dropped slightly, though it was still bigger than a year earlier. Export prices probably moved up a little at the beginning of 1965—partly because of the strong demand from outside the Community, particularly the United States, where manufacturers have increased their orders because of possible labour disputes in the steel industry, and partly because steel producers have been exercising some caution in their sales policy.

Gross fixed asset formation almost certainly made further progress in the final months of 1964, but at a still further reduced rate of growth. A number of major investment projects undertaken by firms—including the Our power station—are almost finished, and there is still some tendency for investment in the iron and steel industry to slacken. Expansion has probably been levelling off in private housing and public investment.

Of the various elements of demand, expansion at the turn of the year seems to have been strongest in private consumers' expenditure. Private incomes rose as a result of an increase in the total number of hours worked and in actual earnings and of adjustments due to the sliding wage scale. Spending on consumer durables again rose appreciably, though not so rapidly as in the first half of the year. Registrations of new passenger-cars in the fourth quarter were again considerably higher than a year before.

Public current expenditure on goods and services rose again, though there was some decline of public consumption in terms of volume when the working week in the public service was cut from 44 to 42 hours at the beginning of 1965.

Industrial production, which had expanded very rapidly between the end of 1963 and the summer of 1964, showed only a very modest upward movement during the fourth quarter. However, the Grand Duchy's production index was 9.4 % higher than in the fourth quarter of 1963.

The available figures indicate that the expansion of imports have tapered off slightly in recent months.

The strain on the labour market still showed no sign of easing, though the shortage of workers on housing sites was probably less serious. There are still practically no reserves of manpower. Total numbers employed in construction and in industry were 3 % higher in the fourth quarter of 1964 than a year before—as against a 1.7 % rise for the third quarter.

As changes in the cost-of-living index give only an inadequate picture of the actual changes in consumer prices, it is difficult to assess the extent of the upward movement of prices that has undoubtedly occurred in the fourth quarter of 1964 and the early part of 1965. The index did fall a little between September and December 1964 and only rose 0.1 % from December 1964 to March 1965, on the monthly average, but this is due to seasonal factors (potato prices falling in the autumn), to the maintenance of direct price controls, and to the fact that electricity prices were cut by an average of 11-12 % on 1 November 1964—probably in view of the sharp increase in supply resulting from the new plant.

2. Outlook

The expansion of the Grand Duchy's economy is likely to lose further momentum in the coming months.

The stimulus to economic activity provided by exports will probably be appreciably weaker as foreign demand for iron and steel products flattens out. Speculative purchases by the United States might continue for a while, but the outlook for exports to the other major importing countries is still only moderate. In the latest EEC survey, businessmen reported that their export order-books were not very fat.

Fixed asset formation may tend to decline. In the case of investment by enterprises the decline could be quite considerable as greater influence is exercised by the factors noted above in the analysis of recent developments (completion of investment projects for new manufacturing plants, less propensity to invest on the part of the iron and steel industry). Although the validity of the outline law on improvement of the Grand Duchy's economic structure was extended for two years at the end of 1964, the authorities intend to be very selective in the action they take in this field. Private expenditure on housing might maintain its current level, but public investment is likely to decrease somewhat, according to the latest figures, as a result of a drop in expenditure on public building.

Private consumers' expenditure will again expand—but not as vigorously as in 1964. Wages and salaries per worker can be counted on to keep rising, partly because of the recent pay increases in the iron and steel industry and the mining industry.

Equal pay for men and women workers and the expected extension of the field of application of the minimum wage will also help to increase personal incomes. The rise in employment figures is most likely to be appreciably less than in 1964.

In view of the on the whole decidedly hesitant movement of demand, the expansion of domestic supply is likely to be very modest. The industrial production index (adjusted for seasonal and fortuitous variations) should remain at its current level or perhaps fall a little, particularly as it does not yet include certain new products. The rise in imports is likely to be modest.

The influence of factors making for continued price increases may remain considerable, even though the pressure of demand is easing. The advance in wage costs will again be vigorous, and no doubt the upward trend in import prices for finished goods will also continue for a time. The elimination of certain agricultural subsidies will probably reinforce the effect these factors will have on prices.

The authorities responsible for economic policy could, however, counteract these tendencies in some measure. Rising prices could be kept within bounds by keener

competition in the retail trade—perhaps by giving effect to measures already discussed for relaxing the company-promotion law of 2 June 1962. Action to slow down the increase in wage costs, as was mentioned in Quarterly Survey 4/1964, might also help in this direction. Finally, the time at which the proposed reduction in income tax are to be introduced must be chosen with due regard to the economic situation, and the scale of the reductions accorded to physical persons must be such that they do not in fact contribute to the upward trend of prices.

Trends of wages, productivity and labour costs in industry

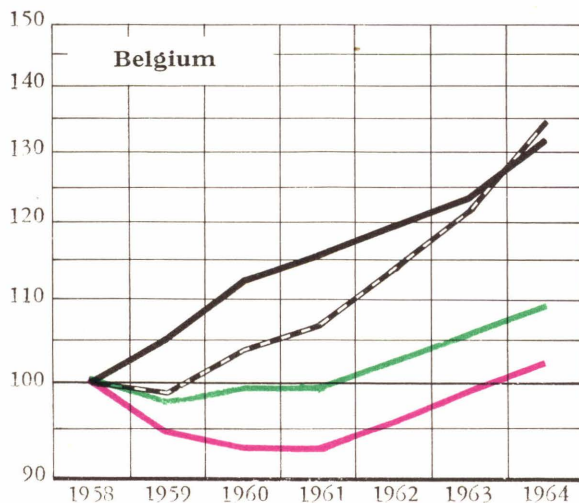
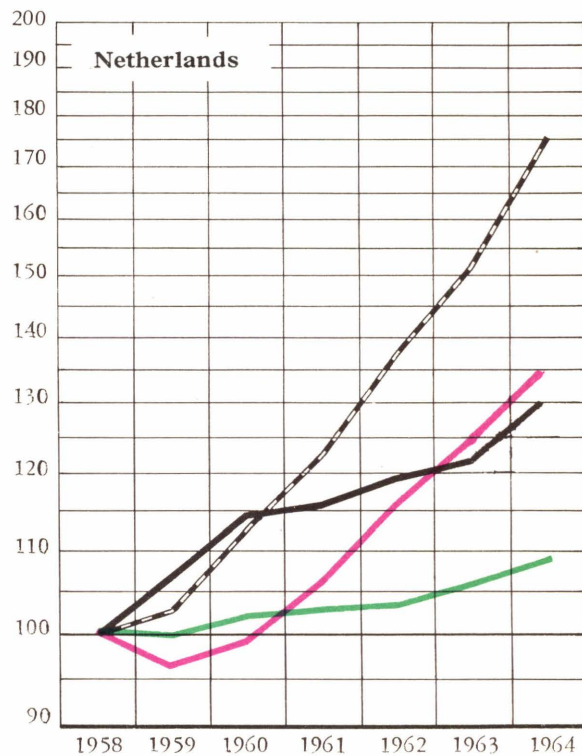
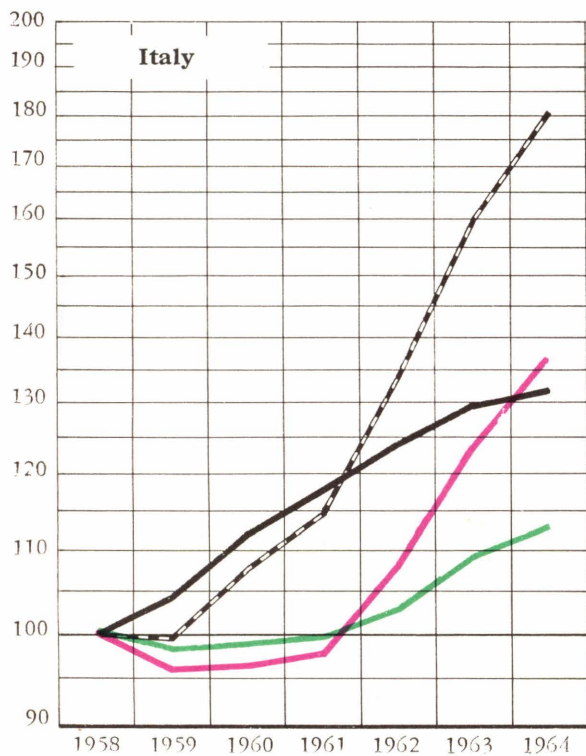
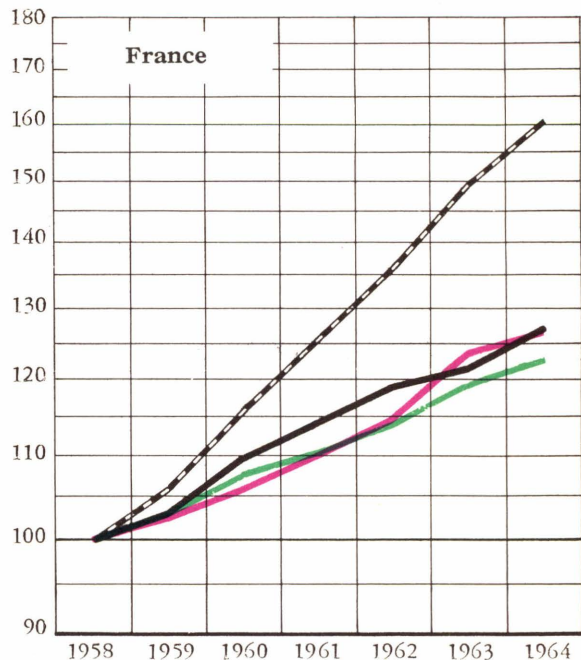
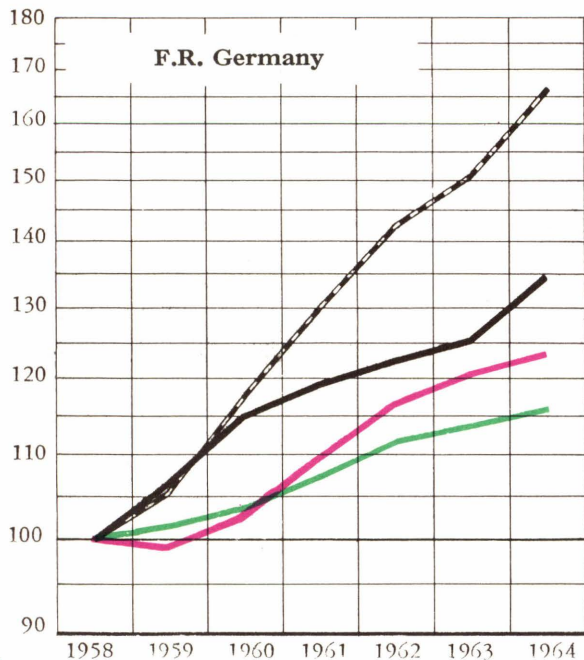
As in previous years (see annexes to Quarterly Surveys Nos. 2/1962, 1/1963 and 2/1964) the trend of labour costs and production (i.e. net production) per person in paid employment, labour costs per unit of output and prices in industry (including building and construction) in member countries and in two important non-member countries are shown in the following pages in chart form.

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

For the definitions and methods used, the reader is referred to the explanations in the annexes to Quarterly Surveys Nos. 2/1962 and 1/1963. Suffice it to recall here that the statistical data have been drawn as far as possible from national accounts. Henceforward this source will be used for data on United States production as well: now that figures for value added at constant prices are available for the United States, the Federal Reserve Index of industrial production will no longer be used. It must also be re-emphasized, to avoid misunderstandings, that the charts show only the actual development of wages and salaries, of "labour productivity", of labour costs per unit of output and of prices, but offer no explanations as to the reasons for these movements. For example, the trend of labour costs per unit of output is purely an arithmetical calculation based on the trend of labour costs per person in paid employment on the one hand and that of production per person in paid employment on the other.

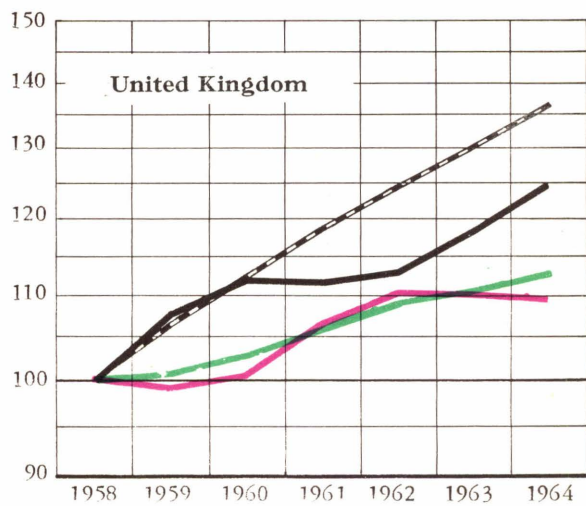
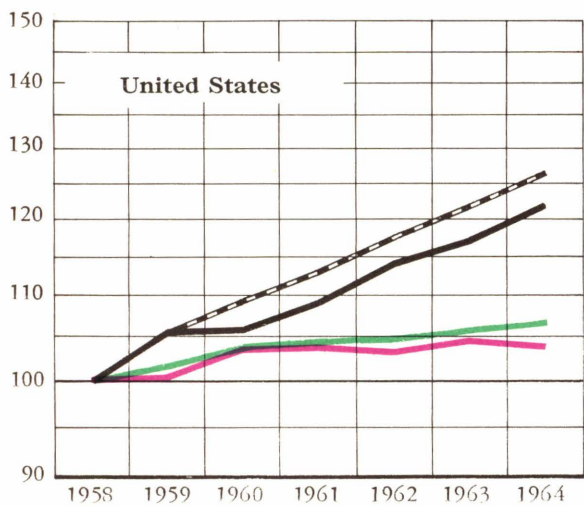
WAGES, PRODUCTIVITY AND WAGE COSTS IN INDUSTRY

1958 = 100



WAGES, PRODUCTIVITY AND WAGE COSTS IN INDUSTRY

1958 = 100



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

Semi-logarithmic scale

The charts are based on the latest available figures, including some which are corrections of figures previously used; data for 1964 in particular are still only provisional, some of them being Commission estimates. For trends in the 1954-58 period, the reader is referred to Quarterly Survey No. 1/1963.

It is inherent in the nature of the curves that they can plot only the trends in each specific country during the period considered; accordingly they enable *changes* to be compared from country to country, but no inter-country comparison of the respective *levels* is possible. The curves are based on calculations in national currencies; there have been some alterations in exchange rates since 1958, and this should be borne in mind when making comparisons.

Labour costs per unit of output rose sharply from 1963 to 1964 in Italy and in the Netherlands. The increase is estimated in these countries at 10 %, compared with 2 to 3 % in the other member countries. In the United Kingdom and in the United States, on the other hand, the 1963/64 comparison showed that once again production per person in paid employment and labour costs per person in paid employment had developed along parallel lines, so that labour costs per unit of output remained practically unchanged in both these countries.

Within the Community, the curves for labour costs per unit of output tended to flatten out appreciably in only two countries—France and (to a lesser extent) Germany, while in the other member countries virtually no essential change in the trend was recorded. In Germany, however, the deceleration in the upward movement of labour costs had already ceased by the second half of 1964, since the gains in labour productivity, though still very substantial, were appreciably less rapid, while the upward movement of wages gathered momentum. These trends are not, however, to be seen in the charts, since the curves are based on annual averages and show year-to-year changes but not changes within a given year.

Except in Italy, where labour productivity made only very slight gains, output per person in paid employment grew from 1963 to 1964 in all the member countries more than twice as fast as from 1962 to 1963. The weather, which was very bad in 1963 and fairly good in 1964, goes far to explain this phenomenon, especially as the figures used here include building and construction. Wage increases per head varied widely from country to country, ranging from 7 % in France to some 17 % in the Netherlands.

Labour costs per unit of output can be expected to rise more slowly in the Community as a whole during 1965. But the loss of tempo will not attain any marked proportions, since generally speaking a smaller improvement in productivity is to be expected than that achieved in 1964. In contrast with the rest of the Community, wages in the Federal Republic of Germany are expected to rise more rapidly than from 1963 to 1964, and this trend is likely to prompt a fresh spurt in the upward movement of labour costs per unit of output.