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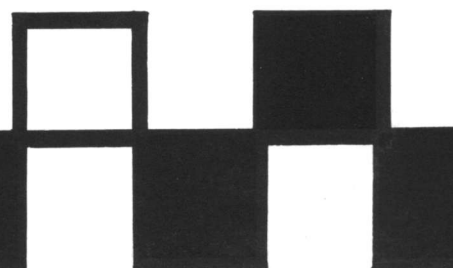
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**Directorate-
General
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**The economic situation
in the Community**

2

1966



Quarterly survey

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

EUROPEAN ECONOMIC COMMUNITY

COMMISSION

The Economic Situation in the Community

JUNE 1966

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Note :

This Survey was completed around mid-June 1966. As regards the most recent developments and where it has not been possible to take them into account because of the pace at which national statistics are prepared and the time it takes to publish the Survey in five languages, number 6-1966 of the "Graphs and Notes on the Economic Situation in the Community" can usefully complete the information supplied here.

I. THE OVERALL SITUATION

The first quarter of 1966 was again — and probably will be in the next few months — marked by fairly vigorous economic growth in the Community.

Effective demand from abroad—especially visible exports both to developing countries and to various industrial countries in Europe—went up less rapidly than in previous months, but customs returns show that the value of goods exported to all non-member countries taken together was nevertheless 7.5 % higher than in the same period of 1965, largely because of deliveries to the United States, which continued to expand with particular vigour.

The increase over the previous quarter shown by internal demand was, however, quite brisk, particularly where gross fixed asset formation is concerned. In most member countries—the Federal Republic of Germany being the most important exception in this respect—expenditure on plant and equipment rose more strongly than before, and expenditure on building was also very high, partly because of very favourable weather conditions; only in Italy was the advance in housing construction again slow. Secondly, investment in stocks on the part of industry and trade in the Community as a whole stimulated expansion appreciably. Lastly, expenditure on consumption continued to rise rapidly, a rather calmer trend in public expenditure on consumption at times being offset by a more vigorous increase in total private consumption. At the same time the effects of a continuing rise in disposable household incomes appear to have been intensified in some member countries by a decline in the propensity to save.

Internal supply in the Community went on expanding into the spring at the same rate as at the end of 1965. The adjusted index of the Statistical Office of the

European Communities shows that from the fourth quarter of 1965 to the first quarter of 1966 industrial production went up by about 1.5 %—the same average as for the previous three months. In the first quarter the unadjusted index was 5 % higher than in the same quarter of 1965.

There were hardly any significant changes in the labour market situation in the Community as a whole. In the Federal Republic of Germany and the Benelux countries the labour shortage remained acute and showed little if any sign of easing. In France and Italy, despite a continuing upsurge of economic activity, the decline in unemployment came temporarily to a halt; the underlying trend, however, appears to have remained slightly downwards.

Imports from non-member countries continued to rise, although somewhat more slowly than in previous months. In the first quarter visible imports were 13.5 % higher in value than at the same time last year.

Intra-Community trade in goods also continued to expand. According to customs returns for imports, its value in the first quarter was 16.5 % higher than a year earlier.

In spite of the generally substantial increase in aggregate supply and the compensatory effect of the Community's internal trade—an effect which was particularly marked in view of the differences in the level of economic activity—the upward movement of prices continued unabated, the increase being even more rapid than before in a few member countries and moderate only in Italy and France. Although this may be partly due to special factors, such as higher prices for certain vegetable foods and increases in indirect taxes and the charges for public utilities, the underlying upward trend also remained appreciable, and was in some respects stronger than before. In April the year-to-year increases in the Dutch and Belgian indices of consumer prices were so disquietingly high (7.4 % and 5.5 % respectively) that price-freezing measures had to be taken. In the Federal Republic of Germany and in Luxembourg the rise was rather more moderate (4.5 % and 3 % respectively), while in France and Italy it was relatively slight (2.8 % and 2.7 %).

The Community's balance of trade with non-member countries has again deteriorated; the deficit reached 772 million u.a. ⁽¹⁾ in the first quarter, as against 335 million u.a. in the same period of 1965. The current account (not seasonally adjusted) may therefore also prove to have closed with a deficit. At the same time net inflows of capital appear to have been smaller than in previous months. The official gold and foreign exchange reserves of the member countries dropped by 426 million u.a. between the end of December and the end of April, a decline which is, however, part-

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

ly linked with the improvement in the net foreign exchange position of the banks and partly with the first payments made as a result of the raising of International Monetary Fund quotas.

In all probability the pace of economic growth in the Community in the second half of 1966 will remain considerable, and may even become slightly faster.

Demand from abroad—once again mainly from the United States and probably in increasing measure from the developing countries as well—can be expected to exert quite a powerful stimulus. Above all, however, internal demand in money terms can be expected to show a tendency to rise somewhat faster than in the first six months. Expenditure on gross fixed asset formation in the Community as a whole should expand at least as vigorously as hitherto, notwithstanding the continuing tendency for such expenditure to slacken in the Federal Republic of Germany; the vigorous expansion of expenditure on consumption will also certainly continue in the next few months.

The prospects for the development of overall demand suggest that the growth of internal supply will continue to be fairly pronounced and may even become slightly stronger again in a few member countries. The rapid expansion of industrial output in France and Italy will ensure that despite the relatively slower pace of expansion in the Federal Republic of Germany, total industrial output in the Community will continue to rise vigorously.

Imports from non-member countries should also expand at least as rapidly as they have done since the end of 1965. The tendency for the Community's trade balance—and thus its current account—to worsen will probably persist.

In the Community as a whole, the movement of prices may slacken somewhat in the next few months; but if this happens it will be due in the main to the waning influence of the special factors already mentioned and, in Belgium and the Netherlands, to price controls—which in principle, are still applicable to industrial products in France also. On the other hand the forces inherent in the business situation that are pushing prices up are unlikely, in view of the combined effect of a sometimes excessive expansion of demand in money terms and of increases in costs, to slacken significantly unless further and effective measures to damp down demand are very soon taken in those member countries where they appear to be urgently necessary.

The development of the economy since the beginning of the year, and the prospects in so far as they can at present be discerned, give no cause for making any appreciable changes in the forecasts for the full year 1966 which were made in the last Quarterly Survey. The growth of the real gross Community product from 1965 to 1966 can still be put at about 4.5 %. The index of industrial production (as defined by the Statistical Office of the European Communities) may show an increase of 6-6.5 %.

The first forecasts have now also been made for 1967. The forecasts assume that, if certain conditions are fulfilled, demand from abroad will rise less vigorously than from 1965 to 1966, but that internal demand in the Community will again expand somewhat more rapidly. In this, the almost certain continuation of the upsurge in economic activity in France and Italy, and the expectation that overall demand will recover slightly in the Federal Republic of Germany, play an important part. At present it is considered possible that the rise in real gross Community product from 1966 to 1967 will be about 4.5 %.

This outlook—which is based on the assumption that there will be little change in present economic policy—does not suggest that the trend towards stabilization of prices and unit costs will be sufficient. The upward movement in Belgium and the Netherlands and perhaps also in the Federal Republic of Germany may indeed turn out to be somewhat less than last year, but the possibility of some acceleration in France and Italy cannot be ruled out.

The outlook for real economic growth, on the other hand, is felt by the Commission to be satisfactory, and to be in line with what is expected under medium-term forecasts. The Commission considers that the short-term economic policy of the member countries ought therefore—preferably as part of new co-ordinated measures at Community level—to aim first and foremost at stabilizing prices and unit costs in most member countries and at preventing the emergence of new strains in France and Italy. If the economic policy instruments chosen are used in judicious proportion, this can be done without greatly hampering the Community's economic growth.

A. Recent developments

1. Demand

In the first quarter of 1966 and the early spring months, overall demand in money terms in the Community may be taken to have risen at about the same relatively rapid rate as towards the end of 1965.

Demand from abroad, however (i.e. actual exports of goods and services to non-member countries) seems to have risen more slowly. This is at any rate true of visible exports, which have tended to rise relatively little. Customs returns show that in the first quarter of 1966 they were only 7.5 % higher in value than in the corresponding period of 1965 when they were markedly depressed by special factors.

Above all, purchases by developing countries and various industrial countries in Europe expanded only sluggishly; their effect in slowing down the increase in the Community's total visible exports was, however, partly offset by expansionary influences from other quarters.

One of these was the rapid growth in the United States' purchases from the Community, which continued in the first quarter and apparently also in the following months. It was again due mainly to a very vigorous expansion of internal demand for consumer and capital goods in that country. The raising of social security contributions at the beginning of 1966 and restrictive fiscal measures at the beginning of the year (cancellation of the reduction in consumption taxes, earlier collection of worth and income taxes) had in fact previously caused no very appreciable slackening in the rise in total private expenditure on consumption; possible restrictive effects were probably largely offset by the sharp rise in mass incomes and a marked decline in the propensity to save.

The rise in incomes was stimulated by the growth of capital expenditure by enterprises and public authorities, which was extremely lively at any rate up to and including the second quarter of 1966.

Output continued to rise. This applies not only to agricultural production but above all to industrial production. Seasonally adjusted, the United States' real gross national product again rose by about 1.5 % from the last quarter of 1965 to the first quarter of 1966, and was thus no less than 6 % higher than a year before.

Nevertheless it was clear that in the United States there was still a gap between domestic demand and real internal supply; this was shown not only by the continuing demand for imports but also by the trend in prices. Price increases in the agricultural sector slackened appreciably towards the end of the winter, but industrial products became at the same time perceptibly dearer, and this trend seems to be mounting.

The member countries' exports in the last few months appear to have received only a moderate stimulus from demand from other industrial countries in Europe, whose underlying growth rate has on the whole become even slower. This applies above all to

imports into the continental EFTA countries, the growth of which was, however, also hampered by the unusually long, hard winter.

In the United Kingdom economic development was affected even somewhat more powerfully than before by the restrictive measures previously adopted, the influence of which was more or less slow to appear (restrictions in the field of financial and credit policy introduced in 1965, reinforced by stricter conditions governing hire purchase which were imposed in February 1966). The rise in overall domestic demand appears to have flattened out slightly. In any case, the tendency for investment in the private sector to decline would seem to have been particularly important in this connection; on the other hand, private consumers' expenditure increased quite considerably until the new Budget proposals were announced at the beginning of May; this was, however, certainly also due in part to the effects of advance purchases made in anticipation of fresh increases in purchase tax, which did not in fact materialize in the Budget.

The seasonally adjusted figures for industrial output in the United Kingdom in the first quarter were much the same as in previous months, in spite of the fact that domestic demand in money terms was on the whole still rising and that exports continued to expand fairly vigorously—here, too, mainly to the United States. On the other hand, imports continued to recover, although slightly more slowly, from the low level to which they had fallen at the beginning of 1965 as a result of the import surcharge and the expectation that it would be reduced. Thus, in spite of the fairly favourable trend in exports, the trade balance again showed a considerable deficit in the first quarter of 1966.

This deficit will probably have increased substantially in the second quarter, owing to the seamen's strike. The paralysis of British merchant shipping is actually affecting the United Kingdom's exports much more than its imports, a large percentage of which are carried in foreign ships.

The pace at which the Community's goods exports to the developing countries were expanding became noticeably slower in the first few months of 1966, partly because of a marked falling-off in purchases by the overseas countries and territories. As is also evident from the further rise in the foreign currency reserves of the developing countries as a whole, the improved receipts from exports in many of those countries have not yet led to any similar increase in their demand for imports.

The underlying growth of internal demand in money terms in the Community was again brisk in the first quarter of 1966 and apparently also in the following months.

Gross fixed asset formation, in particular, would seem to have increased rather more vigorously throughout the Community. In the Federal Republic of Germany growth in the capital expenditure of enterprises did indeed slacken, but in France, on the other hand, the revival in investment became perceptibly stronger, and in Italy it continued as before.

Expenditure on plant and equipment in particular—taking the Community as a whole—tended to expand somewhat more than before; however, the relatively favourable weather towards the end of the winter and in the early spring also encouraged an appreciable increase in building and construction. For example, the number of dwellings completed in the Community in the first quarter of 1966 almost reached the fairly high figure of a year ago, although housing construction in Italy would seem to have been sluggish and even to have declined further. In addition, expenditure on public works in the Community as a whole again went up quite strongly.

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

	1965		1965				1966
	million u.a. (¹)	%	1st quar- ter	2nd quar- ter	3rd quar- ter	4th quar- ter	1st quarter %
All non-member countries :	27 079	+ 12	+ 12	+ 11	+ 14	+ 11	+ 7.5
of which :							
Industrial countries (²)	17 612	+ 12.5	+ 12	+ 11	+ 15	+ 12.5	+ 9
including :							
United States	3 425	+ 20	+ 11.5	+ 19.5	+ 25	+ 23.5	+ 22
EFTA	9 604	+ 8.5	+ 9.5	+ 6.5	+ 11	+ 7.5	+ 5.5
United Kingdom	2 367	+ 3.5	— 5	0	+ 9	+ 9.5	+ 18
Developing countries (³)	7 501	+ 9	+ 10	+ 8.5	+ 11.5	+ 6	+ 0.5
including :							
Associated overseas countries and territories	1 733	+ 5	+ 1	+ 4	+ 8	+ 6	+ 3
Other (⁴)	1 966	+ 19	+ 23	+ 24.5	+ 15.5	+ 15.5	+ 20

Source: Statistical Office of the European Communities.

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

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

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

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

Investment in stocks also stimulated overall demand appreciably. In the first place, stocks of raw materials and semi-finished goods were increased, in view of the favourable trend in production and the stability of world market prices; secondly, the trend

in final demand appears to have induced retailers to increase their stocks of finished goods.

Throughout the Community, expenditure on consumption continued to rise very rapidly. The increase in public current expenditure may turn out to have been somewhat more moderate than in the previous quarter, particularly because wages and salaries and expenditure on defence went up more slowly in the Federal Republic of Germany. Nevertheless private household expenditure, following its general underlying trend, again rose vigorously, although in Belgium and the Netherlands the increase in spending was for a while less than before because of the reaction which had followed the rush to buy before taxes went up at the end of 1965.

The increase in consumption expenditure was due not only to higher incomes but also to a decline in the savings ratio, which was most marked in the Federal Republic of Germany but also occurred in France and Italy.

With regard to the development of the net incomes of employed persons, a slightly slower increase in the Federal Republic of Germany and in Italy was at least partly offset by a stronger upward movement in France. In Italy and France consumption again probably also received a greater stimulus from the amounts drawn from their business or profession by self-employed persons. In Belgium and the Netherlands there was hardly any change in the generally vigorous upward movement.

If private consumption is broken down into the different categories of expenditure, it is particularly striking that sales of consumer durables in the Netherlands and Belgium, where various indirect taxes were raised on 1 January 1966, were temporarily rather low; in the other member countries, however, sales of these goods expanded more rapidly, which was certainly due partly to the decline in the propensity to save. Thus in the first quarter sales of passenger and estate cars in the Netherlands were about 45 % down on the same period of 1965, while in the Federal Republic of Germany and in France the underlying expansion of demand for these types of vehicle was maintained, and at the same time sales on the Italian market showed a definite increase, once the weakness which had followed the wave of buying caused by tax changes was over.

2. Production

In the first quarter and at the beginning of the spring, internal supply in the Community continued to rise at the same slightly faster pace as in late 1965.

With regard to agricultural production, sowings do not appear to have been adversely affected by the bad weather in the first few months of 1966, and vegetable production—although relatively insignificant in the first quarter—should have turned out rather better than a year earlier. The supply of livestock products, especially milk and milk products, probably also went up in the Community.

Although the increase in industrial production compared with the previous quarter did not become any more rapid, it nevertheless remained quite considerable. According to the adjusted index of the Statistical Office of the European Communities, industrial production (excluding construction, food, beverages and tobacco) went up by about 1.5 % from the fourth quarter of 1965 to the first quarter of 1966; the unadjusted index for the months of January, February and March was on the average 5 % up on the same period of 1965.

Once again expansion was most rapid in the consumer goods and durables industries, although no more so than in previous months. In particular, output of passenger and estate cars again showed a marked upward trend; as in the last months of 1965, its year-to-year growth rate in the first quarter was 15 %. The textile industry increased its output by 10 % compared with the same period of last year.

Production of capital goods in the Community in the first quarter reflected not only the hesitant trend of demand for plant and equipment in the Federal Republic of Germany but also a more pronounced recovery in France (chiefly in electrical engineering) and in Italy (chiefly in mechanical engineering).

In the basic materials industries, the advance in output was again relatively weak. The increase in building activity did of course give a fairly powerful stimulus to the production of building materials, but the growth of production in the chemical industry, which had previously been very vigorous, became slightly slower. Iron and steel output was lower in the first few months of 1966 than in the same period of 1965, although there was a temporary improvement in the flow of new orders. In the first quarter of 1966 the coal mines produced 7 % less than in the same period of 1965.

In the services sector, development particularly in branches connected with consumption contributed to the increase in the Community's internal supply.

In the first quarter the number of persons in paid employment in the Community as a whole should prove to have been a little higher than in previous months. Only in France did the upsurge of economic activity—which was at first shown in considerable advances in productivity and more hours worked, as is at present still the case in Italy—lead to an increase in the numbers employed in the first few months of 1966 compared with the previous quarter. In the other member countries there was little if any change.

Nor has the number of unemployed, adjusted for seasonal and fortuitous factors, shown any perceptible change on the whole. In the Federal Republic of Germany, it did not fall any further—which was in any case hardly possible, given the extremely low level of unemployment in that country. In the Netherlands, however, after some slight indications that the labour market situation was easing during the course of last year, there were no further signs of an increase in the unemployment figure—which was also quite low in that country. In Italy the decline in unemployment was halted in January 1966, largely because of the low level of activity in the construction sector; subsequently, however, the trend appears to have become somewhat more favourable. In France, too, there was temporarily, in the spring, a further slight increase in the num-

ber of persons seeking employment. These tendencies persisted in Belgium—partly, however, because of underlying, not structural, difficulties—but without there having been any really substantial easing of the labour market.

3. The balance of the markets

Imports of goods and services from non-member countries, which had expanded particularly vigorously towards the end of 1965, partly as a result of transient speculative factors, appear nevertheless to have risen fairly rapidly again in the first quarter of 1966 and the spring months. Customs returns show that the value of visible imports in the first quarter went up by no less than 13.5 %, compared with the same period of 1965 when they were hampered by certain special factors.

The increase in imports into the Community was mainly due to the brisk underlying expansion of demand for imports in France and Italy. This largely made up not only for the slower growth rate of German imports but also—once the wave of speculative purchases had spent itself—for a temporary weakening of imports into the Belgo-Luxembourg Economic Union.

From the incomplete figures at present available, there does not appear to have been any significant change in the trend compared with previous months, either as regards the relative proportion of various classes of goods imported or as regards their origin. Thus the continued brisk rise in demand for finished goods again did much to stimulate purchases from industrialized non-member countries. Above all, the recovery in imports from the United Kingdom, which began during the fourth quarter of 1965, was maintained in the beginning of 1966 and became considerably more pronounced. In addition, however, the Community's imports from the United States increased again substantially, partly owing to continued replenishment of stocks of raw materials in some member countries. Moreover, this latter factor—intensified by a rise in imports of agricultural products—made for further increases in purchases from the developing countries.

Visible trade between the member countries, which had been rising particularly briskly in the last few months of 1965, continued to expand, although slightly more slowly. Customs returns show that imports in the first quarter were 16.5 % higher in value than in the same period of 1965.

The upward trend in intra-Community trade, which was further encouraged by the fresh reduction in internal tariffs which took place on 1 January 1966, primarily reflected the powerful increase in demand in France and Italy. In the first quarter, France's imports from the other member countries went up by 18 % in value, compared with the same period of 1965, and Italy's by 19.5 %. In spite of the slacker trend in economic activity in the Federal Republic of Germany, its purchases from other member countries remained high in the first quarter. In the Benelux countries, on the other hand, where certain imports had been brought forward to the last few months of 1965,

imports from other member countries slowed down perceptibly, although only temporarily, in the first quarter of 1966.

The swift expansion of demand from France and Italy enabled the Federal Republic of Germany to continue to increase its exports to the rest of the Community quite rapidly. At the same time, however, France's deliveries went up considerably, especially those to Italy and the Federal Republic of Germany. In the first quarter they were 20 % higher in value than in the same period of 1965. On the other hand, exports from Italy and the Belgo-Luxembourg Economic Union to other member countries showed a perceptibly slower rate of growth, and deliveries from the Netherlands to the other EEC countries were even slightly below the figure for the first quarter of 1965; this was, however, also partly the result of special factors, such as the cessation of certain armaments exports and the effects of foot-and-mouth disease.

Visible imports from non-member countries

(% change in values on preceding year)

Imports from	1965		1965				1966
	million u.a. (¹)	%	1st quar- ter	2nd quar- ter	3rd quar- ter	4th quar- ter	1st quar- ter
All non-member countries	28 562	+ 6.5	+ 0.5	+ 3	+ 11.5	+ 10.5	+ 13.5
of which :							
Industrial countries (²)	16 216	+ 5	- 2	+ 3.5	+ 8.5	+ 9.5	+ 15
including :							
United States	5 687	+ 4.5	- 8	+ 8	+ 9	+ 9.5	+ 20
EFTA	6 893	+ 4.5	+ 4	+ 1	+ 6.5	+ 7.5	+ 9
United Kingdom	2 605	+ 1	- 1.5	- 5.5	+ 1.5	+ 9	+ 9.5
Developing countries (³)	10 522	+ 7	+ 3.5	+ 1	+ 14	+ 10	+ 10
including :							
Associated overseas countries and territories	2 046	+ 0.5	- 4	- 3.5	+ 0.5	+ 4.5	+ 9.5
Central and South America	2 615	+ 6	0	- 0.5	+ 23	+ 4.5	+ 4.5
Others (⁴)	1 824	+ 18	+ 9	+ 13	+ 22.5	+ 25.5	+ 24.5

Source : Statistical Office of the European Communities.

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

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

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

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

The movements in intra-Community trade outlined above were reflected, firstly, in a continuing tendency for Italy's trade balance with the other member countries to deteriorate. Secondly, the Netherlands deficit, which had already increased towards the end of 1965, remained considerable, and the surplus of the Belgo-Luxembourg Economic Union was slightly reduced. In contrast to this, the Federal Republic of Germany maintained the improvement in its foreign trade position vis-à-vis the other member countries. France's balance of trade with the rest of the Community showed no appreciable change.

In the Community as a whole the upward movement of prices continued unabated. In France and Italy it was still moderate, but in the other member countries it remained rapid—and in some countries even became more so.

In the Benelux countries and the Federal Republic of Germany, prices for crop products, particularly vegetables and potatoes, which had risen sharply towards the end of 1965, remained very high until into the spring; the seasonal tendency for these prices to fall had but little effect. Pigmeat, however, generally became somewhat cheaper. Only in France and Belgium did beef become dearer than usual for the time of year; in the other member countries the price remained high but still more or less stable.

In France and Italy the prices of finished industrial goods rose only slightly. In spite of higher prices for imported raw materials, the trend in unit costs had no significant effect in raising prices in these countries. For one thing, substantial advances were made in productivity, whereas wage increases tended to remain moderate, owing to the after-effects of the previous slowdown in economic activity; secondly, the pressure of supply in relation to demand was substantial, because sufficient capacities were still available and competition remained keen. In the other member countries, however, there were again marked increases in the prices of finished industrial goods; this was perhaps slightly slower than before in the Federal Republic of Germany, but more rapid in the Netherlands and Belgium. The increase in these two countries was due not only to the effects of higher indirect taxes but also to the strong pressure of demand—particularly in the consumption sector—and to further substantial increases in wage costs per unit of production.

The prices of services continued to rise sharply throughout the Community—and thus also in France and Italy, although this tendency was perhaps less marked there than in the other member countries. In the Federal Republic of Germany, the Netherlands and France, controlled and recently decontrolled rents were raised considerably; furthermore, all member countries put up their charges for public utilities, which were running more and more at a loss owing to higher costs.

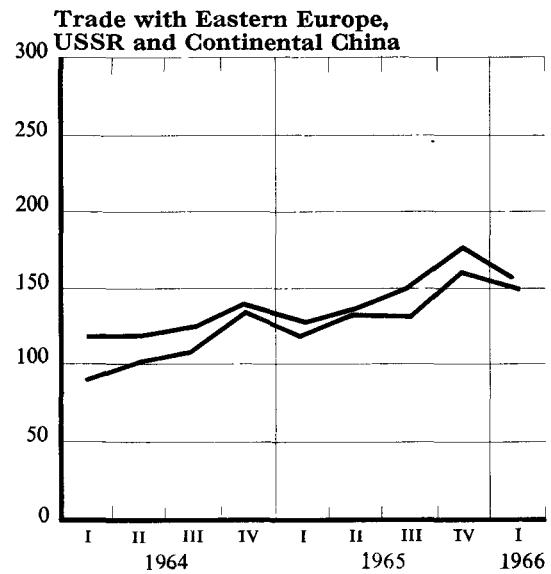
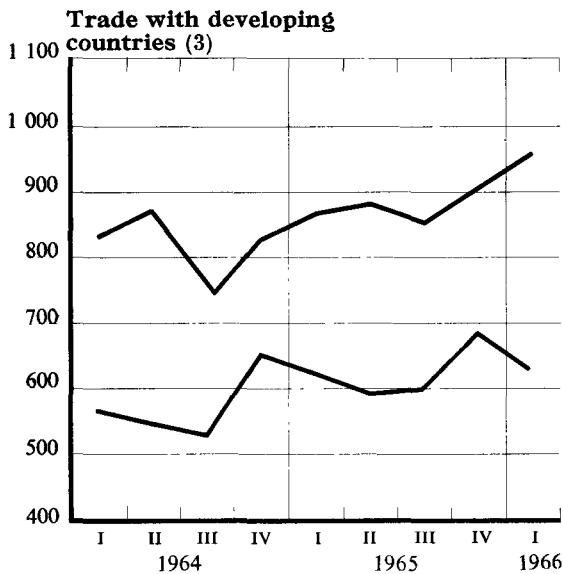
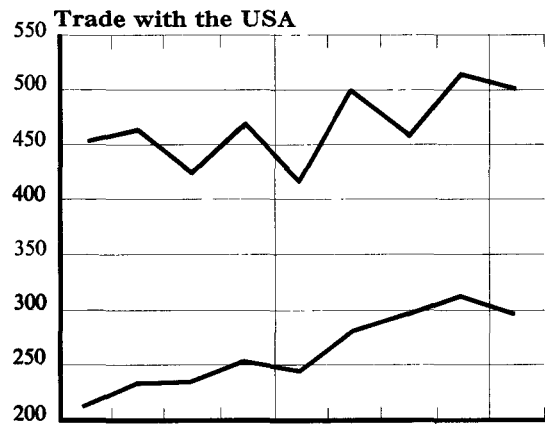
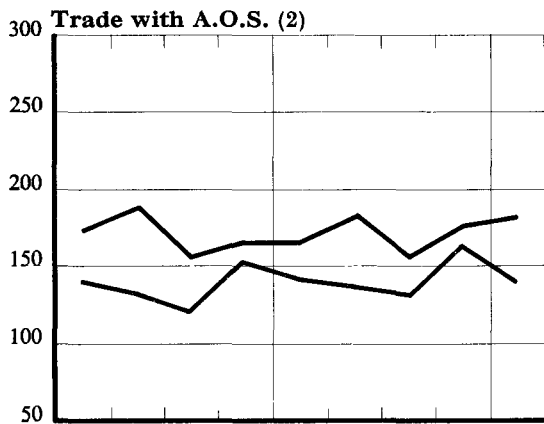
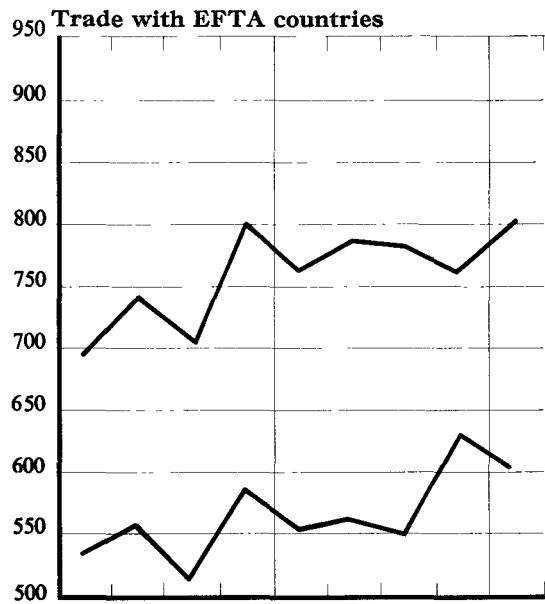
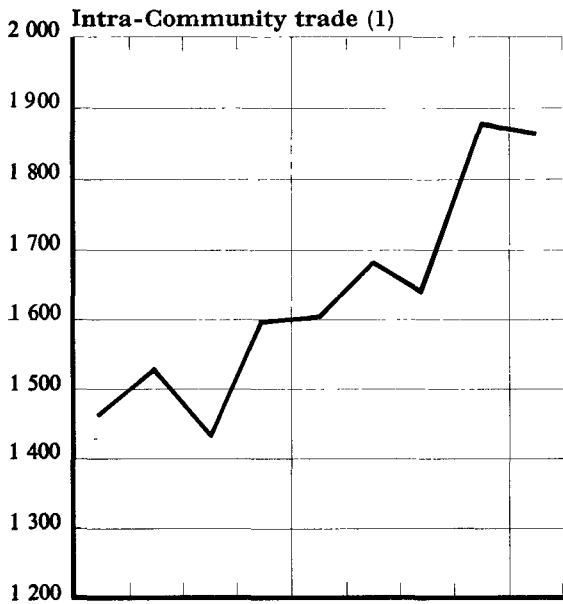
The increases in national cost-of-living or retail price indices in April 1966, compared with a year before, were as follows : 7.4 % in the Netherlands, 5.5 % in Belgium, 4.5 % in the Federal Republic of Germany, 3 % in Luxembourg, 2.8 % in France, and 2.4 % in Italy.

As imports rose more rapidly than exports, the Community's balance of visible trade with non-member countries deteriorated considerably. According to customs returns (fob-cif), the deficit in the first quarter of 1966 was 772 million u.a.—more than

COMMUNITY TRADE

Monthly averages

In million u. a. *



— Exports

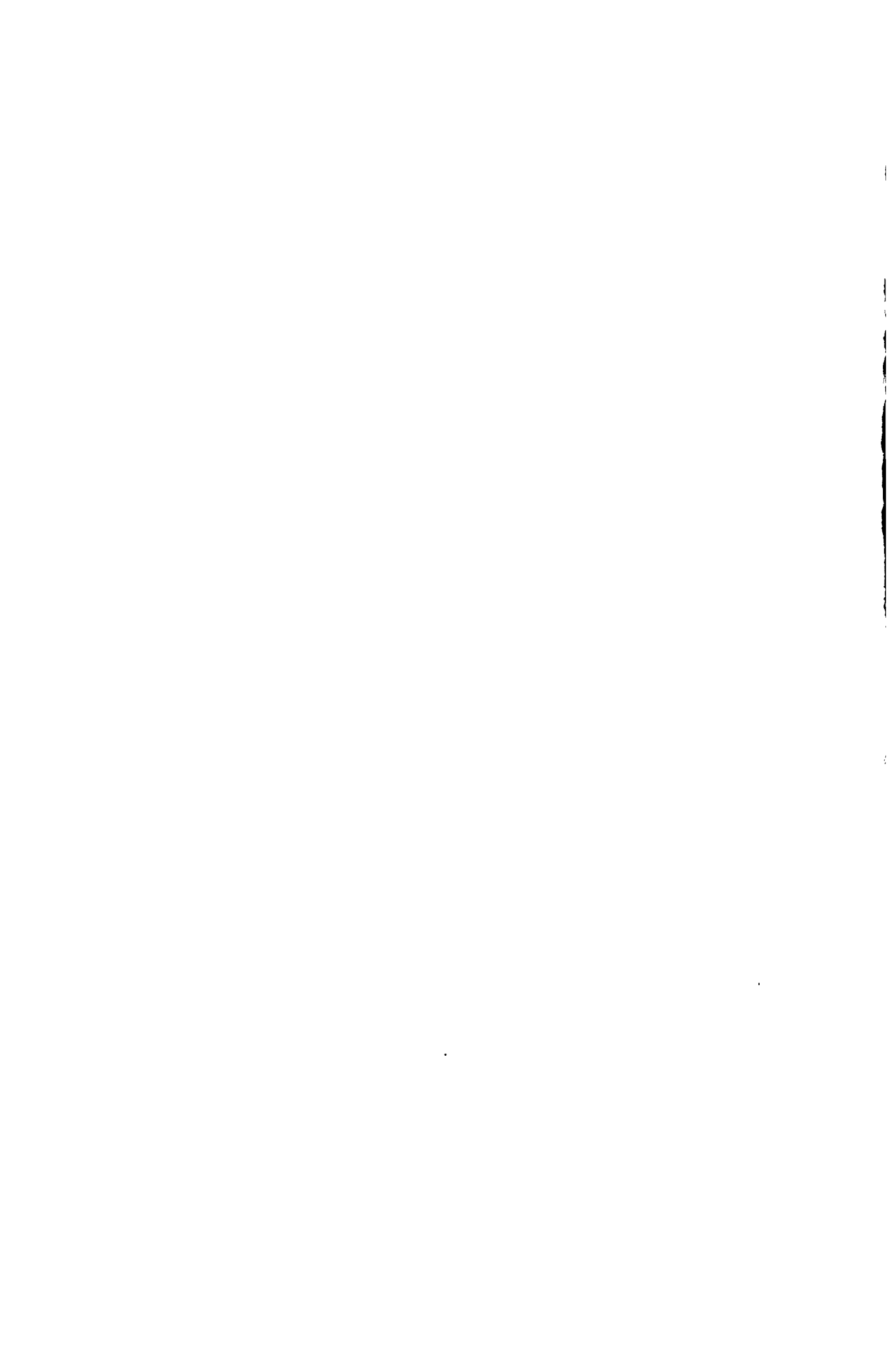
— Imports

(1) According to import returns.

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

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

* 1 unit of account = 0.888671 gramme of fine gold.



twice as much as in the same period of the previous year. The full current account (not seasonally adjusted) may therefore also have shown a deficit. As net inflows of capital—particularly short-term funds—were certainly less heavy in the first quarter than in previous months, the overall balance of payments will probably show a deficit.

In any case, the member countries' official reserves of gold and foreign currency (gross) fell by 426 million u.a. between the end of 1965 and the end of April 1966, but this was partly because the net foreign exchange position of the banks, which had worsened perceptibly, improved at the end of the year owing to the "window dressing" usual at that time—and also because of the payments made in connection with the raising of International Monetary Fund quotas.

In the first quarter and also, as far as can yet be ascertained, in the few months that followed, the balance of payments did less to increase internal liquidities, and in a few countries it sometimes helped to reduce them considerably. On the other hand, bank lending to business and private customers expanded more rapidly in most member countries. This was the case in the Benelux countries, where extensive purchases had been made before the end of 1965 in anticipation of higher taxes and it was therefore expected that the increase in lending would become more moderate in the first few months of this year. The demand for loans also rose more rapidly than in the previous quarter in the Federal Republic of Germany, and in France it continued very brisk. Only in Italy was the increase in short-term lending still moderate.

The cash transactions of the public authorities largely had the effect of reducing internal liquidity—following the seasonal pattern of receipts and disbursements. In the Federal Republic of Germany, the Bund even achieved a substantially larger cash surplus in the first three months of 1966 than in the same period of last year; but in this connection it must be borne in mind that the Federal Budget for 1966 was only passed by the Parliament at the end of May this year, and that the Bund's disbursements in the comparable period of 1965 had been unusually high. In France, the Treasury used its surplus funds to purchase a fair number of the bills for interim financing of building projects held by the Bank of France. In Italy, owing to seasonal factors, Treasury transactions also helped to reduce bank liquidity. In Belgium, however, Treasury transactions—but especially transactions involving changes in indebtedness—again did much to increase liquidity. Tax revenue in that country has, of course, also risen considerably, which is enough by itself to strain bank liquidity. However, in view of the rapid turnover of public funds and the fact that the State is not only greatly indebted to the Central Bank but also more or less directly to the banks, the latter's liquidity was scarcely affected by this.

Finally, demand for notes and coin increased in several member countries. On the whole, therefore, the strains on money markets became more acute. In Belgium and the Netherlands, particularly, interest rates rose perceptibly, while in the Federal Republic of Germany the situation remained very strained. In France there was still no fundamental change in the monetary trend but here, too, the money market has already tightened perceptibly.

The monetary authorities either pursued the same monetary and credit policy as before or else, as in the Benelux countries, reintroduced or tightened their restrictions. In Belgium the banks were asked to limit the increase in lending in 1966 to 12 % of the level reached at the end of 1965, and to do this as selectively as possible, i.e. to come down most heavily on loans for purposes of consumption and stock-building. In three member countries Bank rate was raised in May or June : in the Netherlands from 4.5 % to 5 %, in the Federal Republic of Germany from 4 % to 5 %, and in Belgium from 4.75 % to 5.25 %.

In bond markets the general trend was still towards higher interest rates. Only in Italy did the tendency for interest rates to fall persist at first; in that country, sales of bonds were again chiefly sustained by large purchases by the banks, but towards the end of the period under review interest rates were again tending to rise slightly, for the first time for two years. In France there appears to have been some decline in the appeal of long-term investments for private savers. The appreciable decrease in new issues compared with a year ago would also seem to suggest that this was so. In the Federal Republic of Germany there were further falls in share prices and turnovers; only in May was some stabilization attained. In that country, activity on subsidiary capital markets did indeed increase during the first quarter; in particular, substantially more loans by private treaty were taken up than in the same period of 1965. In the Netherlands, where the public authorities made greater demands on the fixed-interest market in order to obtain funds, there was also a considerable rise in interest rates. In Belgium, in the case of the second State Loan issued in May, the terms of issue had to be slightly altered in favour of the subscriber.

On the stock markets, the trend of turnovers and prices was generally relatively weak. This was partly due to the tightening of bank liquidity and to a substantial falling-off in American purchases, which had previously been fairly high; in addition, the prospects for profit were in many cases considered to be not very good, in view of the persistence of the strong upward movement in wages. The prices of the shares of companies in branches with structural difficulties also depressed the price level. Lastly, the fall in prices on the New York stock market, which occurred after an excessively strong speculative increase, had psychological effects on the trend in share prices in several member countries.

B. Outlook

Economic activity in the Community in the remaining months of 1966 can be expected to receive a fairly powerful stimulus from internal demand, but demand from abroad should also increase perceptibly.

In the last Quarterly Survey it was expected that exports of goods and services to non-member countries would expand somewhat more than was thought at the end of 1965. The latest information supports this view. It now seems likely that visible exports for the full year 1966 will increase by about 9-10 % in value—only a little less than last year.

There should again be a very substantial rise in United States' imports from the Community. Partly because of the effects of the Vietnam conflict and perhaps also partly because all the appropriate measures to counteract inflationary pressures at home have not yet been taken, all the essential components of domestic demand in money terms should continue to expand quite rapidly in the next few months. For example it appears inevitable that public expenditure—particularly on defence—will be considerably higher than the budget estimates for 1966. As to fixed investment by enterprises, the latest business surveys point to a more rapid increase in capital investment in the next few months, even if delivery difficulties, higher prices in the capital goods industries and the President's appeals for moderation have some effect in slowing down the execution of investment plans. (The McGraw-Hill survey carried out in March revealed that industrialists were intending to increase their investment in fixed assets by 18.6 % in 1966 compared with 1965 when the actual increase was 15.7 %). Under the circumstances, the disposable incomes of households, and therefore also their expenditure on consumption, will also certainly continue to rise sharply unless new restrictive fiscal measures are immediately adopted.

In certain sectors, however, private consumers' expenditure has recently been showing signs of slackening. This is true in particular of car purchases; as, moreover, the retailers and the industry had been overestimating sales potential for some time, the relatively large stocks held by retailers also led to a reduction in the number of orders received by car manufacturers, and production was temporarily slowed down. It is, however, assumed that this is a development peculiar to the sector concerned, that it will probably not last long, and that it will in any case not become so pronounced as to slow down overall economic activity to any significant extent.

Domestic supply will probably become less elastic because, in spite of the continuing investment boom, it is unlikely that the increase in production capacities will keep pace with the rise in overall demand in money terms this year, since reserves of utilizable, sufficiently mobile manpower have shrunk considerably. The underlying upward movement in prices and the vigorous expansion of imports, particularly of industrial goods, can therefore be expected to continue.

In 1966 the economic trend in the United Kingdom will be less affected by new fiscal measures than was generally supposed before the Chancellor of the Exchequer made his Budget speech. The Budget for 1966/67 contains no new increases in the tra-

ditional taxes on incomes and consumption, which would certainly have accentuated the present slackening in the growth of domestic demand in money terms. Instead, a selective employment tax is to be introduced in September, which will encourage the transfer of workers from certain services sectors to the manufacturing industries. This measure will certainly produce results in 1966, especially where prices are concerned, but these may, however, be partly offset by other factors : on the one hand, there will be the deflationary effect of the new tax and, on the other, the sectors concerned are almost certain to try to pass the tax on, since there is in fact very little they can do to absorb this increase in costs by raising productivity.

Much more significant for the development of the Community's exports in the second half of 1966 would, however, seem to be the British Government's decision to abolish the import surcharge at the end of November without replacing it by any other restrictions on imports. In these circumstances, the United Kingdom's demand for imports of finished and semi-finished goods is likely to be held back considerably in the next few months.

There have recently been no significant changes in the prospects for economic growth in the other important industrial countries. Their purchases from the Community can therefore be expected to continue to rise fairly briskly on the whole but, compared with previous months, the increase may be somewhat less rapid.

With regard to the developing countries, the forecasts made in the last Quarterly Survey can also be maintained. The tendencies so far discernible on the world markets for raw materials suggest that these countries' earnings of foreign currency will continue to increase quite considerably and that—as their currency reserves have been rising steadily since the end of 1964—their imports of finished goods will soon begin to pick up again.

The underlying growth of internal demand in the Community should continue, and may perhaps become slightly more rapid in the second half of 1966 than in the first.

Thus, taking an overall view, there would seem to be a distinct possibility that gross fixed asset formation will increase slightly faster. In France and Italy there are in any case appreciable inducements for enterprises to step up their investment in plant and equipment and in construction. The results of the EEC investment survey point to a considerable increase in expenditure on these kinds of investment (especially in Italy, where the decline had it is true been most marked). In the Netherlands the increase in enterprises' expenditure on investment appears to be becoming only slightly slower. The generally powerful upward movement will hardly be completely offset by the continued appreciable slackening in the growth of investment expenditure in the Federal Republic of Germany during the same period which seems likely in view of the trend in new orders in the capital goods industries, for example.

Public capital expenditure will continue to rise briskly in all member countries, especially France and the Belgo-Luxembourg Economic Union—although financing difficulties may limit its expansion in the latter countries. Local authorities in the Netherlands are also likely to encounter difficulties as regards financing, but government expenditure in that country will continue to rise sharply—unless the recent decisions to check

it already have an effect this year, which is improbable. Lastly, public investment in the Federal Republic of Germany is continuing to expand, although more slowly than before.

In addition, the prospects for housing construction in the Community seem to have again become more favourable to expansion. The slight tendency for housing construction to slacken in France may persist at first, but in the Federal Republic of Germany and, to a lesser extent, in Belgium, the number of building permits issued for housing has again been showing a definite increase in the last few months; this should have some effect, although perhaps not its full effect, on the trend in expenditure in the second half of 1966. In the Netherlands, expenditure on new housing will continue to rise, but at a rate that has become somewhat slower. Lastly, there are signs that the decline in actual expenditure on housing construction in Italy has passed its lowest point and that a recovery may now set in.

Expenditure on consumption should continue to rise appreciably in the next few months. If the present policy is continued, public current expenditure will go up even more rapidly, but partly for seasonal or semi-seasonal reasons. Above all, however, there will again be a vigorous increase in private households' expenditure on consumption, even if the tendency towards a decline in the propensity to save, which was apparent in the first few months of the year, should not continue.

In all probability, disposable household incomes will continue to rise steeply. In the Federal Republic of Germany the rate at which the incomes of most wage-earners are rising, which became somewhat slower during the first half of the year, is not likely to show any change, and in Belgium the recent very brisk increase may even become somewhat more moderate because of the effects that the new price freeze will have on the sliding wage scales. In the Netherlands, on the other hand, the acute strains on the labour market make it very unlikely that the advance in actual earnings will turn out to be substantially less rapid than last year—in spite of the 7 % limit on pay rises. In France and Italy, the total wage and salary bill has already begun to rise more rapidly, owing to a further lengthening of working hours, an increase in the numbers employed, and the fact that the basic hourly wage is tending to go up somewhat faster because of the trend in economic activity, which is now once again expansionary. In most member countries transfer incomes should go up rather less than in the same period of 1965; they will, however, generally rise at least as fast as wages and salaries. Lastly, the profits drawn from their businesses by entrepreneurs in Italy and France will be larger than before.

In view of these prospects for the development of overall demand, internal supply in the Community should continue to expand fairly rapidly, and in some member countries possibly even slightly faster than before.

Industrial production in the Community as a whole may possibly rise by an average of 1.5 % per quarter, the increase being more rapid in France and Italy and slower in the Federal Republic of Germany. For the most part, advances in production will certainly be accompanied by advances in productivity per worker, although some increase in the number of persons employed in industry and the services sector can be expected in Italy and France.

Trends on labour markets are not likely to show any significant changes: there will be a further slight easing in the Federal Republic of Germany, and possibly also in Belgium and the Netherlands, but pronounced overemployment will persist in all these countries and in Luxembourg to a greater or lesser degree; in France, slight strains may possibly recur in certain areas and sectors; in Italy unemployment—which is still comparatively high—will fall slightly.

In view of the growing demand for raw materials and the more rapid increase in purchases of plant, equipment and consumer goods in several member countries, the Community's imports from non-member countries should continue to rise at least as fast as they have since the end of 1965. As, at the same time, the growth of exports may again become slightly slower in the course of the year, the Community's balance of trade—and therefore its current account—will certainly continue to show a tendency to deteriorate, which will be more pronounced in some countries than in others.

In the Community as a whole, the rise in prices may turn out to be somewhat less steep than recently; this would, however, be mainly the result of special factors: owing to bad weather in 1965 and its effects on the prices of potatoes, vegetables and fruit, the weather in the next few months will be of considerable importance; normal harvests; and still more good ones, may be influential in keeping food prices down. Moreover, the direct effect of the higher taxes on consumption in Belgium and the Netherlands is for the most part already to be seen in prices. In addition, measures to freeze prices have been introduced in those two countries, and these should at least outwardly slow down the upward movement of prices. Lastly, no increases in charges for public utilities as great as those in the first quarter are to be expected in the coming months.

On the other hand, the forces that push prices up and are inherent in the economic situation are not likely to weaken very much in the remaining months of this year, in view of the combination of expanding demand with continuing cost increases. Only in France and Italy should the rise in prices remain moderate, but a slight quickening in those two countries cannot be ruled out.

In view of the actual development of the economy since the beginning of the year, and the prospects outlined above, no important modifications need to be made in the last Quarterly Survey's quantitative forecasts for the changes in the real Community product and expenditure for the full year 1966: the real gross Community product is still expected to increase by 4.5 % from 1965 to 1966. Industrial production in the Community (as defined for the index of the Statistical Office of the European Communities, i.e. excluding construction, food, beverages and tobacco) should rise by 6-6.5 %.

On the expenditure side, private consumption now seems likely to go up by about 8 % from 1965 to 1966. With a probable increase of 3.5 % in consumer prices (in terms of national accounting), the increase in real private consumption would be 4.5 %, which is also in line with the previous estimate.

The first forecasts for the development of the economy in 1967, which are still inevitably very tentative, suggest that in the coming year expansion in the Community, taken as a whole, will continue at a fairly brisk pace, even if exports to non-member countries were to expand noticeably less vigorously than from 1965 to 1966.

Community product and expenditure

	1963 ⁽¹⁾	1964		1965 ⁽³⁾		1966 ⁽⁴⁾
	At current prices (in '000 million u.a. ⁽⁶⁾)	% change on preceding year ⁽²⁾				
		Volume	Value	Volume	Value	Volume
Gross Community product	249.9	+ 5.7	+ 10.1	+ 3.9	+ 7.6	+ 4.5
Private consumption	153.0	+ 4.5	+ 8.3	+ 4.3	+ 7.7	+ 4.5
Public current expenditure	37.2	+ 2.3	+ 8.6	+ 4.2	+ 10.2	+ 3.5
Gross fixed asset formation	57.1	+ 8.4	+ 12.6	+ 3.2	+ 5.8	+ 4.5
Balance exports ⁽⁵⁾ less imports ⁽⁵⁾ (in '000 million u.a. current prices)	+ 0.6		+ 1.4		+ 2.8	+ 2.4

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

⁽²⁾ Community aggregates based on official exchange parities.

⁽³⁾ Commission estimates.

⁽⁴⁾ Commission forecasts.

⁽⁵⁾ Goods, services and factor income.

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

Note :

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

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

In view of the effects that events in south-east Asia may have both on the American economy and on the world economy, the prospects for the development of demand from abroad in 1967 are particularly uncertain.

However, as far as the probable development of the United States' economy is concerned, it would certainly be prudent to assume that expansion will slow down. It is in fact not very likely that the continuing upsurge in industrial investment—which will perhaps be intensified in 1966—will also be maintained at the same pace in 1967. In coming months strain on the money and credit markets could well increase. In addition, anti-inflationary fiscal measures are certainly to be expected after the autumn elections, and these would be sure to have a considerable effect on investment and private consumption. Nevertheless the increase in private consumers' expenditure may still be substantial, although less vigorous than in 1966, because experience has shown that in this type of economic situation the savings ratio in the United States tends to fall. Public

current expenditure should continue to rise, but very probably not at the same rapid rate as from 1965 to 1966.

In the event of a solution to the Vietnam conflict, a drastic reduction in military expenditure could however lead—theoretically—to the risk of a recession. But there can hardly be any doubt but that the Administration would immediately introduce an effective programme to keep business moving. Even then, however, the increase in domestic demand and in production would slow down.

All in all, there are thus many reasons for expecting some slackening in the growth of United States' imports—which is at present very rapid.

In 1967 the economic situation in the United Kingdom will certainly not be such as to exert any powerful stimulus on world trade. In any case, the balance of payments situation does not allow of any great expansion of domestic demand or of imports, especially if the need to repay foreign debts is taken into account. The relative weakness of industrial investment, which is reflected in the present trend in orders for plant and equipment, should in fact act as a brake. On the other hand, in 1967 the deflationary effect of the new selective employment tax will be weakened by the allowances that will then be paid to the manufacturing and particularly to the exporting industries, because the amount received by these enterprises will be more than they had previously paid in tax. This will not only encourage exports but also—relatively—the growth of domestic demand. Public expenditure will also certainly continue to increase quite vigorously. Lastly, the abolition in the import surcharge on finished and semi-finished goods at the end of November 1966 will stimulate imports to some extent. On the whole, therefore, the United Kingdom's purchases from the Community may expand rather more from 1966 to 1967 than from 1965 to 1966.

The forces likely to be released by the development of the economy in the other EFTA countries will probably not provide any particularly strong stimulus to the Community's exports in 1967. In 1966 domestic demand is still rising too rapidly in most of these countries, and in some of them this is reflected in a worsening of their balance of payments. In practically all these countries measures to restrain demand have therefore been taken or are contemplated, and the effects of these should still be felt in 1967. The same will probably also be true of Canada, while in Japan, on the other hand, the current revival in economic activity may continue.

In contrast to this, the prospects for the Community's sales to the developing countries in 1967 appear to be extremely good. The currency reserves of most of these countries have already risen appreciably since the end of 1964; the result will certainly be a widening of import arrangements, particularly in 1967. In addition, the possibilities for financing have been enhanced by the recent raising of International Monetary Fund quotas. In the circumstances, the developing countries' imports can be expected to show a fairly marked increase from 1966 to 1967—even if world market prices for industrial raw materials were to be depressed as a result of the Vietnam conflict being brought to an end.

While, on the whole, the increase from 1966 to 1967 in external demand for goods and services from the Community may turn out to be somewhat less than from 1965 to

1966, the prospects for the growth of internal demand are, on the other hand, quite good. In France and Italy, the more rapid rise in industrial investment should continue in 1967 and have a perceptible multiplier effect on total domestic demand. In the Federal Republic of Germany, the slackening in the growth of investment demand and, to a lesser extent, in public and private expenditure on consumption will certainly come to an end; it is all the more probable that the growth of domestic demand in money terms will become stronger in the course of the year because it seems likely that investment will revive as a result of the more rapid upswing in exports, the improvement in the balance of payments, and the efforts taken to rationalize enterprises in view of the persistent labour shortage, and also because the relative restraint exercised in public expenditure in 1966 seems likely to be undermined by expansionary tendencies in 1967.

Owing to the influence of the buoyant business situation in the other member countries, the expansion of overall demand in the Belgo-Luxembourg Economic Union should hardly be much less than in 1966. Only in the Netherlands, where overall demand has been rising particularly vigorously in the last few years, is the pace likely to slacken somewhat. However, the prospects for these member countries are particularly uncertain; to a great extent their development will depend on the type of stabilization policy they adopt—as it now seems they must, in view of the grave situation as regards prices and costs and—in the Netherlands—also in view of the trend in the balance of payments.

In view of these prospects for demand, and the fact that it should be feasible to increase output, the Commission now thinks it possible that the real gross Community product will rise by about 4.5 % from 1966 to 1967.

It also follows from what has been said above that in most of the member countries it will be difficult to slow down the upward movement of prices and costs very much in 1967; this may even become more pronounced in member countries like Italy and France where there are large or fairly large reserves of production factors.

It may also be supposed that the brisk growth of imports from non-member countries will continue in 1967 and may perhaps become even stronger, in which case the Community's balance of current payments is likely to go on deteriorating.

* * *

The dangers that these forecasts reveal were dealt with very forcefully by the Commission in the last Quarterly Survey, and there is no need to go into the details again: the danger of a chain reaction in the Community, a cost-price spiral; the danger of general inflation followed by serious tendencies towards recession.

At the present time, four member countries—the Netherlands, Belgium, the Federal Republic of Germany and Luxembourg—are either still in the inflationary grip of excessive demand or else in the transitional stage between excessive demand and cost inflation, which is the inevitable consequence of the demand inflation that was not combated with sufficient force before and was even sometimes aggravated by the public authorities' attitude. These member countries, it should be noted, did not follow the Council's recommendations on stabilization closely enough or long enough, particularly as

regards their budget policy. The German Federal Government has, to be sure, successfully made efforts in this direction in its budget policy for 1966—but only after the effects of the restrictive credit policy had become evident; in Belgium and the Netherlands, however, the trend in overall budget policy has remained much too expansionary, and monetary and credit policy also have not done enough to further the aim of stabilization.

In the last two countries, increases in prices and costs—the effects of which are already apparent in their current accounts—have now become so alarming that the authorities have been obliged to introduce emergency measures: a price freeze in Belgium and the Netherlands, and a national ceiling on increases in negotiated wage rates in the Netherlands. At the same time, Italy and France are experiencing an upsurge of economic activity which will certainly continue for quite a long time to come, with the danger of new strains in prices and costs unless the expansion of demand, both as a whole and in its main components, is regulated very carefully.

As the economies of the Community countries are so closely interwoven, it will hardly be possible, in the above circumstances, for the tendencies towards stabilization in the Federal Republic of Germany to develop sufficiently—in any case, they are weak and are still threatened by excessive public spending and an over-rapid increase in expenditure on consumption; on the contrary, there is a possibility that the growth of domestic demand in money terms may start to pick up again too soon.

The trends in saving in almost all member countries are worth mentioning—not only in this connection but also where the longer-term prospects are concerned—but they give little cause for satisfaction.

In all member countries except France, public saving (i.e. the surplus of current public revenue over current public expenditure which is available for financing public investment) has in fact either decreased considerably in the last few years or else, as in Belgium, has dwindled to the vanishing point. Similarly, in all member countries saving by enterprises (i.e. profits not withdrawn from businesses) has either risen relatively little in the last few years or else has actually decreased although prices have in general risen more or less substantially.

In contrast to this, saving by private households has indeed sometimes risen vigorously—both in absolute terms and also in relation to total disposable income—but in many cases this increase was not sufficient to offset the decline in saving in the other sectors. Given the relatively rapid shift in income distribution in the last few years in favour of those whose savings ratio is still very low, this would in any case not have been possible.

The imbalance between supply and demand for capital, caused by the decline in saving by enterprises and by public authorities and the fact that this has not been fully offset by an increase in saving by private households is the main reason for the rise in interest rates in the member countries. In fact, financial requirements have not developed in line with the available resources obtained from saving; in some member countries capital expenditure by the public authorities is even showing a tendency to increase more rapidly.

The situation has lately become more serious because the savings ratio of private households has stopped rising, and in some member countries—certainly in the Federal Republic of Germany and probably also in other member countries—it has even begun to fall. In Italy and France cyclical and special factors may have contributed to this—e.g. renewed confidence in the upswing of economic activity or relaxation of the pressure exerted by urgent housing needs; in the other member countries it is possible that the increase in prices has meanwhile passed the psychological point beyond which saving in nominal terms falls off sharply—perhaps more sharply than saving in material assets rises. The possibility of such a reaction occurring cannot be ruled out in countries where the year-to-year increase in prices is greater than the usual rate of interest on savings deposits—as in the Netherlands, Belgium and the Federal Republic of Germany. Saving in fixed-interest securities, where interest rates have since reached extremely high levels in certain member countries—is not so widespread that it could offset the unfavourable trend in savings deposits. Moreover, the risk of fixed-interest security prices falling is a deterrent to investors.

The dangers in such a development, should it continue, are obvious: persistent tendencies towards an excessive increase in consumption; ever greater difficulties in financing investment—the increase in which can certainly not be regarded as being generally too great in most member countries; attempts by enterprises to obtain funds for investment by raising their prices—which can be done up to a point, at least at consumer level, under the circumstances outlined above; the permanent danger of funds being created for financing—for example, by excessive increases in borrowing or by imports of capital—which have an immediate inflationary effect, at least in a situation of full employment. Moreover, this last danger exists not only where enterprises but also public authorities are concerned: utilization of relatively short-term loans from the banks or even from the Central Bank; placing of long-term issues with the banks, which finance them by means of short-term deposits or receive direct or indirect aid for this purpose from the Central Bank.

From this list of danger points and comparison of them with recent happenings, it is clear that we are already in the middle of the danger area in some respects. Short-term economic policy ought to react accordingly; changes must be made in the policy that has been pursued hitherto.

In many ways, present economic policy does not correspond, or not sufficiently closely, to what is required in the short term; the main need is to avoid the dangers mentioned above, to stabilize prices and unit costs, and to achieve a satisfactory level of balanced economic growth under these conditions, particularly vis-à-vis the outside world.

The information at present available on the budgets for 1966 and the cash position up to the present time show that this applies above all to the public authorities' financial policy. In the Federal Republic of Germany, the Bund's expenditure should, it is true, rise by only about 4 % (over 1965 when its actual expenditure was, however, exceptionally high), while the tightness of the capital market should make it impossible for the local authorities to continue to increase their expenditure unduly; but, on the other hand, the budgetary expenditure of the Länder seems to be showing a tendency to rise considerably

more than that of the Bund. In the Netherlands, owing to the raising of indirect taxes and the charges of public undertaking, the net impact of the public authorities' overall budget operations will in fact prove less strong than last year; nevertheless it still tends to be much too powerful, in view of the fact that, for the State alone, the increase in expenditure is estimated at 11 % in the draft budget for 1966 but in fact will probably turn out to be appreciably higher. In Belgium, too, the expansionary effect of the national budget will be mitigated by higher indirect taxes and charges of public undertakings which came into effect at the beginning of the year. But the influence of the latter will only be relative, because in that country the increase in expenditure, which is becoming even more rapid, is again causing a considerable deficit on the State's current transactions and, in addition, it is planned to spend more on investment, which would tend to produce a particularly large deficit in the overall budget.

In France and Italy, it is not at present necessary to take general financial measures in order to maintain economic equilibrium; the need may, however, arise sooner than was previously supposed. The French national budget, which was balanced in 1965, will no doubt remain approximately in balance in 1966; but this result will probably only be attributable to higher revenues produced by a more rapid increase in the nominal gross national product than had been expected. The question arises whether it would not be better, instead of using the additional revenue immediately to finance additional expenditure, to try to counteract the cyclical trend to some extent, at least towards the end of the year and in 1967 when the increase in demand will begin to exert considerable pressure on resources. In Italy, the much enlarged deficit of the public authorities is to a great extent being financed by monetary or quasi-monetary measures—to say nothing of the fact that a great deal too much of the increase in public expenditure is for items which directly or indirectly promote consumption. Such a policy could quite soon lead to the development of new strains, as the upswing in economic activity is gathering momentum.

It is not only in Italy that part of the deficit is being financed by monetary measures; this is also happening in Belgium and to a much less extent—in the Netherlands and the Federal Republic of Germany.

Current monetary and credit policy seems to be much better suited to the needs of the present economic situation in the various member countries than is their budget policy. In the Federal Republic of Germany it has, quite rightly, remained definitely restrictive. In Belgium, the monetary authorities have recently reintroduced quantitative restrictions on the expansion of bank advances; in the Netherlands, similar restrictions have been maintained. In addition, Bank rate has been raised in these three countries. In the Netherlands, especially, the development of the overall payments balance has recently had a restrictive effect on internal liquidity.

In France, the growing demand for liquidity from industry and private persons in recent months has led to strains on the money market, which have mainly been alleviated by changes in the minimum reserve ratio. If this demand continues to show a powerful increase as the upswing of economic activity becomes stronger, the question may arise whether the monetary authorities can continue to make abundant liquidities available while still pursuing the objective of economic stability. In Italy no such phenomenon

has yet become apparent; in spite of the liquidity of the money market, short-term lending by banks has shown only a moderate increase, because the economy clearly has abundant liquid resources available as a result of continuing payments surpluses with abroad and the monetary financing practised by the public authorities. The banks have put a considerable part of their short-term liquid funds into bonds issued by public authorities. This may perhaps lead to difficulties and necessitate further aid from the Central Bank, should the increase in lending to businesses and private customers become more rapid—as it no doubt will, sooner or later, since the level of economic activity is already quite high. This situation calls for extreme vigilance as regards monetary and credit policy.

As regards incomes policy, little progress has been made of late, except in a few member countries where for the first time high-level discussions have been held with the two sides of industry to consider lines of development for the various categories of income, some of these discussions being based on forecasts for economic development in the short term. It would be an exaggeration to say that these talks have already had a decisive influence by helping to achieve a more balanced development of the economy.

As mentioned above, direct action has recently been taken in Belgium and the Netherlands to reinforce price policy, in view of the alarming rates of increase shown in the annual indices of consumer prices and, in Belgium, their effect on sliding wage scales; this takes the form of a price freeze introduced at first for a limited period. All price increases must be notified and authorized; authorization is granted only in exceptional cases, e.g. in the Netherlands when increases are justified by external factors such as higher prices for imports of raw materials. In the Netherlands, as a counterpart to this restrictive price policy, a limit has been imposed—also only for a fixed period—on wage increases for 1966 compared with 1965; the limit has been set at 7 % which, in view of the “wage drift”, must be regarded as high. (With the present tightness of the labour market, “wage drift” and the increase in the numbers employed may cause the total bill for wages and salaries to rise by a further 5 %).

When price-freezing measures were introduced in France as part of the stabilization programme of September 1963, the Commission expressed the view that such measures can be a useful expedient in the short term, inasmuch as they are able to produce a calmer psychological atmosphere and check speculative tendencies. If they are applied for a longer period, they will be ineffective unless they are combined with a serious attempt to combat excessive demand; or else—if this is done and the price freeze can therefore become really effective—there is the danger that the adverse effect on industrial investment, and therefore on the prospects for economic growth, may be too great, unless at the same time corresponding controls are also imposed on wages. In addition, there are the general disadvantages which follow from such an extensive disruption of the market mechanism, particularly distortions in the distribution of the factors of production.

However, at that time, the price freeze in France was accompanied by further vigorous action to combat excessive demand, particularly by instruments of public financial policy. At present it appears urgently necessary that similar action should be taken in the Netherlands and Belgium. The governments of both countries have indeed expressed their intention to limit the increase in public expenditure. The Belgian Government does not, however, appear to be intending to go even so far as to wipe out

the deficit in the ordinary national budget this year. The Netherlands Government is planning, *inter alia*, to avoid any increase in the number of persons employed by the State, and—where possible—to spread the execution of certain national investment programmes over a longer period; in addition, it intends to exert greater pressure on local authorities' investment.

Nevertheless, it would seem to be advisable in those two countries, as also in Luxembourg and the Federal Republic of Germany, to fix definite quantitative targets, in the second half of 1966 and for 1967, for a reduction of the expansionary effects of public budgets. The first aim for such a policy should be to achieve a specified percentage reduction, compared with the actual budget realization in the corresponding period of the previous year, in the deficits of the State, on the one hand, and of all the subordinate authorities taken together, on the other. (In the Federal Republic of Germany this would have to be done at three levels: Bund, Länder and local authorities). Such a recommendation, depending on the percentage reduction specified, might in the Federal Republic of Germany primarily concern the budgets of the Länder—which would, moreover, seem to be particularly appropriate. In the other member countries mentioned in this connection, the efforts required would of necessity have to be greater and would have to be made at all levels.

Implementation of a policy of this kind might begin by restricting the increase in expenditure. Subsequently it should mainly concern public current expenditure and income transfers. If, however, political or economic priorities make it impossible or undesirable to slow down the increase in expenditure sufficiently, it would be necessary to take steps to bring about a corresponding increase in current revenue. In that case care would also have to be taken to see that the measures adopted affected the expansion of consumption as much as possible and not industrial investment.

It would also be important for Belgium, the Netherlands, Luxembourg and the Federal Republic of Germany strictly to avoid financing parts of their public expenditure in a way that would increase liquidity—i.e. they should not have the Central Bank or other banks cover part of their deficit if bank loans to the public authorities (or bank purchases of securities from the public authorities) are not offset by a corresponding increase in long-term deposits.

In the Federal Republic of Germany credit policy should continue to follow its present course at least until labour markets and the trends in wages, salaries, consumption and prices have begun to ease sufficiently.

In Belgium and the Netherlands all necessary steps should be taken to keep the increase in lending within the prescribed limits; should prices nevertheless continue to rise at the present rate, it would perhaps be necessary to consider an even more stringent reduction in the permitted increase in lending. In view of the present balance of payments trends, there is at present no need to fear, in any of the countries mentioned, that inflows of foreign capital will become so large as to frustrate an internal stabilization policy of the kind that has just been described.

In Italy and France where, owing to the revival in investment, economic expansion has now become quite rapid and should increasingly assume a more general character,

all the instruments of trade-cycle policy should be brought into play in order to keep expansion balanced—i.e. to maintain, or even improve, price stability and, to this end, to avoid above all any excessive increase in public and private expenditure on consumption.

In France, it would be desirable at least to avoid a budget deficit in 1966 and to achieve a certain surplus in 1967—in so far as this may be necessary to offset the effects of a rapid expansion of the other components of demand. In Italy, it would be desirable gradually to reduce the very large Treasury deficit. In particular, such a policy would mean that in both countries a limit would have to be set on the growth of public expenditure; this should mainly be directed at expenditure on consumption and transfers of income, as there is still a need to increase public investment and transfers of public capital. In Italy, moreover, the amount of the deficit financed by monetary means should be progressively reduced, and the aim should be to depend exclusively on private domestic saving in 1967.

In France and Italy, credit policy should certainly not be such as to jeopardize the revival of economic expansion, but this does not mean that it should allow an excessively rapid increase in bank lending.

In the interests of economic growth, this short-term economic policy should be supplemented by an effective incomes policy—for the more incomes policy is directly instrumental in stabilizing costs, the less will purely short-term policy measures necessarily affect the expansion of production. In France and Italy, an incomes policy might even distinctly encourage growth. The authorities should therefore make fresh efforts to promote understanding and co-operation between the two sides of industry in order to ensure that incomes develop in a way that is more in keeping with short-term economic policy requirements.

In the member countries which show signs of inflation and are affected in varying degree by cyclical overemployment—that is, in all except France and Italy—it might in the present circumstances be possible to adopt simple pragmatic methods, which would not necessarily be based on any particular ideas concerning the proper distribution of the fruits of economic growth among the various income groups, but would simply be designed, as an emergency measure, to bring about an immediate and general reduction of the excessive rise in incomes. For example, the two sides of industry might agree that the increase in the principal categories of income should be reduced by a certain percentage in the second half of 1966 and in 1967 compared with the previous year—starting out from the actual increase in 1965 over 1964.

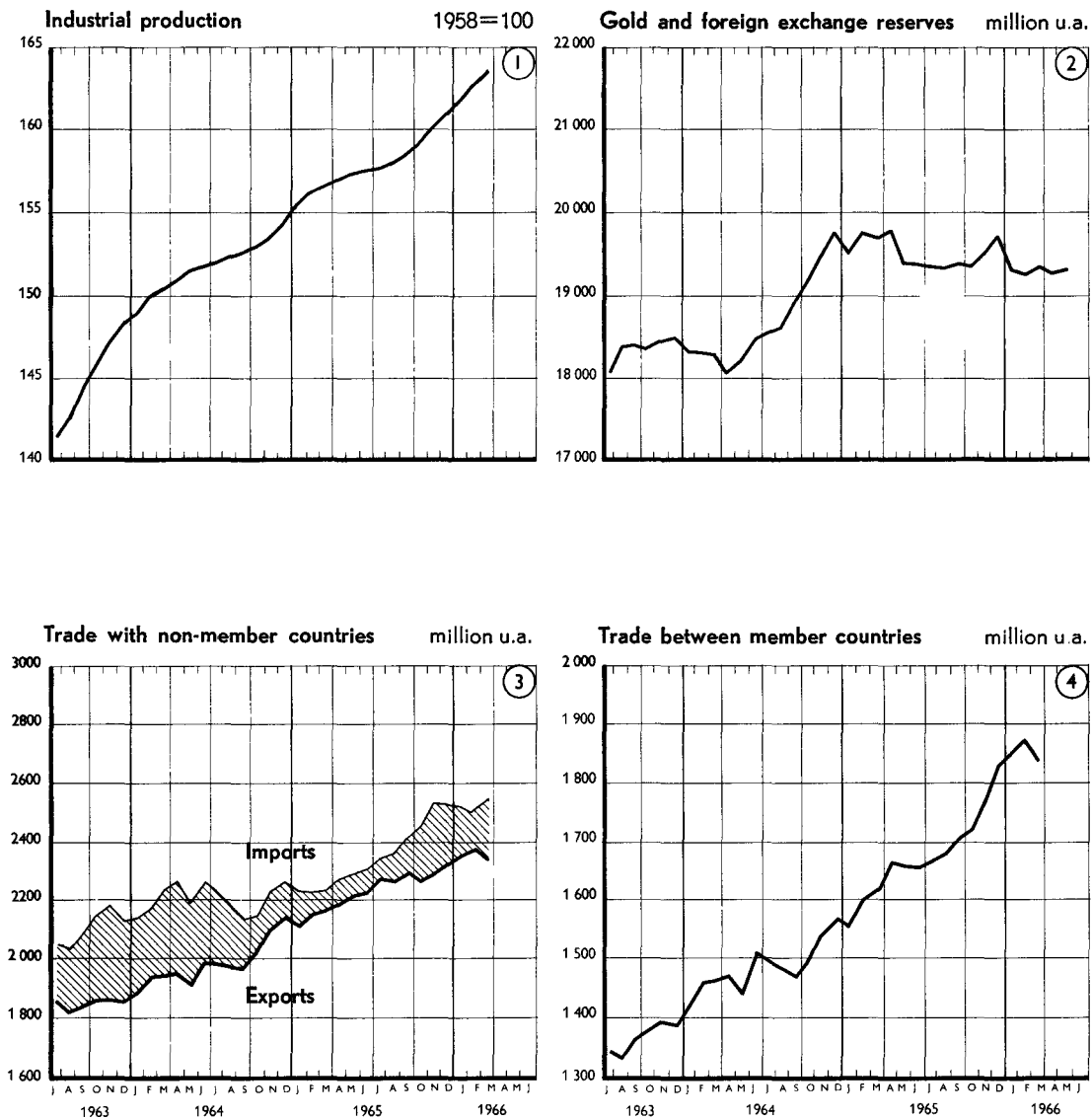
In France and Italy, on the other hand, it should be possible to reach an immediate agreement to bring the percentage increase in the total wage and salary bill (including social security contributions) down to the percentage increase in the volume of production during the same period. Even then, the present advances in productivity and those expected in 1967—which will probably again be quite substantial—would still allow of a considerable increase in wages and improvement in purchasing power; at the same time, however, the saving of enterprises, which declined greatly in the period 1963-65, might return to its normal level and thus permit a satisfactory development of the investments that are so important for the continuation of economic expansion.

From what has just been said, and from what was said earlier, it follows that it would be very desirable to encourage saving by private households, in view of the great demand for funds on the part of the public authorities and of enterprises. This applies particularly to member countries where the propensity to save has recently been showing signs of declining or where, as in Italy, it is relatively low owing to structural factors or changes in the distribution of income. In this connection, it is important that national measures should be taken to encourage saving among the lower and middle income groups, particularly by providing tax incentives and bonuses; but it is also essential that the present shortage of savings in relation to the demand for capital should be reflected in the price (i.e. in the interest rate) in general, and therefore also in that of ordinary savings deposits. The national measures advocated above in order to encourage saving must, however, be carried out in a way that is compatible with the objectives of stabilization policy. With regard to saving by enterprises (the profits and therefore the possibilities of self-financing for the investments of many enterprises) it is worth considering whether the price freeze for industrial products, which was originally introduced as a short-term measure but has now been in force for almost three years, should not be relaxed more rapidly. It is unlikely that the level of prices would rise substantially as a result, provided that an economic policy appropriate to the present situation, such as that outlined above, were applied in other fields; it is more likely that there would be shifts within the price level.

It should also be remembered that there are other ways of combating price increases effectively by means of customs policy—especially in intra-Community trade; these would be particularly appropriate in view of the differences in the general business trend between the various Community countries. Since, moreover, it has been decided that customs frontiers within the Community will shortly be abolished altogether, it is really hard to see why governments who are concerned over price increases do not make more use of this possibility.

The Commission intends to make concrete proposals to the Council for the short-term economic policy outlined above. It must also be pointed out, however, that there are many structural factors that push prices up—such as restraint of competition, delay in modernizing the distribution system, and the situation in the energy sector. A relatively short-term economic policy cannot, by its very nature, be expected to counteract these factors; the fact that too little has so far been done to combat them by means of longer-term economic policy measures makes the task of short-term economic policy, and in particular of stabilization policy, very much heavier. Unfortunately measures are still frequently taken which serve rather to strengthen the structural forces that push prices up—e.g. measures to keep production capacities too high in the coalmines. It is to be hoped that a solution to these problems may be found through the co-ordination of medium-term economic policy in the Community.

ECONOMIC INDICATORS



NOTES:

Source: Statistical Office of the European Communities.

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

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

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

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

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

TABLE 1: Basic data (1964)

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

TABLE 2: Development of basic economic data

	% change by volume on preceding year							Volume indices (1958 = 100)	Contri- bution (in %) to 1964 GNP
	1959	1960	1961	1962	1963	1964	1965		
Gross Community product	5.2	7.8	5.4	5.5	4.2	5.7	3.9	144	—
Industrial production	6.3	11.9	6.9	5.8	5.2	7.1	4.4	158	—
Visible imports	5.1	20.5	6.0	11.3	10.2	6.9	5.0	185	—
Private consumers' expenditure	3.7	6.3	6.3	6.4	5.7	4.5	4.3	144	60
Gross fixed asset formation	8.2	10.7	10.2	6.8	4.9	8.4	3.2	165	23
Visible exports	12.5	11.1	3.0	1.0	3.8	9.3	11.0	164	—
Intra-Community visible trade	24.2	22.0	15.0	13.9	16.0	13.2	12.2	292	—
Gross product per capita	4.2	6.9	4.4	4.3	3.0	4.6	2.7	134	—

TABLE 3 : Basic monthly indicators

	Year	Jan.	Feb.	Mar.	Apr.	May	June	July	Aug.	Sept.	Oct.	Nov.	Dec.
Industrial production (1958 = 100)	1964	147	152	156	156	159	155	143	121	154	159	164	157
	1965	154	159	157	163	164	164	147	123	162	167	171	166
	1966	161	166	170	173								
Imports from non-member countries (cif, million u.a.)	1964	2 238	2 168	2 237	2 381	2 192	2 320	2 254	1 886	2 085	2 270	2 238	2 460
	1965	2 243	2 090	2 422	2 368	2 380	2 352	2 404	2 156	2 386	2 443	2 558	2 754
	1966	2 516	2 367	2 782									
Exports to non-member countries (fob, million u.a.)	1964	1 891	1 878	1 959	2 038	1 866	2 036	2 053	1 731	2 030	2 252	2 113	2 291
	1965	1 940	2 064	2 414	2 172	2 249	2 192	2 343	1 997	2 289	2 380	2 367	2 649
	1966	2 153	2 179	2 567									
Balance of trade (million u.a.)	1964	- 397	- 308	- 278	- 342	- 326	- 288	- 201	- 155	- 55	- 18	- 125	- 169
	1965	- 307	- 22	- 8	- 196	- 131	- 160	- 56	- 159	- 97	- 63	- 191	- 105
	1966	- 363	- 188	- 215									
Intra-Community trade (million u.a.)	1964	1 436	1 452	1 496	1 577	1 415	1 576	1 532	1 243	1 512	1 654	1 510	1 623
	1965	1 442	1 573	1 801	1 680	1 661	1 691	1 735	1 437	1 734	1 871	1 812	1 933
	1966	1 654	1 790	2 087									

NOTES

Source : Statistical Office of the European Communities.

Table 1

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

Table 2

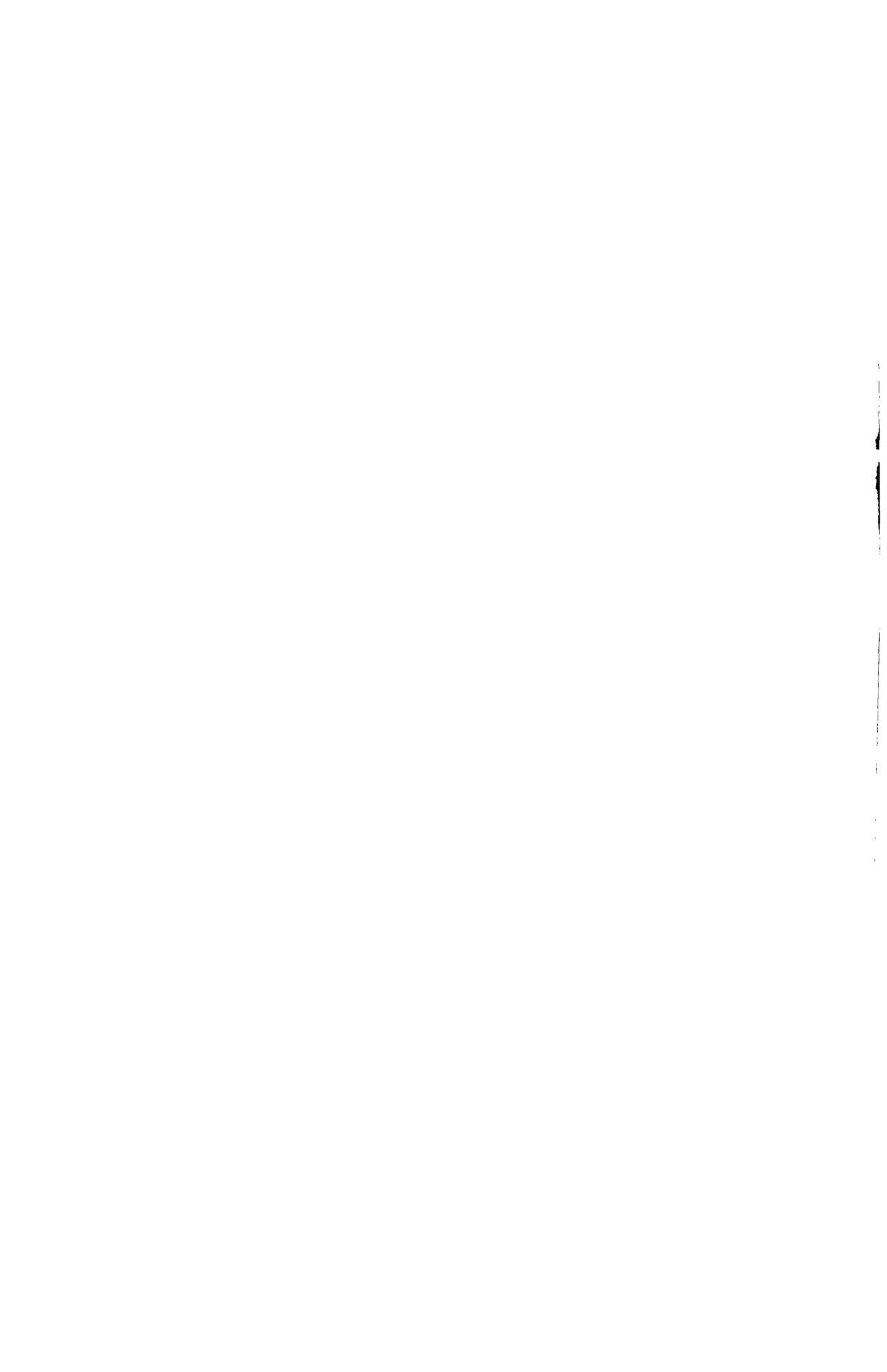
- The final column of the table gives a % breakdown of GNP at market prices by main categories of expenditure. The calculation of the Community's GNP has been made on the basis of official rates of exchange.
- Industrial production: index of the Statistical Office of the European Communities, excluding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

Table 3

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



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



A. Federal Republic of Germany

The main feature of the economic situation in the first quarter and in the succeeding months of spring was a more marked trend towards an easing-off in the domestic market. The economy of the Federal Republic is in fact going through a phase of slower expansion in demand and production.

The most noticeable symptom of this development in the first quarter was a further decline in the growth of domestic monetary demand; in particular, there was an appreciable slowing-down in the tempo of gross fixed asset formation. But private consumer demand—which was already at a very high level—tended to increase somewhat less briskly than before. On the other hand, there was a further marked increase in demand from abroad.

The trends in overall demand and in the various sectors of demand, together with the continued upsurge in imports, was reflected in a marked flattening-off in the rate of growth of production. This was the case with industrial production, at least, which—according to the Federal Statistical Office's Index of production per working day—was only 2.8 % higher, on the average, during the first four months of 1966 than in the same period of the previous year. There was actually a decline in the output of the capital goods industries, while the consumer goods industries showed a further marked increase in output.

Nevertheless, there was no general relaxation of pressure on the labour market, although there was some small sign of easing, particularly in the trend of the figures for unfilled vacancies.

There was a further marked upward movement in prices, and it was only in those sectors in which the underlying slackening of economic activity was particularly noticeable, that a certain steadying of price trends occurred. The cost of living index in March/April was no less than 4.4 % up on the corresponding period of the previous year.

The trend towards an improvement in the trade balance continued, although on a reduced scale. There was still a considerable deficit, however, in the balance of payments on current account (the deficit in the first quarter was approximately 1 000 million DM).

In the coming months up to the end of the year 1966 the overall trend of demand and production is likely to remain steady for some time. Later on, however, it seems likely that the factors making for expansion will have an increasing effect; this applies in particular to the growth of exports, the continuing expansion of consumption and—last, but not least—the further considerable increase in public expenditure. In these circumstances, it is possible that industrial production will start to expand more rapidly again.

These trends may well continue beyond the end of 1966 and set the tone for the development of the economy in the year 1967, along with a certain recovery in the growth of firms' capital expenditure which they will engender. The growth of domestic demand would then become more marked, while the growth of exports might possibly slacken to some degree. At the present time, the Commission's staff consider it possible that there may be an increase of from 4 to 4.5 % in the real gross national product for 1967 as compared with 1966.

These prospects give no definite indication of a stabilization of prices and unit costs. It must be the task of economic policy to make better use of the present phase and to promote the stabilizing forces by putting a stronger curb on the expansion of public current expenditure and private consumer demand in particular and on the upward movement of costs—and above all to ensure that these forces are not checked again in 1967 by a premature and excessive upturn in the domestic economy.

1. Recent developments

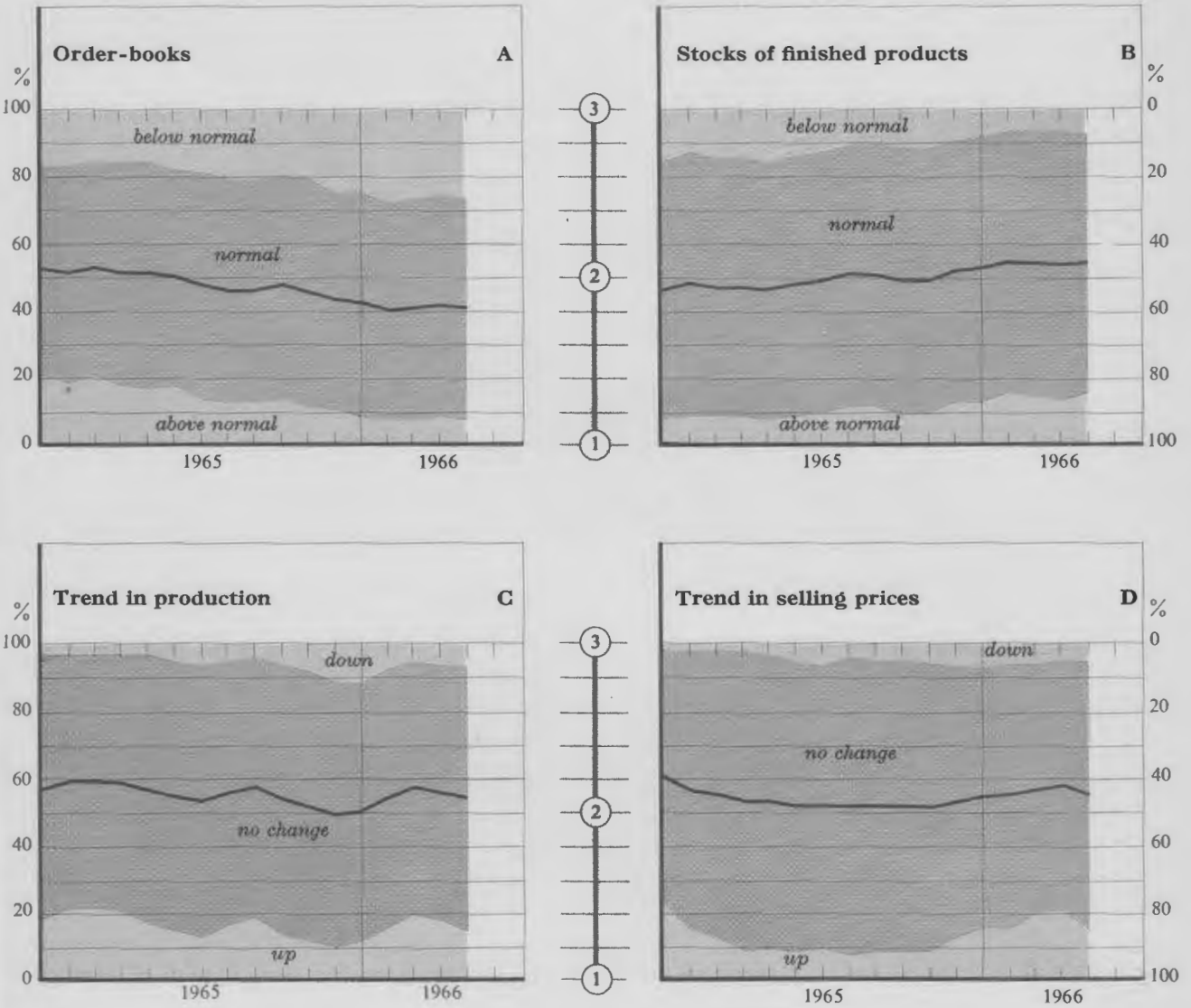
During the first quarter of 1966 and, as far as can at present be seen, during the month of April too, foreign demand was one of the main factors stimulating business activity. In fact, it seems likely that the export of goods and services, which had been following an upward trend again since the summer of 1965, showed a further appreciable increase. According to the foreign trade statistics, visible exports in the first quarter exceeded the very high level of the corresponding period in the previous year by 9 % in value and 7 % in volume. In April a year-to-year growth rate of almost 12 % (value) was achieved.

There was once again a particularly brisk increase in exports to the majority of member countries and a further rise in exports to the United States. Exports to the EFTA countries as a whole, however, continued to be sluggish.

In contrast to foreign demand, there was a further slackening in the rate of increase of domestic demand. This applied particularly to gross fixed asset formation. There was a slight decline in the rate of increase in expenditure on plant and equipment taken as a whole and a further increase in the number of industries in which investment programmes were postponed. The falling-off in investment was due in no small measure to the fact that no substantial backlog of orders had been accumulated in the capital goods industries during the previous period of expansion. Moreover, there was only a slight upward trend in building investment. The fairly high level of building investment in the first quarter by comparison with the corresponding period in the previous year was due mainly to the more favourable weather conditions and the increased production capacity of the building industry.

There have also been signs recently of a slackening in the build-up of stocks, largely as a reflection of the slower rate of increase in production. In the capital goods

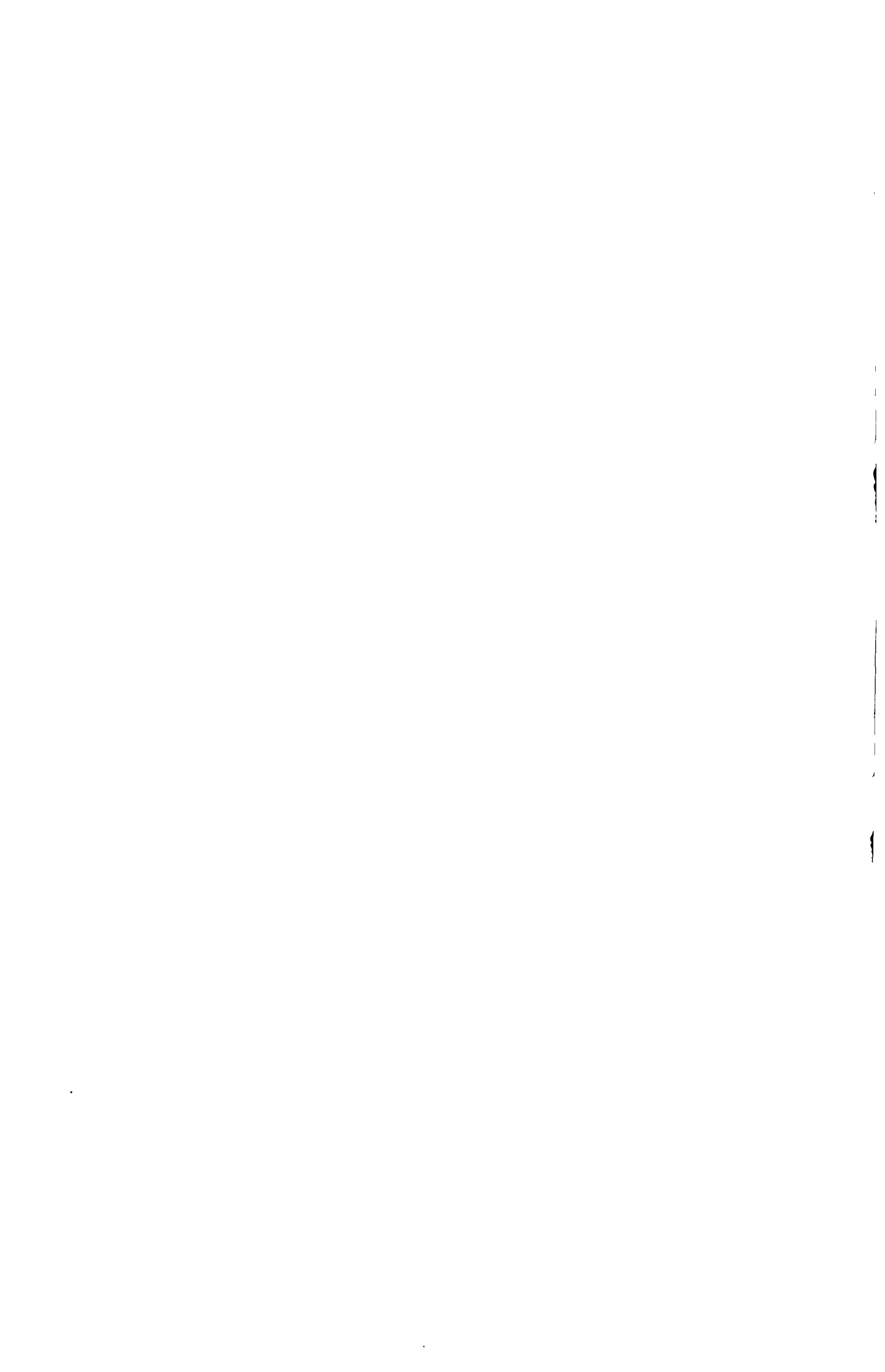
BUSINESSMEN'S VIEWS ON THE INDUSTRIAL SITUATION



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

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

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



industries there even seems to have been a deliberate running-down of stocks of finished manufactures.

Public expenditure on goods and services increased again at a somewhat slower rate. The growth in the wage and salary bill and—more especially—in defence expenditure, was noticeably less than in the first quarter of 1965.

A vigorous expansion of private consumers' expenditure again played a leading role in stimulating business activity. But here again there may have been a slight reduction in the rate of increase. Nevertheless, retail trade turnover remained at a very high level; in the first quarter it was a good 10 % up (in value) on the corresponding period of the previous year.

There seems to have been some slowing down in the rate of increase of personal incomes. At all events, the gross figure for wages and incomes in industry did not increase as sharply in the first quarter as in the last quarter of 1965. It was 8.2 % higher than in the first quarter of 1965, whereas in the previous quarter the year-to-year growth rate had been 9.6 %.

The effects of the previous year's reduction in the wage tax had largely disappeared by now, and total net wages and salaries again increased more slowly than gross wages and salaries. If we also take into account the sluggish growth of net income from business activity and property, it seems likely that there may have been a slowing-down in the rate of expansion of the total disposable income of households. This slowing-down appears to have been more marked than the expansion of private consumers' expenditure, which means that the savings ratio must have declined. Other indicators do in fact point to a decline in saving.

Domestic production responded to the easing-off of expansion of total demand by a reduction in its rate of growth and a concentration of this growth into certain sectors. This applied to industrial production in particular. In the field of capital goods production, and particularly in mechanical engineering, there was actually a fall in output, whereas production continued to expand at a higher rate in the consumer goods industries. According to the Federal Statistical Office's index of production per working day, industrial production in the first quarter was only 2.4 % up on the corresponding period in the previous year.

There was, however, no real general relaxation of pressure on the labour market. The number of persons unemployed at the end of May was about 108 000, only slightly more than at the end of May 1965. The unemployment rate (the number of unemployed as a percentage of the total number of employed and unemployed workers) was only 0.5 % at the end of May. Nevertheless, there were some signs of an easing in the situation. In particular, there was a drop in the number of vacancies for male workers reported to employment exchanges, although this figure was still several times greater than the number of unemployed. And the net increase in the number of foreign workers in employment, which had risen very sharply in the corresponding period of the previous year, was no longer quite so great in the first four to five months of this year.

There was some contrast between the trend of production and that of imports of goods and services. In the fourth quarter of 1965, imports had reacted particularly

strongly to the slowing-down in the expansion of total demand, but in the first three months of 1966 they increased vigorously again. The high rates of increase which had been observed at certain periods in the previous year were not achieved again, however. Customs returns show that visible imports increased by 8.1 % in volume and 11.2 % in value in the first quarter of 1966 by comparison with the corresponding period in 1965. As in the fourth quarter of 1965, the levelling off in commercial imports was much less than of total imports, owing to the appreciable drop in imports on Government account.

In spite of the slackening in the expansion of overall monetary demand, there was still no improvement in the domestic equilibrium during the period under review. Prices continued to rise in the consumer goods industries and related sectors; once again this was largely a reflection of demand. In those sectors where demand was declining, or where the expansion of demand was slackening off, the upward movement of wages and the increased cost of imported goods were once again the main factors militating against a stabilization of prices.

Industrial producers' prices rose once again; in April they were 2.3 % up by comparison with those of 12 months before. Food prices also continued to show an upward trend and reached a relatively high level by comparison with the previous year. Consumer prices were also influenced by a rise in decontrolled rents and by increases in the tariffs of public transport undertakings and public utilities. In April, the year-to-year increase in the cost of living index (for the average consumer group) was no less than 4.5 %.

The trend of the economy led to a continuation of the recovery in the trade balance which had set in in the autumn of the previous year. Nevertheless, this movement was not so strongly in evidence in the first quarter of 1966 owing to the relatively sharp increase in imports. The surplus in the trade balance (on the basis of customs returns) was DM 845 million, compared with a surplus of DM 604 million in the previous quarter and one of DM 1 098 million in the first quarter of 1965—i.e. before the sharp deterioration which had marked the second and third quarters of 1965.

The services balance, however, showed a substantial deficit (approximately DM 390 million), mainly owing to increased net expenditure on foreign travel and large interest payments. As there was also a very considerable deficit on unrequited payments, the current account again showed a substantial deficit (approximately DM 0.9 million) in the first quarter of 1966. Nevertheless, there was a surplus (approximately DM 200 million) on the overall balance of payments. In fact there was a substantial surplus (approximately DM 1 200 million) on capital transactions (excluding changes in the net foreign exchange position of the commercial banks, but including items which can only be listed under errors and omissions).

The surplus on the balance of payments was not reflected in the official gold and foreign exchange reserves, which actually declined by DM 1 177 million between the end of 1965 and the end of March 1966. On the other hand, the net foreign exchange position of the commercial banks improved by DM 1 390 million, largely as a result of seasonal conditions.

The balance of payments again tended to reduce the liquidity of the banks in the first quarter of 1966, if their foreign investments are taken into account. In addition, the cash transactions of the public authorities had the effect of making money tighter

than is normal at this season. Finally, the banks also had to set aside substantial sums again to meet their minimum reserve obligations, which had been temporarily reduced at the end of the previous year. Nevertheless, there was a further acceleration in the growth of advances to business and private customers, and strain on the money markets therefore increased. The banks' recourse to the financing assistance of the Bundesbank was on such a scale that the Bundesbank found it necessary to increase bank rate from 4 % to 5 % with effect from 27 May; this was also due in no small measure to the continuing pressures on the economy.

The capital market continued to be tight, especially as the capital demands of the public authorities remained at a very high level. The yield on fixed interest stocks reached 7.7 % in April; this was the result not only of "objective market data" but also of a wait-and-see policy on the part of investors.

National product and expenditure

	1963 ⁽²⁾	1964 ⁽²⁾		1965 ⁽²⁾		1966 ⁽³⁾
	At current prices (in DM '000 million)	% change on preceding year				
		Volume	Value	Volume	Value	Volume
Gross national product	377.6	+ 6.6	+ 9.6	+ 4.6	+ 8.5	+ 4
Imports ⁽¹⁾	70.0	+ 10.7	+ 11.8	+ 14.3	+ 17.5	+ 7.5
Private consumption	215.9	+ 5.3	+ 7.8	+ 6.3	+ 9.8	+ 4.5
Public current expenditure	59.2	— 0.1	+ 4.5	+ 6.4	+ 12.8	+ 2
Gross fixed asset formation	95.3	+ 11.8	+ 14.5	+ 6.5	+ 8.8	+ 3.5
Exports ⁽¹⁾	75.0	+ 9.6	+ 11.4	+ 6.6	+ 9.1	+ 9

⁽¹⁾ Goods, services and factor income.

⁽²⁾ Federal Statistical Office "Wirtschaft und Statistik", No. 3/1966.

⁽³⁾ Commission forecasts.

Note :

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

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

2. Outlook

At the present time the economic outlook for the coming months up to the end of 1966 suggests a further continuation of the existing trends, which—in some important sectors of the economy—are steady.

Admittedly, foreign demand is likely to continue to encourage expansion, possibly on an increasing scale. Evidence for this can be found both in the prospects for business in the major export markets and in the fact that the slackening of domestic demand has freed some productive capacity and this has already caused a noticeable shortening of delivery dates for export business. During the first quarter there was a marked increase, by comparison with the previous quarter, in the number of foreign orders received by industry, and particularly by the capital goods industries; the overall total was 11.6 % (in value) above that of a year ago.

Domestic demand, on the other hand, is likely to continue to expand at a moderate rate—at least until the autumn.

The main feature is likely to be a further slight fall in the rate of increase of overall expenditure on gross fixed asset formation. This is especially true for business investment. In the first quarter of 1966 home orders received by the capital goods industries, particularly mechanical engineering, fell by comparison with the previous quarter.

There is unlikely, however, to be any very marked slackening of business investment. There may be some slowing down in wage increases, and the rate of increase in productivity is likely to improve somewhat; as prices are still rising, in some cases quite considerably, overall profit margins are unlikely to fall further in the coming months; on the contrary, they may well start to improve again. Finally, it seems unlikely that there will be any further tightening of facilities for outside financing—unless new credit restrictions are introduced by the authorities.

In regard to building permits, it is also clear that there is unlikely to be any sustained drop in investment by the business sector. And while no brisk expansion in overall demand for building is to be expected—particularly as public investment in construction is scarcely likely to increase substantially again, owing to the difficulties of the local authorities and the Länder in financing their extraordinary budgets—the upward tendency seems likely to be resumed after a short interval. Evidence for this is provided by the very sharp increase in the number of building permits issued for residential construction in the first quarter.

The rate of growth of public current expenditure is likely to remain moderate by comparison with the very rapid expansion witnessed in the previous year, owing to the cautious budgetary policy of the Federal Government, although the possibility of some acceleration cannot be excluded.

Private consumers' expenditure, on the other hand, will continue to increase sharply during the rest of the year and will give a considerable fillip to the economy. But this may mark the peak of the boom in consumer goods.

The disposable income of households is again likely to increase somewhat more slowly than before, mainly owing to a certain slackening in the upward movement of salaries and wages; this in turn reflects a decline in business profit margins, poorer sales prospects and a slight easing of the overall labour shortage in industry. On the other hand, it would probably be wrong to reckon on any noticeable increase in the savings ratio in the near future.

In view of these prospects for the trend of overall demand, there is no reason to forecast any further substantial slackening of production. It is more likely that industrial production will tend to follow a somewhat clearer upward course again during the rest of the year, thanks to expanding exports and consumer demand and to the fact that there will be very little further falling-off in capital expenditure. At the same time, the contrasting trends which have become apparent in recent months—a falling off of production in certain branches of the capital goods industry coupled with a high rate of growth in consumer goods production—are unlikely to develop very much further.

Imports, on the other hand, may tend to flatten out again somewhat. Firstly because there is unlikely to be any continuation of the previous sharp growth in imports of capital goods—which was obviously due to a time lag—and secondly because the rate of increase in the import of finished manufactures, depending as it does on the trend of consumption, is likely to be somewhat less sharp. Finally, current forecasts of production are not sufficiently optimistic to bring about an increase in imports of raw materials for the purpose of building up stocks of raw materials and primary products.

It seems probable that only a more perceptible relaxation of the strains on the economy, and particularly on the labour market, would suffice to tip the scales in favour of the trend towards price stabilization. The possibility of some improvement in the price situation in the coming months cannot, of course, be ruled out; but there is unlikely to be any substantial slackening in the upward movement of consumer prices. With the flattening-off in the expansion of demand, the rise in prices will be determined largely by the continuing increase in costs and its after-effects. Wage costs per unit of production, in particular, continue to rise: the slackening in the upward trend of wages is not sufficient to bring them into line with the current increase in productivity.

On the other hand, the external equilibrium is likely to show a further improvement, as there will probably be a continuation of the trend towards a reduction in the deficit on current account.

The development of the economy so far during 1966, and the likely trends outlined above for the rest of the year give no grounds for making any substantial alteration to the quantitative forecasts contained in the last Survey (1/1966) for the results for the whole year 1966 as compared with 1965. It is only necessary to make some reduction in the rate of increase in the volume of imports and to raise it slightly in the case of exports. The forecasted increase in real GNP has been raised from 3.5 % to 4 %, but this has been done largely as a result of rounding off figures upward or downward.

Preliminary surveys of the probable economic trends in 1967 show that there is likely to be a continuation and even some acceleration of the expansion of overall demand and production in the course of the year. It seems reasonable to assume that there will again be a sharp rise in demand from abroad. This, together with the continuing growth of consumer demand, may well have an appreciable effect on business investment; experience in the Federal Republic has shown that this combination of factors, particularly if at the same time there is a temporary slackening in the rate of imports, very soon sets off a recovery in investment. This, in turn, would further stimulate consumer demand.

Obviously national economic and financial policy will play a very large part in determining whether and to what extent such a development will take place. But the basic trends of public policy in regard to expenditure are so expansionary that it can be assumed a priori that there will at least be no curbs on economic development from this quarter. And there is a limit to what can be done by financial and credit policy—even though there are certainly still some possibilities here for restricting credit expansion more effectively.

Working on these suppositions, the Commission's staff now forecast the likelihood of a real growth of from 4 to 4.5 % (increase of the GNP by volume in 1967 as compared with 1966). Some increase in the rate of imports would also be likely in these circumstances.

It is the task of economic policy to make use of the present breathing space in the development of the economy and check the upward movement of prices, which—partly as a delayed effect of the last boom—still threatens the country's economic equilibrium. This task is all the more urgent because the first signs of the next boom are already recognizable.

Official financial policy has a particularly important part to play here. It is true that the policy of the Federal Government, at least, in regard to expenditure and revenue seems to be better adjusted to the overall requirements of economic policy than in the previous year—which was, however, characterized by an exceptionally high level of expenditure. This also seems to be largely the case with the local authorities—although it is solely due to the difficulties of financing their extraordinary budgets owing to the tightness of the capital market. But the Länder as a whole will probably have to make considerable efforts if they are to succeed in bringing down their planned average increase in expenditure for 1966 as against 1965 (10 %) to a level in keeping with the state of the economy. Here again, the tightness of the capital market acts as a curb, but the Länder probably have more financial reserves and resources than the local authorities, in addition to the fact that they can still attract extra funds on the capital market.

In this connection, the increased taxation revenue arising from the relatively sharp rise in prices should under no circumstances be used to finance additional expenditure, but should be devoted to the reduction of deficits, to supplementary debt redemption or to the building up of central bank credits.

In view of the situation outlined above, and the future outlook, it will scarcely be necessary to lay further emphasis on the need for continued restraint in monetary and credit policy. Although an easing of restrictions would probably not lead inevitably to an immediate new boom in business investment, there can be little doubt that it would at once produce an acceleration in the growth of public expenditure.

In addition to restricting the growth of public expenditure, the authorities should make improvements in the structure of this expenditure. The restrictions which have been introduced so far, particularly through the "compulsion of empty coffers" mainly affect direct public investment, and have little effect on the rapidly expanding public current expenditure, income transfers and other subsidies of every kind. In a rapidly deteriorating situation of imbalance this may be a valid policy up to a certain point as

a temporary measure—provided its overall effects are adequate to reduce the overheating of the economy. But this has not been the case so far in the Federal Republic; and that is one of the main reasons why the efforts to achieve stabilization have gone on over a substantial period and will continue for some time longer. In these circumstances unless the emphasis in the restrictions is shifted away from investment and on to consumer expansion—and the differences in the extent to which capacity is utilized in the corresponding branches of industry argues in favour of this policy—economic growth will be severely distorted and obstructed.

Finally, it would be a great step forward if the efforts of the Federal Government in the field of incomes policy could be strengthened and made to yield practical results. There can be no disputing the fact that the discussions on stabilization which have been held at a regular interval with the representatives of the major groupings involved in economic affairs have had a restraining influence, in the present business situation, on the upward movement of costs and prices. The maximum use should be made of this opportunity.

In the present transitional phase of economic development, some effective progress ought to be made with the long-planned improvement and enlargement of the Government's economic armoury. The fullest support should be given to the Federal Government's efforts to extend the scope of economic policy by means of a special outline law. Recent experience indicates that expansionary trends are having an increasingly marked effect on the upward movement of prices while the slackening-off periods have become shorter. This makes it all the more necessary for those in charge of economic policy to adopt prophylactic measures, which direct the course of economic development, instead of concentrating in therapeutic measures—i.e. those which correct faulty developments.

3. The economic situation in West Berlin

The expansion of the economy of West Berlin slackened off only slightly during the first quarter of 1966 by comparison with the previous quarter, and it was still substantially greater than in the Federal Republic.

Visible exports continued to increase at an only slightly reduced rate. The year-to-year growth rate for the first quarter was 7.5 % (value). Exports to Member States, in particular, expanded at a greatly increased rate. Deliveries to the Federal Republic also increased, but somewhat more slowly.

According to the available statistics, which are incomplete, it would appear that there was only a slight falling-off from the previous extremely high rate of increase of gross fixed asset formation. This applies mainly to business investment; public investment and house building were adversely affected by the long spell of cold weather.

Private consumption increased somewhat more slowly. At all events, there was a slackening in the rate of increase of retail turnover. This may be due in part to a somewhat less rapid rise in wages and salaries.

There was no overall easing of the situation on the labour market, despite a slight fall in the number of persons employed in industry; in fact it grew more acute. By the end of April the number of unemployed had fallen to the lowest figure ever recorded for this season, and the number of industrial vacancies reported was greater than it had been a year before.

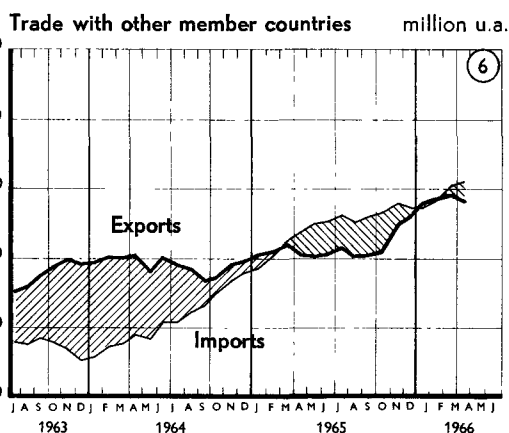
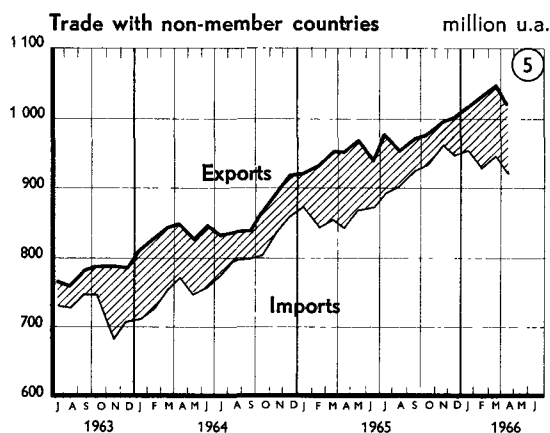
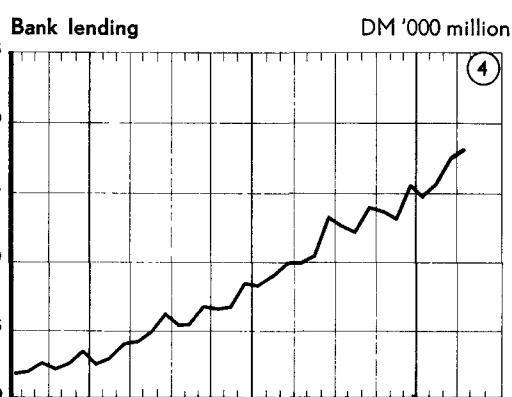
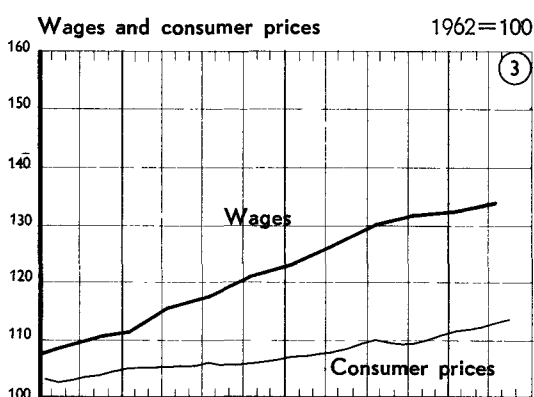
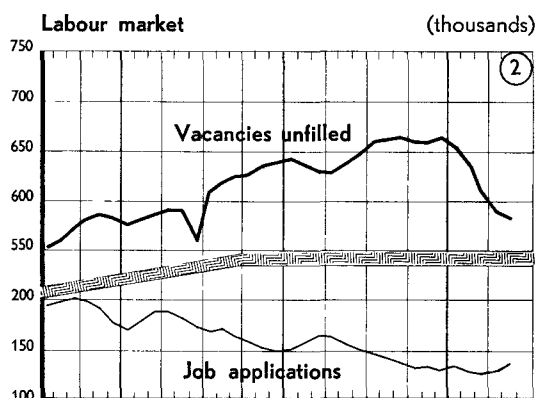
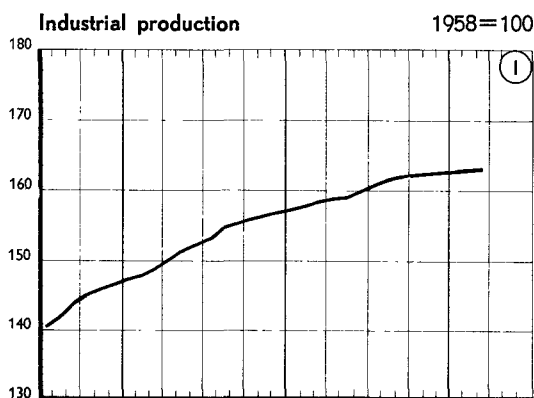
Industrial production rose much faster than in the Federal Republic during the first quarter. But the rate of expansion appears to have slowed down somewhat, due mainly to a slackening in the activities of the consumer goods industries and mechanical engineering. The overall year-to-year rate of growth in industrial production was 6 %, compared with a good 11 % in the last quarter of 1965.

The deficit in the visible trade balance with the Federal Republic fell slightly to approximately DM 35 million in the first quarter, as the increase in purchases levelled off more noticeably than the increase in deliveries to the Federal area.

There was a particularly sharp rise in consumer prices in West Berlin. In April 1966 the cost of living index was no less than 6 % higher than 12 months before.

The outlook for the coming months indicates clearly that the brisk upswing in the economy will continue. On the demand side, therefore, the way lies open for a further vigorous growth of the West Berlin economy. There has recently been a noticeable improvement in the flow of orders to industry, and order books appear to have grown fuller. But the further expansion of the West Berlin economy may be restricted to some extent by the continuance of the serious labour shortage and by certain difficulties of a structural nature.

ECONOMIC INDICATORS



NOTES:

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

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

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

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

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

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

Federal Republic of Germany

TABLE 1: Basic data (1965)

Total area ('000 sq. km.)	248.5
Total population ('000)	59 012
Density of population per sq. km.	238
Working population ('000)	27 153
Working population, breakdown by main sector (%)	
— Agriculture	10.9
— Industry	48.7
of which : Construction	8.2
— Services	40.4
Percentage share of gross domestic product	
— Agriculture	5.9
— Industry	50.9
of which: Construction	8.2
— Services	43.2
Gross product per capita (DM)	7 601

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

	% change by volume on preceding year						Volume indices (1958 = 100)	Contri- bution (in %) to 1964 GNP
	1960	1961	1962	1963	1964	1965		
Gross national product	8.8	5.4	4.2	3.3	6.6	4.6	147	—
Industrial production	10.7	6.3	4.5	2.7	8.5	5.7	157	—
Total imports	16.9	8.1	11.4	8.0	10.7	14.3	225	20.5
Private consumers' expenditure	6.9	6.8	5.9	2.9	5.3	6.3	147	56.9
Public current expenditure on goods and services	7.6	7.8	11.5	7.5	— 0.1	6.4	161	15.6
Gross fixed asset formation	11.3	9.4	5.9	2.9	11.8	6.5	178	26.5
Total exports	13.0	3.5	3.9	9.0	9.6	6.6	174	20.3
Gross national product per capita	7.7	4.0	2.8	2.2	5.3	3.2	135	—
Gross national product per person gainfully employed	7.0	4.0	3.4	3.0	6.2	3.9	139	—

Federal Republic of Germany

TABLE 3: Foreign trade (at current prices)

	% change on preceding year							Indices 1958 = 100	Million u.a.	% of the total
	1959	1960	1961	1962	1963	1964	1965			
Visible exports										
Total	11.3	16.4	11.1	4.5	10.2	10.9	10.3	208	17 892	100
Intra-EEC	13.5	23.3	19.6	20.9	20.8	8.4	6.7	262	6 306	35.2
To non-EEC countries	10.5	13.8	7.6	1.0	4.7	12.5	12.4	181	11 586	64.4
Exports of food, beverages and tobacco										
Total	11.2	9.3	4.3	7.3	16.0	20.5	25.0	238	435	2.4
Intra-EEC	13.7	10.2	1.0	8.1	23.9	22.1	22.6	254	166	0.9
To non-EEC countries	9.8	8.8	6.3	6.9	11.5	19.5	26.6	229	269	1.5
Exports of raw materials and manufactures										
Total	11.3	16.6	11.3	4.5	10.1	10.8	10.0	208	17 458	97.6
Intra-EEC	13.5	23.6	20.1	12.2	20.8	8.1	6.3	262	6 140	34.3
To non-EEC countries	10.5	13.9	7.6	0.9	4.6	12.3	12.1	180	11 338	63.3
Visible imports										
Total	15.2	19.2	8.3	12.2	6.0	12.2	19.6	237	17 472	100
Intra-EEC	29.8	22.9	13.3	16.6	8.7	17.4	30.7	351	6 660	38.1
From non-EEC countries	10.1	17.7	6.1	10.3	4.7	9.7	13.6	198	10 812	61.9
Imports of food, beverages and tobacco										
Total	15.2	4.1	7.9	20.1	- 8.3	8.3	21.6	188	3 651	20.9
Intra-EEC	25.2	13.9	15.8	15.9	- 0.0	9.3	23.0	268	1 349	7.7
From non-EEC countries	11.7	0.3	4.4	22.2	-12.2	7.8	13.1	160	2 302	13.2
Imports of raw materials and manufactures										
Total	15.1	24.6	8.4	9.9	10.7	13.3	19.0	255	13 821	79.1
Intra-EEC	31.4	26.0	12.5	16.8	11.5	19.7	31.3	381	5 311	30.4
From non-EEC countries	9.5	24.0	6.7	6.8	10.3	10.2	12.5	211	8 510	48.7

TABLE 4: Basic monthly indicators

	Year	Jan.	Feb.	Mar.	Apr.	May	June	July	Aug.	Sept.	Oct.	Nov.	Dec.	
Industrial production (1958 = 100)	1964	134	141	148	148	158	151	142	137	153	159	166	155	
	1965	150	152	152	163	163	162	147	143	161	167	171	158	
	1966	151	156	167	169	162								
Total orders received (1958 = 100)	1964	160	164	171	185	165	178	177	153	181	192	185	179	
	1965	166	173	198	190	188	182	180	164	197	200	196	188	
	1966	173	178	216	191									
of which :														
	home orders	1964	153	158	168	182	163	174	177	154	179	190	181	172
	1965	161	167	193	188	185	178	176	165	196	198	192	177	
1966	163	170	203	185										
foreign orders	1964	190	193	187	200	176	193	178	156	190	203	203	206	
1965	187	195	222	199	201	200	198	173	206	210	214	214	233	
1966	211	213	250	222										
Building: number of permits issued (DM '000 million)	1964	2.49	2.58	2.89	3.34	3.32	3.62	3.82	3.87	3.72	4.01	3.55	3.51	
	1965	2.63	2.61	3.25	3.61	4.04	3.85	4.45	4.39	4.27	4.17	3.81	3.77	
	1966	2.95	2.97	4.00	3.75									
Private consumers' expenditure: Retail turnover (1958 = 100)	1964	126	122	143	147	142	137	149	131	139	167	168	223	
	1965	134	129	154	170	156	150	167	143	155	179	195	241	
	1966	144	142	174	175									
Total visible imports (million u.a.)	1964	1 078	1 058	1 158	1 231	1 097	1 233	1 311	1 141	1 246	1 370	1 368	1 419	
	1965	1 331	1 247	1 492	1 396	1 479	1 484	1 523	1 375	1 542	1 566	1 584	1 606	
	1966	1 446	1 397	1 685	1 476	1 542								
Total visible exports (million u.a.)	1964	1 240	1 289	1 362	1 423	1 281	1 350	1 363	1 172	1 329	1 487	1 390	1 538	
	1965	1 304	1 353	1 627	1 397	1 544	1 407	1 535	1 297	1 481	1 583	1 557	1 768	
	1966	1 492	1 490	1 757	1 559	1 702								
Balance of trade (million u.a.)	1964	+ 162	+ 231	+ 204	+ 192	+ 184	+ 117	+ 57	+ 31	+ 83	+ 118	+ 22	+ 118	
	1965	+ 32	+ 106	+ 135	+ 1	+ 65	- 77	+ 26	- 77	- 62	+ 17	- 27	+ 162	
	1966	+ 46	+ 93	+ 72	+ 83	+ 160								
Official gold and foreign exchange reserves (million u.a.)	1964	7 012	7 206	7 114	6 968	6 921	7 158	7 049	7 024	7 059	7 052	6 944	6 969	
	1965	6 604	6 702	6 860	6 825	6 486	6 393	6 295	6 211	6 303	6 335	6 354	6 352	
	1966	6 190	6 139	6 150	6 072	5 975								
Money supply (DM '000 million)	1964	63.5	64.2	64.3	65.3	66.7	67.7	67.8	68.7	68.4	69.0	71.5	72.9	
	1965	69.4	70.4	70.1	71.4	73.3	74.0	74.1	74.2	74.2	75.1	77.5	78.4	
	1966	74.0	74.5	74.2	75.9									

Federal Republic of Germany

NOTES

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

Table 1

- Total population, including West Berlin. Yearly average (estimate)
- Working population in employment, including West Berlin. Yearly average. Source : Statistisches Bundesamt.
- Breakdown of gross domestic product at factor cost. (1964 figures.)

Table 2

- Source : Statistisches Bundesamt. Wirtschaft und Statistik.
- GNP in 1958 prices.
- Industrial production : value added at market prices.
- Total exports and imports : goods, services and factor income.

Table 3

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

Table 4

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

B. France

Further noticeable progress was made in the growth of the economy during the first quarter and spring of 1966.

There was practically no slackening in the powerful stimulus provided by foreign demand. In particular, exports to the other EEC countries continued to increase rapidly.

A growing stimulus to the expansion of domestic demand was provided by business investment, particularly by private industrial expenditure on buildings and equipment, which rose noticeably again. At the same time, private consumption continued to increase—again probably at a somewhat higher rate—partly because disposable incomes rose at least as fast as before and partly because there was apparently a further decline in the propensity to save.

Domestic supply continued to expand briskly. In the first quarter industrial production was 7 % up on the corresponding period in the previous year. The contribution to GNP made by the service industries, too, appears to have risen vigorously. Only in the building industry was there a noticeable slowing-down of activity, due to a certain slackening in expenditure on residential construction.

There was a further sharp increase in imports, particularly of raw materials and finished manufactures.

Thanks to this marked elasticity of supply, the upward movement of prices was relatively slight, particularly as there was practically no relaxation of price controls on manufactured goods at producer level. Largely owing to the rapid and continuous increase in the cost of services and a further—unseasonable—increase in food prices, the level of retail prices rose by 1.1 % during the first four months of the year; in April it was 2.8 % up on April 1965.

The trend towards a deterioration in the trade balance, again, was still slight. Nevertheless, the payments surplus in the first quarter is likely to have been smaller than a year ago. The official gold and foreign exchange reserves (gross) increased by only FF 554 million between the end of December 1965 and the end of March 1966, compared with an increase of FF 1042 million in the first quarter of 1965. It is possible, however, that the net foreign exchange position of the commercial banks may have improved somewhat in this period.

Everything seems to indicate that the relatively rapid expansion of the economy will continue during the remainder of 1966 and will be further consolidated by the steady upturn in investment. Private firms are likely to increase still further their expenditure on building and equipment, and thus pave the way for fuller employment, a faster rise in incomes and a steady expansion of private consumers' expenditure—particularly as the stimuli exerted by the expenditure of the whole public sector will continue to be very strong. There may also be a further vigorous increase in demand from abroad.

In view of the reserves of production capacity which are still available, we can certainly expect a further vigorous increase in domestic production. But imports, too, will increase substantially.

It is possible, however, that certain pressures may build up even before the end of 1966, which could cause a gradual increase in the upward movement of prices and a trend towards a further slight reduction in the payments surplus on current account.

A first, and obviously very tentative, forecast for 1967 indicates a continuation of economic growth, the mainspring of which is likely to be the growing momentum of capital expenditure. There may well be a very vigorous expansion of personal incomes and consumer expenditure. It would, however, be prudent to allow for a reduction in the elasticity of domestic supply. The Commission's staff at present consider that the increase in the GNP for 1967 by comparison with 1966 is likely to be about 5.5 %, implying some slowing-down in the rate of increase in the course of the year.

These forecasts suggest that it should be the task of economic policy to keep the expansion of demand sufficiently under control to prevent any overtaking of productive resources and consequent resurgence of inflationary pressures in the field of wages and prices. Particular care should be taken to ensure that official budgetary policy does not create any further stimuli of this kind; on the contrary, it should act to some degree as a counterbalance to the extent that there is an acceleration of private capital and consumers' expenditure.

1. Recent developments

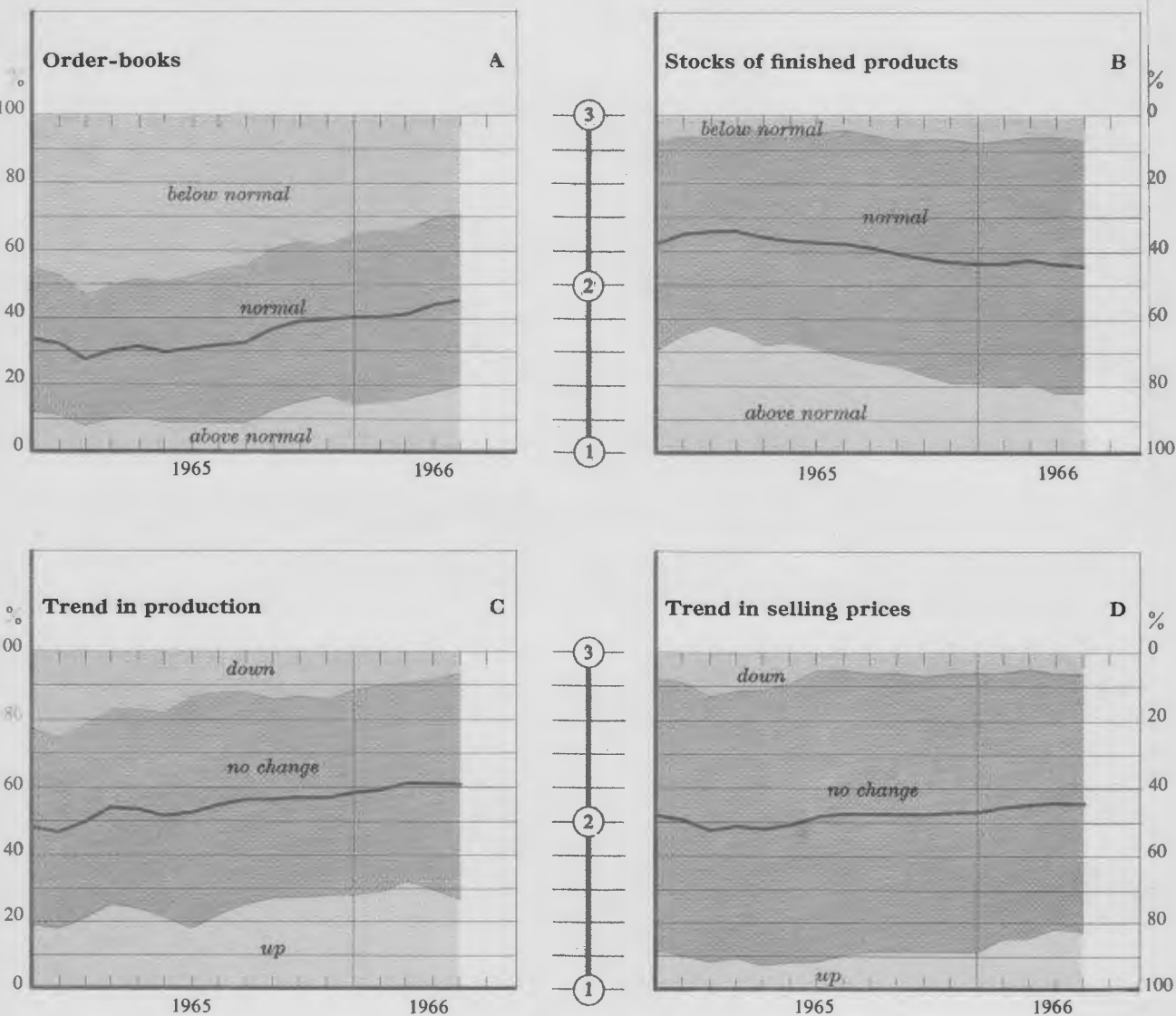
There was a further rapid rise in the export of goods and services. In spite of very poor January figures—which were purely fortuitous—the average value of visible exports during the first quarter, on the basis of French customs returns, was no less than 13.5 % higher than in the corresponding period of the previous year.

Once again, exports to the other EEC countries—particularly Italy, but also the Federal Republic of Germany—rose especially vigorously, while exports to non-member countries again increased at a slower rate, mainly because of a certain falling-off in sales within the Franc Zone and in some EFTA countries.

Domestic demand continued to increase briskly during recent months; this was due increasingly to gross fixed asset formation by enterprises. The upturn in capital investment by private firms, of which the first signs became visible towards the end of 1965, has in fact fully materialized since then. This has been accompanied by a very brisk rise in capital expenditure by public enterprises and by the State. Only in residential construction does there appear to have been a very hesitant trend in expenditure, as a result of some very poor figures for housing authorizations and housing starts in 1965.

Investment in stocks again acted as a stimulus to expansion. There was a further adjustment of stocks of raw materials and semi-manufactures to the rising volume of

BUSINESSMEN'S VIEWS ON THE INDUSTRIAL SITUATION



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

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

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

production, and a further stocking up of finished goods, retailers being particularly active in this direction in view of—and in expectation of—a rapid upturn in private consumption.

It would appear that private consumers' expenditure—after a somewhat sluggish start to the year, probably owing to weather conditions—picked up again in the last few months. Not only was there a continued upward trend in the demand for durable consumer goods, but the demand for services rose particularly strongly.

This renewed expansion of private consumption was due to a more rapid increase both in mass incomes and in the amounts withdrawn from their businesses by self-employed persons. Not only did hourly wage rates rise by 1.65 %—rather more than previously—between 1 January and 1 April 1966, but the total number of hours worked increased at a greater rate, largely owing to an increase in the number of employed persons. And although the burden of taxation on gross personal incomes is likely to have been somewhat higher than in the last quarter of 1965, as a result of the operation of the assessment system, disposable incomes must have increased at least as rapidly as before.

There are also various indications which suggest that households again made some reduction in their savings ratio. At all events, those savings which can be statistically identified (savings accounts, bonds and equities) showed a relatively smaller increase in the first quarter of 1966 than during the same period of 1965: the perceptible decline in investment in bonds and equities was not compensated by a further rise in savings accounts.

Domestic supply continued to respond very flexibly to this rather rapid overall increase in demand. Industrial production continued to grow at a vigorous rate. According to the seasonally adjusted INSEE index (excluding construction), after eliminating certain fortuitous factors ⁽¹⁾ industrial production appears to have increased by a good 2 % during the first quarter of 1966. In March the gross index was 8.5 % above the figure for the same month in the preceding year.

The trend of the individual components of the INSEE index and the results of the EEC business surveys show that the expansion in the field of consumer goods continued to be particularly rapid and has now spread to the domestic appliance industry; also that there has been an increasing recovery in the capital goods industries; and finally that in the field of basic materials the growth in the production of metals and—even more—of building materials, has again been very modest.

There was in fact a considerable slowing-down in the rate of increase of building output, mainly due to the falling demand in the residential building sector. Nevertheless, according to the INSEE index, building output in the first quarter was still 7.2 % up on the first quarter of 1965, in spite of the unfavourable weather conditions.

The increase in output was again due mainly to advances in productivity, which must have been very substantial in those sectors, in particular, in which capacity had still not reached optimum utilization. In spite of this, the trend towards increased

(1) In addition to exceptional variations in weather, statistical divergences appear to have led to the January index being too low and the December index somewhat too high.

employment continued: as there was very little scope for any lengthening of the effective working week—in the early spring it appears almost to have reached its peak again—the last few months witnessed a continual increase in the number of persons employed. Hence there was a further marked drop in the (seasonally adjusted) number of persons seeking employment during the first quarter, while the number of vacancies increased substantially.

There was again a vigorous increase in imports of goods and services. In the first place, rising domestic production and a desire to replenish stocks led to a further rapid increase in raw material imports; secondly, the demand for foreign manufactures for consumption and investment purposes continued to follow an upward trend. The total volume of visible imports—based on customs returns—was 13 % higher in the first quarter of 1966 than in the corresponding period of the previous year.

In view of the great elasticity of overall supply and of the favourable trend in wage costs per unit of production resulting from rapid advances in productivity, the underlying upward trend of prices continued to be moderate. The cost of living, according to the INSEE index for 259 products, rose by 1.1 % between December 1965 and April 1966—i.e. by the same percentage as in the corresponding period of the previous year. The increase over April 1965 was 2.8 %.

Once again, the upward movement of prices was least marked in the case of manufactured goods and most pronounced in the case of services. This divergence is only partially explained by autonomous price increase (rents, transport charges) or by variations in the cost structure; it is also a result of the fact that the price stop on manufactured goods, which was generally maintained, caused a relatively greater demand for other goods and particularly for services.

Mainly as a result of the vigorous increase in exports, the trend towards a deterioration in the trade balance which had been noticeable since the middle of the previous year remained relatively slight. Nevertheless, the visible trade deficit, according to customs returns, was larger in the first quarter of 1966 (more than FF 410 million) than in the first quarter of 1965 (barely FF 300 million). Partly for this reason, the balance of payments is not likely to show the same large surplus as it did a year previously. At all events, the increase in the official gold and foreign exchange reserves (gross) in the first three months of 1966 was only FF 554 million compared with FF 1 042 million in the corresponding period of the previous year. Admittedly, the net foreign exchange position of the commercial banks may have improved somewhat—contrary to the previous year's trend—as the banks found it preferable to delay the repatriation of their funds in view of the margin of interest in the foreign money markets.

Hence the balance of payments did relatively little to expand internal liquidity during the early months of this year. The overall transactions of the Treasury actually tended to reduce liquidity. It is true that the cash position of the public finances showed a heavy deficit, mainly because of an exceptionally large increase in expenditure, whereas there had been a small surplus in the first quarter of 1965; but the Treasury had such substantial resources at its disposal at this time that it was able not only to finance this deficit but also to take over construction bills of the Caisse des Dépôts et Consignations

on an exceptionally large scale from the Bank of France. The fact that there was no slackening in the underlying increase in the volume of money (cash circulation and sight deposits) can be explained by the further vigorous expansion of bank advances to business and private individuals.

The money market was under strain during the last few months, and there was a clear upward trend in call loan rates, although the authorities attempted to counter this trend by a flexible use of the minimum reserve regulations and by open market operations.

There was relatively little call on the capital market in the first quarter, particularly by public institutions. New issues totalled only FF 3 400 million, compared with nearly 4 900 million in the first quarter of 1965. Nevertheless, interest rates on the capital market also showed a clear upward trend, indicating sluggishness in the formation of long-term savings and in its flow on to the capital market.

National product and expenditure

	1963 ⁽²⁾	1964 ⁽²⁾		1965 ⁽²⁾		1966 ⁽³⁾
	At current prices (in FF. '000 million)	% change on preceding year				
		Volume	Value	Volume	Value	Volume
Gross national product	396.0	+ 5.9	+ 9.9	+ 3.4	+ 6.0	+ 5.5
Imports ⁽¹⁾	54.9	+ 12.4	+ 14.9	+ 3.6	+ 4.0	+ 11
Private consumption	256.9	+ 4.7	+ 8.3	+ 3.2	+ 5.9	+ 5
Public current expenditure	53.4	+ 4.8	+ 9.9	+ 2.3	+ 4.8	+ 4
Gross fixed asset formation	79.6	+ 11.8	+ 15.9	+ 5.3	+ 8.4	+ 6
Exports ⁽¹⁾	56.6	+ 7.7	+ 10.8	+ 10.9	+ 11.6	+ 9.5

⁽¹⁾ Goods, services and factor income.

⁽²⁾ Report on the national finances for the year 1965, published by the ministère de l'économie et des finances, Paris.

⁽³⁾ Commission forecasts.

Note :

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

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

2. Outlook

All the indications are that the relatively rapid expansion of overall demand will continue and gain momentum during the coming months.

Demand from abroad is likely to remain vigorous; as French firms' delivery dates and competitiveness do not seem to be noticeably affected by shortages of capacity and by prices, there is nothing to prevent a further expansion of exports.

In particular, there is a likelihood of better sales possibilities in the other member countries, especially as the slackening in business activities in the Federal Republic of Germany is apparently having less of a restraining effect on the German demand for imports than had previously been anticipated. It will also doubtless be possible to achieve a further considerable expansion of exports to the other industrialized Western countries. Finally, it must be borne in mind that the foreign currency resources of the developing countries have increased, and that the French Government has changed the system for granting export credits and the conditions under which they are granted.

A further vigorous upswing in domestic demand now seems much more certain because the recovery of business investment has clearly set in and is likely to gain momentum in the coming months.

Available information—in particular the assessment of orders and forecasts of production in the capital goods industries covered by the ECC business surveys—suggests that there will be a rapid increase in expenditure on gross fixed asset formation. This trend will be stimulated not only by the anticipated upturn in sales and the fuller utilization of manufacturing capacity, but also by improved possibilities for self-financing, resulting partly from the easing of the pressure of labour costs and partly from substantial direct or indirect tax reliefs (reform of taxation of dividends, tax credits).

These considerations apply primarily, of course, to the private sector of the economy; the public enterprises and the State continue to be covered by the investment programmes laid down in the Fifth Plan, which provides for a very considerable increase in expenditure in 1966. It is of course possible that residential construction may continue to make a relatively poor contribution to overall gross fixed asset formation, although the number of building permits issued has tended to increase again since the autumn of 1965.

The recovery in investment has provided a firmer basis for a continued expansion of private consumption. The length of the working week is likely to increase somewhat in the coming months, and—more important still—the number of persons in paid employment is likely to show a further increase. The gradual change in the labour situation is certain to cause a slight increase in the upward movement of wages, so that earned incomes as a whole are likely to grow more rapidly. In addition, income transfers resulting from various social measures will increase more rapidly, and the amounts withdrawn from their businesses by self-employed persons will rise faster than before as a result both of the general trend of economic activity and of increases in various agricultural prices.

This probable trend in personal incomes, coupled with a relatively moderate burden of taxation, should lead to a continued and rapid expansion of private consumers'

expenditure, even if the propensity to save should increase again to some extent in the course of the year.

Broadly speaking, supply will still be able to respond very elastically to this generally substantial increase in overall demand. In particular, it is to be expected that industrial production will continue to expand more or less at the same rapid rate. There may be a slackening-off in some important consumer goods industries—due in part to an increasingly full utilization of industrial capacity—but on the other hand there will undoubtedly be an upswing in the capital goods industries. At any rate, production forecasts by managements are increasingly optimistic: the balance of the positive and negative replies to the relevant question in the monthly ECC business survey for industry as a whole rose from plus 17 at the end of December 1965 to plus 21 at the end of March 1966, while for the investment goods industries there was actually a rise of from plus 8 to plus 18.

Imports will doubtless increase further—not only because of the increased demand for raw materials and semi-manufactures to meet the needs of expanding production and stock-building, but also to satisfy the growing demand for consumer and capital goods. But in view of the favourable outlook for exports, the trend towards a further decline in the surplus on foreign trade is likely to remain very slight for the present.

In spite of the very high overall elasticity of supply, the possibility of a recurrence of certain tensions in the relationship between supply and demand later on in 1966 cannot be entirely ruled out, at least in certain sectors of the market. These strains are likely to exert their influence mainly on the trend of prices. At least in those sectors in which the Government's price policy allows prices to find their own level, it seems likely that managements will tend increasingly to raise prices even where there has been no renewed pressure of costs, in order to restore what is regarded as a "normal" profit margin. In addition, there are still forces of a structural nature tending to force prices upwards. Finally, we may expect other "autonomous" price increases, particularly in agriculture. There is therefore a fairly considerable likelihood of some acceleration in the increase of prices at the producers' stage and in trade.

The way in which the economic situation has developed so far in 1966 and the outlook for the remainder of this year are very close indeed to the forecasts published in the last Quarterly Survey (1/1966). It is therefore not considered necessary to alter the forecasts given in that Survey for national product and expenditure for the whole year 1966. It still seems likely that the GNP at constant prices will be about 5.5 % higher in 1966 than in 1965.

A forecast beyond the end of 1966 and into the year 1967, so far as this is possible at present, suggests that there will be a further very rapid growth in the economy. In fact, the main element of uncertainty in this connection has been largely eliminated as a result of the recovery which has now taken place in private business investment. It is to be expected that such investment will gain further momentum in 1967 in an atmosphere of economic expansion—particularly as the fiscal measures taken to promote expansion since 1965, notably the 10 % tax allowance for investment in plant and equipment, will come into full operation at the same time. In addition, capital expenditure in the entire public sector will certainly continue to be governed by the targets set in the Fifth Plan,

and exports may reasonably be expected to rise further, even though possibly at a somewhat slower rate; there should therefore be nothing to prevent a very rapid expansion of personal incomes and private consumers' expenditure.

In spite of rising capital investment and a relatively large increase in the working population, it seems likely that there will be a decline in the elasticity of domestic supply during 1967. The Commission's staff at present consider it possible that real GNP will be about 5.5 % higher than in 1966. This rate of growth would correspond to the rate forecast for 1966, but it would imply a certain underlying slackening of real expansion during 1967.

These prospects indicate that it should be the task of economic policy to prevent overall monetary demand from expanding too rapidly and, above all to ensure that it is adjusted in good time to the decreasing elasticity of supply, since otherwise productive capacity will become overloaded and, in particular, this may cause new and serious strains in the labour market: if that should happen, wage increases might again outstrip productivity, and this—combined with the pull of excessive demand—might accelerate the upward movement of prices.

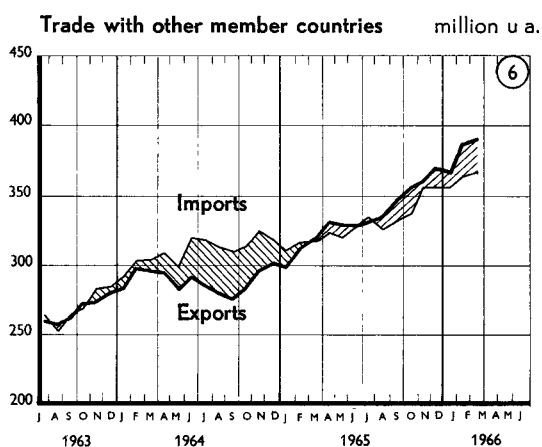
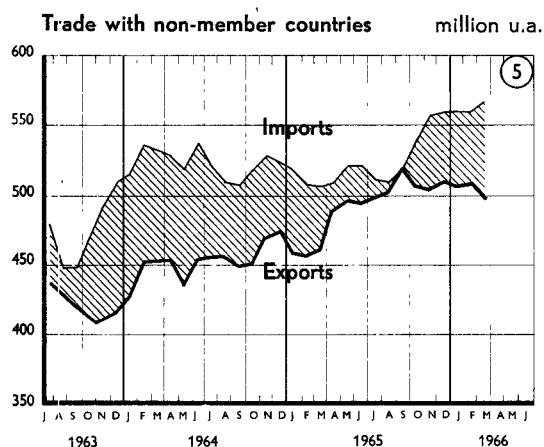
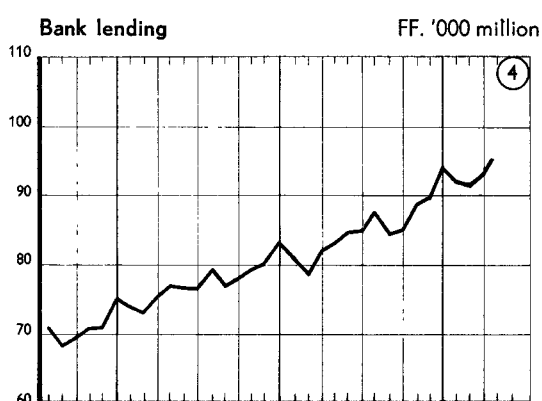
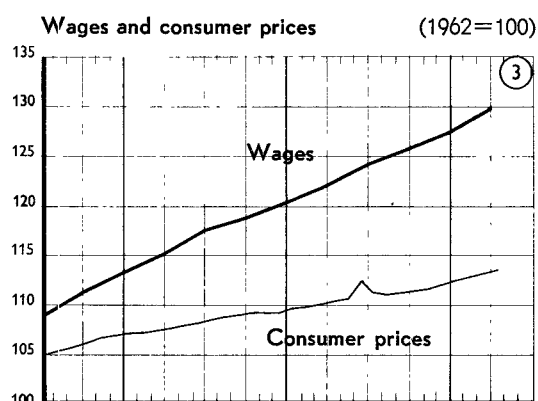
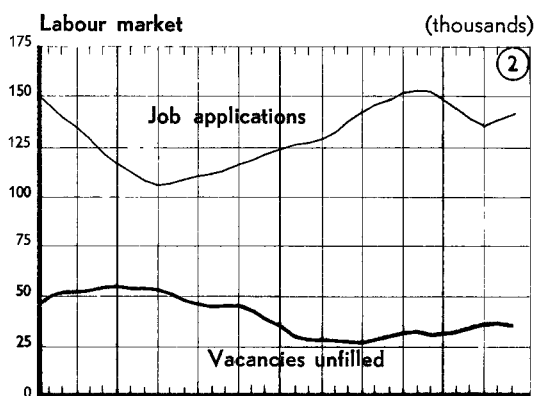
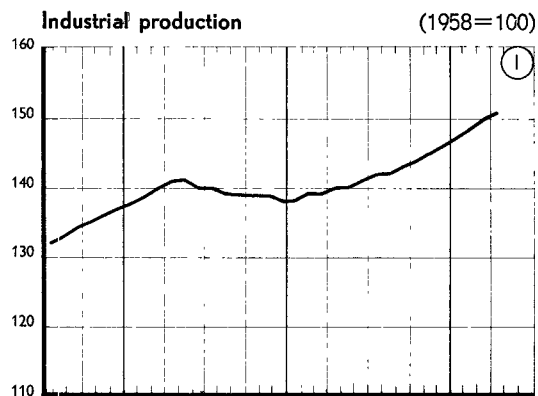
Special care should be taken to ensure that the public finances not only do nothing to stimulate additional demand, but exert a stabilizing effect as private capital and consumer expenditure gain momentum. This means that for the remainder of 1966 the present efforts to keep the Treasury's cash transactions in equilibrium whatever happens should be continued. For 1967 would probably be a very good thing if a slight cash surplus was achieved. The draft budget ought to take these factors into account. And the pattern of expenditure should continue to be designed to achieve stability with growth, giving investment expenditure priority over expenditure which will directly or indirectly stimulate consumption.

To the extent that fiscal policy is adapted to the objectives of short-term economic policy, a more flexible monetary and credit policy could be applied—and this may continue to be desirable for some time longer to allow for the financing of increasing business investment. Nevertheless, the monetary authorities must remain watchful in order to be able to check any over-rapid and excessive expansion of internal liquidity in good time.

Moreover, any threat to monetary equilibrium could be eliminated if the expansion of credit was matched by a corresponding growth in long-term savings. It might therefore be advisable to introduce new and effective measures to encourage private saving, especially as there has obviously been a tendency for savings—particularly in the form of long-term investment—to decline further during the last few months.

Moreover, in order to ensure a rapid but balanced growth, it is particularly important that efforts to achieve structural improvements in the economic, monetary and financial field should be still further intensified. The bills which the Government is shortly to introduce for the improvement of vocational education, the promotion of technological and scientific research, and the establishment of a mortgage market, are therefore very welcome, even though a more comprehensive solution would have been preferable as far as the proposed restriction of the mortgage market to banks and other financial institutions is concerned.

ECONOMIC INDICATORS



NOTES:

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

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

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

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

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

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

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

France

TABLE 1: Basic data (1965)

Total area ('000 sq. km.)	551.2
Total population ('000)	48 797
Density of population per sq. km.	88
Working population ('000)	19 642
Working population, breakdown by main sector (%)	
— Agriculture	17.3
— Industry	39.9
of which : Construction	9.4
— Services	42.8
Percentage share of gross domestic product	
— Agriculture	8
— Industry	46
of which: Construction	9
— Services	46
Gross product per capita (FF)	9 432

TABLE 2: Development of basic economic data

	% change by volume on preceding year							Volume indices (1958 = 100)	Contri- bution (in %) to 1964 GNP
	1959	1960	1961	1962	1963	1964	1965	1965	1965
Gross national product	+ 2.7	+ 7.6	+ 4.6	+ 6.6	+ 5.2	+ 5.9	+ 3.4	142	—
Industrial production	+ 2.8	+ 7.7	+ 5.5	+ 6.2	+ 6.4	+ 7.4	+ 3.0	146	—
Total imports	- 1.7	+16.3	+ 7.2	+ 8.6	+12.2	+12.4	+ 3.6	174	14.2
Private consumers' expenditure	+ 1.9	+ 5.5	+ 5.9	+ 6.9	+ 6.8	+ 4.7	+ 3.2	141	63.8
Public current expenditure on goods and services	+ 6.6	+ 2.7	+ 3.4	+ 4.3	+ 1.2	+ 4.8	+ 2.3	128	13.3
Gross fixed asset formation	+ 2.3	+ 6.8	+10.5	+ 7.8	+ 7.5	+10.0	+ 7.1	165	21.7
Total exports	+11.9	+17.3	+ 5.4	+ 3.1	+ 8.2	+ 7.7	+10.9	184	15.2
Gross national product per capita	+ 1.7	+ 6.5	+ 3.5	+ 4.7	+ 3.3	+ 4.7	+ 2.3	130	—
Gross national product per person gainfully employed	+ 3.4	+ 7.6	+ 4.5	+ 6.4	+ 3.9	+ 4.7	+ 3.4	139	—

TABLE 3: Foreign trade (at current prices)

	% change on preceding year							Indices 1958 = 100	Million u.a.	% of the total
	1959	1960	1961	1962	1963	1964	1965			
Visible exports										
Total	+ 9.4	+22.5	+ 5.2	+ 2.0	+ 9.8	+11.3	+11.8	196	10 050	100
Intra-EEC	+33.7	+33.9	+18.8	+11.9	+14.2	+12.8	+18.0	362	4 116	41.0
To non-EEC countries	+ 2.4	+18.2	- 0.5	- 3.0	+ 7.2	+10.3	+ 7.8	149	5 934	59.0
Exports of food, beverages and tobacco										
Total	- 0.3	+36.3	+17.4	- 2.9	+22.0	+14.4	+11.5	241	1 601	15.9
Intra-EEC	+47.2	+54.6	+26.2	+ 1.4	+34.5	+16.6	+26.5	577	704	7.0
To non-EEC countries	-11.0	+29.3	+13.6	- 5.1	+15.4	+13.0	+ 2.0	165	897	8.9
Exports of raw materials and manufactures										
Total	+11.0	+20.2	+ 3.3	+ 3.0	+ 7.8	+10.7	+11.8	190	8 449	84.1
Intra-EEC	+32.6	+31.1	+17.5	+13.9	+10.9	+12.1	+16.4	336	3 411	34.0
To non-EEC countries	+ 4.8	+16.2	- 2.7	- 2.6	+ 6.0	+ 9.8	+ 9.0	146	5 038	50.1
Visible imports										
Total	- 9.2	+23.3	+ 6.3	+12.8	+15.9	+15.4	+ 2.7	184	10 338	100
Intra-EEC	+10.8	+36.3	+13.6	+20.0	+24.3	+20.3	+ 6.7	327	4 015	38.8
From non-EEC countries	-15.1	+19.0	+ 3.3	+ 9.2	+12.3	+12.4	+ 0.3	144	6 323	61.2
Imports of food, beverages and tobacco										
Total	-15.9	+ 6.2	- 2.3	+19.8	+ 5.1	+14.9	- 0.6	126	1 772	17.1
Intra-EEC	+54.3	+16.7	-12.3	+37.6	+37.4	+26.2	+ 8.9	410	378	3.6
From non-EEC countries	-20.8	+ 4.7	- 0.8	+17.4	0	+12.5	- 2.8	106	1 394	13.5
Imports of raw materials and manufactures										
Total	- 7.1	+23.7	+ 8.5	+10.9	+18.8	+15.5	+ 3.4	204	8 566	82.9
Intra-EEC	+ 7.5	+37.9	+16.3	+18.7	+22.7	+19.8	+ 6.5	321	3 638	35.2
From non-EEC countries	-12.5	+24.5	+ 4.5	+ 6.6	+16.3	+12.6	+ 1.2	161	4 928	47.7

TABLE 4: Basic monthly indicators

	Year	Jan.	Feb.	Mar.	Apr.	May	June	July	Aug.	Sept.	Oct.	Nov.	Dec.
Industrial production (1958 = 100)	1964	143	146	145	150	149	149	129	84	139	146	151	148
	1965	141	145	144	146	146	148	129	91	142	151	156	158
	1966	150	156	158									
Building : number of permits issued ('000)	1964	39.8	39.3	43.1	47.6	41.5	47.6	51.0	33.3	44.2	67.9	47.3	72.5
	1965	38.8	44.7	45.9	43.8	44.6	50.5	41.8	44.4	49.6	53.2	57.6	33.0
	1966	41.3	36.3	42.2									
Private consumers' expenditure : turnover of department stores (1958 = 100)	1964	189	178	197	199	209	203	206	183	225	249	218	330
	1965	211	181	204	228	219	223	232	199	258	244	236	352
	1966	216	192										
Total visible imports (million u.a.)	1964	861	846	883	930	841	896	814	630	783	840	827	917
	1965	816	799	934	900	872	866	827	679	810	890	926	1 023
	1966	899	936	1 102	997	1 003							
Total visible exports (million u.a.)	1964	731	751	768	771	705	797	754	554	697	834	806	823
	1965	688	732	896	839	853	823	877	651	824	916	903	998
	1966	780	877	1 029	952	909							
Balance of trade (million u.a.)	1964	- 130	- 95	- 114	- 159	- 136	- 99	- 60	- 76	- 86	- 6	- 21	- 94
	1965	- 128	- 17	- 36	- 61	- 19	- 43	+ 30	- 28	+ 14	+ 26	- 23	- 25
	1966	- 119	- 59	- 73	- 45	- 94							
Official gold and foreign exchange reserves (gross, million u.a.)	1964	4 481	4 494	4 477	4 533	4 680	4 737	4 813	4 827	4 863	4 902	4 999	5 105
	1965	5 172	5 254	5 316	5 367	5 341	5 350	5 336	5 346	5 381	5 381	5 449	5 459
	1966	5 468	5 503	5 571	5 649	5 724							
Money supply (FF '000 million)	1964	147.7	146.6	143.6	148.6	149.0	152.1	156.3	154.8	155.2	155.8	154.5	162.0
	1965	159.3	157.9	159.9	161.9	162.6	166.1	170.1	169.2	170.2	171.6	169.9	177.2
	1966	174.9	173.6	175.6	177.3								

France

NOTES

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

Table 1

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

Table 2

- GNP at market prices. Source: Rapport sur les comptes de la Nation, ministère de l'économie et des finances, Paris.
- Industrial production : value added by industry.
- Total exports and imports : goods, services and factor income.
- The figures for GNP per head and per person in employment from 1958 to 1964 are Commission estimates based on the component series.

Table 3

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

Table 4

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

C. Italy

The upward trend in the economic cycle continued in the first quarter of 1966.

There was a further appreciable increase in effective demand from abroad, although the rate of increase was slower. Domestic demand, too, again increased noticeably. Although investment in construction declined further, total expenditure on gross fixed asset formation is likely to have increased, as the recovery in investment by enterprises in plant and equipment apparently continued. Private consumers' expenditure again rose sharply, largely as a result of the substantial increases in personal incomes which took place at the end of the previous year.

On the supply side, industrial production (excluding building) rose by a good 1.5 % (seasonally adjusted figure) between the fourth quarter of 1965 and the first quarter of 1966, in spite of prolonged strikes, reaching a level 10.5 % above that of a year before.

There was a particularly sharp increase in imports of goods and services; visible imports were 19.5 % higher than in the corresponding period of the previous year.

In spite of the further marked growth in production, the total number of hours worked only rose slightly—and solely because of an increase in working hours per employee. The slight downward trend in the unemployment figures, which had been observable from time to time during the previous year, continued at the end of the winter.

Prices again rose—largely as a result of increased costs—although relatively more slowly. In April the wholesale price index was 2.9 % higher than in April 1965, and the consumer price index rose by 2.7 % during the same period.

The deterioration in the current account continued. As this was accompanied by an increased deficit on capital transactions, there was a sharp fall in the surplus on the overall balance of payments (to Lit. 88 000 million in the first four months of 1966). The official net gold and foreign exchange reserves fell substantially between the end of December 1965 and the end of April 1966—by Lit. 105 000 million to 2747 000 million—due to continuing exports of funds by the commercial banks.

The trend of the economy in the coming months seems likely to remain expansionary. Exports should again rise substantially, even if not so quickly as in the preceding year; however, their importance as a factor in the country's economic growth may gradually decline, largely because there is likely to be a pronounced rise in domestic demand—particularly for capital goods—and hence a larger proportion of production is likely to be sold on the home market.

The underlying upward movement of prices will probably continue, although at a noticeably slower tempo. The current account will tend to deteriorate further, but will still yield a substantial surplus on the year 1966.

According to preliminary—and naturally very tentative—estimates for 1967, the economic trends outlined above are likely to continue and, particularly in the case of domestic demand, to become more pronounced, so that an increase of at least 5 % in real GNP is not at all impossible. In these circumstances, prices and costs could start to rise at a faster rate again. The payments surplus on the current account will undoubtedly decline again.

In the light of these prospects, those responsible for economic policy are faced with the task of giving continued support to real economic growth—particularly at its weak point (construction)—but reducing the scale of this support as private capital and consumer demand increase. In particular, the budget deficits should be progressively reduced by restricting the growth of all expenditure which encourages consumption and going over to purely non-monetary financing, in order to avoid a renewed intensification of the upward movement of costs and prices.

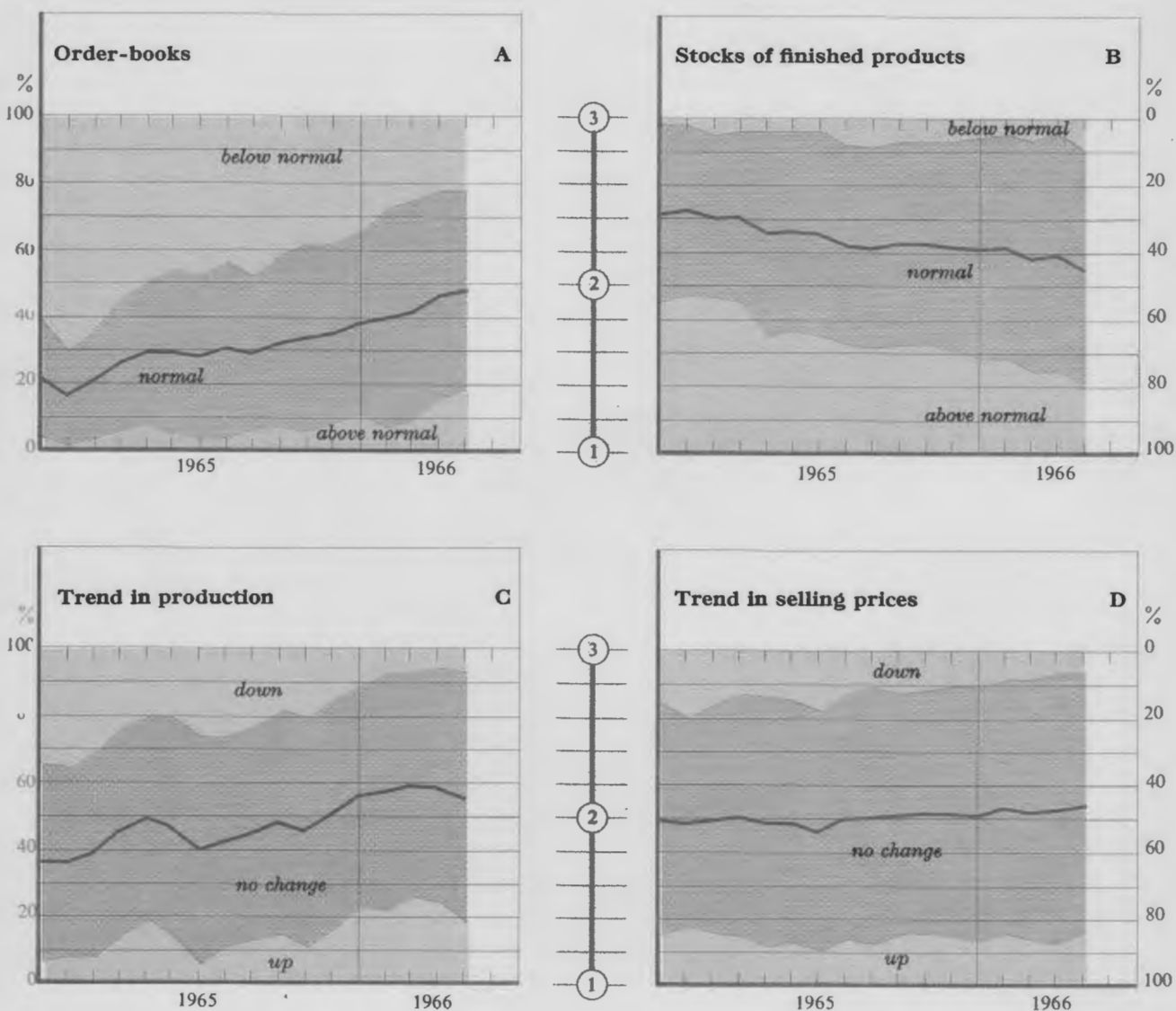
1. Recent developments

Exports of goods and services again showed a marked increase in the first quarter of 1966, although the rate of increase slackened. This slackening applied only to visible exports, particularly those destined for the other member countries; it was most marked in the export of capital goods. Nevertheless, according to the foreign trade returns, exports were 12.6 % higher in value than in the corresponding period of the previous year. The statistics of the Foreign Currency Office point to a further rapid increase in the export of services.

At the same time, domestic demand appears to have risen appreciably. This applies first and foremost to expenditure on gross fixed asset formation. Admittedly, investment in construction seems to have shown a further downward trend, in spite of a marked increase in public works, mainly owing to a continuing decline in investment in residential construction. According to the ISTAT quarterly sample surveys, the fall in the number of persons employed in the construction sector as a whole between October and January was greater than the seasonal average—but of course weather conditions this year were particularly unfavourable. In addition, the statistics of the wage equalization funds for January/February showed a drop in the number of hours worked per building worker which was probably above the seasonal average; but between February and March the trend seems to have been in the opposite direction. Business investment in plant and equipment, on the other hand, increased vigorously. In fact, there was a marked upward trend not only in imports of plant and equipment, but also in production and unfulfilled home orders in certain important capital goods industries.

There appears to have been a definite overall rise in investment in stocks, due in particular to accelerated re-stocking of raw materials and semi-manufactures.

BUSINESSMEN'S VIEWS ON THE INDUSTRIAL SITUATION



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

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

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

Consumers' expenditure apparently rose quite sharply. At any rate, there was a marked expansion of governmental public expenditure in the narrower sense of the term during the first three months of 1966. The rapid increase in production and, above all, the filling-up of home order books, both of which were features of the consumer goods industries, point to a vigorous expansion in private consumers' expenditure as well. New registrations of private cars, which were still declining at the end of 1965, have since been rising; in the first five months of 1966 they were nearly 10 % higher than a year before.

There is likely to have been some slackening in the rate of growth of mass incomes during the first quarter. While minimum wages and salaries fixed under national agreements (including both the further increase in cost-of-living allowances and family allowances) are likely to have risen by about 1 % per head—and effective per-capita wages and incomes probably somewhat more—there seems likely to have been a slight downward movement in the number of employed persons, largely as a result of the poor performance of the construction industry. Transfer incomes appear to have remained fairly steady.

The continued rapid increase in private consumers' expenditure, in spite of the moderate rate of increase in mass incomes, is probably due mainly to the fact that the particularly sharp rise in incomes at the end of the previous year was not reflected in increased expenditure until early 1966.

In regard to the situation on the labour market, the ISTAT quarterly sample surveys indicate that the number of wage and salary earners was down by 2.4 % in January 1966 as compared with a year previously. If the building sector is excluded, however, the drop was barely 1 %. In fact, the number of hours worked per employed person in industry (again excluding the building trade) probably rose again slightly. At all events, there was a drop in the number of workers on short time; in January, according to ISTAT, it was nearly 50 % below the figure for January 1965. And up to March there was a further drop in short-time working for which the wage equalization funds made compensation payments in industry (excluding the building sector).

There was a slight upward trend in the unemployment figures until January, but the weather in that month was particularly unfavourable. ISTAT summary figures show that unemployment rose to 5.2 % above those of a year previously. But according to Ministry of Labour statistics unemployment tended to fall again slightly in February/April.

The supply situation improved markedly, particularly in industrial production. Seasonally adjusted ISCO figures, based on the ISTAT index, suggest that it may have risen by about 1.5 % between the fourth quarter of 1965 and the first quarter of 1966. Thus the gross index was 10.5 % higher than in the first quarter of 1965; provisional information suggests that the increase between March and April was markedly above the seasonal average.

This result is all the more remarkable, because output was affected by serious strikes, particularly in the iron and steel industry and the metal-working industries. The biggest expansion was in paper making, petroleum by-products, and chemicals. There were also marked improvements in production in the textile industries and en-

gineering. On the other hand, the seasonally-adjusted figures for production in the iron and steel industry in January and February and in the cement industry in January showed a decline. In February, however, cement production seems to have risen very rapidly.

There was a further vigorous rise in imports of goods and services. In the first quarter, visible imports were 19.5 % greater in value (probably not quite so much by volume) than in the corresponding period of 1965—but in that period they had been running at a particularly low level. The expansion was particularly marked in capital goods, raw materials and primary products. There also appears to have been a further increase in imports of services.

There was a further slackening in the rise of prices during the early months of 1966. It must be borne in mind, however, that the rise in wholesale prices in December 1965 had been considerably above the seasonal average. In that month, wholesale prices had risen by 0.5 %, mainly because of an increase in food prices. Food prices fell again slightly up to the end of February, as a result of seasonal influences, but an upward trend set in again in March/April. There was a drop in retail food prices—which actually went on until March—and hence the overall index of consumer prices rose only slightly between December and April, despite a further sharp increase in the price of services; prices of industrial consumer goods remained more or less stable. In April, the overall index was 2.7 % up on that of April 1965. The corresponding rise in wholesale prices was 2.9 %. It is noteworthy that prices of capital goods had begun to rise again at the end of 1965, and this trend continued in the early months of 1966.

There was a substantial deterioration in the trade balance in the first quarter of 1966. The deficit, based on customs returns, rose to Lit. 140 000 million, compared with Lit. 33 000 million in the fourth quarter of 1965; it was thus more than one-third higher than in 1965 as a whole.

In spite of another substantial surplus on the services balance, and although the terms of payment again moved in Italy's favour, the overall balance of payments in the first quarter showed a surplus of only Lit. 48 000 million. This was the result not only of the deterioration in the trade balance, which we have already mentioned, but also of a continuing and increased deficitary trend in capital movements (apart from the capital movements reflecting the alteration in the terms of payments). In April, too, the surplus on the balance of payments—Lit. 40 000 million—was relatively low.

The official net gold and foreign exchange reserves actually fell by Lit. 146 000 million—to Lit. 2 706 000 million—between December 1965 and March 1966, as the banks resumed their exports of funds, following their "window-dressing" operations in December; they rose again in April, however (by Lit. 41 000 million).

Hence, in contrast to the previous quarters, foreign transactions had a restrictive effect on the domestic liquidity of the banks, during the first quarter of 1966. The Treasury's cash transactions—due to seasonal influences—had an even stronger effect in reducing liquidity. In this situation, the banks made their first substantial recourse for a considerable time to central bank credit, particularly as the demand for bank advances had increased still further in February/March. In this period the total of out-

standing advances was actually 8.9 % higher than at the corresponding period of the previous year.

Developments on the securities market in the first four months of 1966 were again more varied. While share prices eased again after rising steadily from November 1965 to February 1966, the bond market remained remarkably buoyant. The yield on securities began to increase slightly for the first time in two years.

National product and expenditure

	1963	1964 ⁽²⁾		1965 ⁽²⁾		1966 ⁽²⁾
	At current prices (in Lit. '000 million)	% change on preceding year				
		Volume	Value	Volume	Value	Volume
Gross national product	30 193	+ 2.7	+ 9.7	+ 3.4	+ 7.1	+ 4.5
Imports ⁽¹⁾	5 438	— 5.1	— 2.7	+ 0.9	+ 2.1	+ 18
Private consumption	19 281	+ 2.3	+ 8.1	+ 2.1	+ 6.0	+ 5
Public current expenditure	4 101	+ 4.0	+ 13.6	+ 3.7	+ 11.6	+ 5
Gross fixed asset formation	7 150	— 6.5	— 0.7	— 8.2	— 6.8	+ 5
Exports ⁽¹⁾	4 753	+ 11.6	+ 15.4	+ 19.9	+ 20.1	+ 10

⁽¹⁾ Goods, services and factor income.

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

⁽³⁾ Commission forecasts.

Note :

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

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

2. Outlook

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

This applies in the first place to exports of goods and services, although some slackening of the rate of growth is still likely. The high level of world business activity is expected to continue, and this should bring considerable benefits to Italian exports,

⁽¹⁾ Compare the corresponding remarks in the Quarterly Surveys 4/1965 and 1/1966.

since Italian delivery dates are relatively short and for some time past prices have been rising more slowly in Italy than in many other countries. In addition, more favourable conditions for export credits are likely to be introduced shortly. The increase in industry's unfulfilled export orders, which is indicated by the EEC business surveys carried out during the first three months of 1966, confirms this hypothesis of a very marked overall increase in exports.

Domestic demand, too, seems likely to expand.

The trend of gross fixed asset formation may be affected for some time longer by the low level of investment in construction, but there are many indications to suggest that the forces of growth will increasingly prevail in this field too, in spite of the continuing effect of certain technical and psychological obstacles.

The propensity to invest—not merely in the building sector—will be stimulated by the availability of relatively large funds and by lower interest rates. In addition, the official regulations issued last autumn to promote residential construction, which did not have the desired effect immediately, may gradually produce an increase in demand. And the proposal put forward recently by the government for a progressive decontrol of rents is likely to stimulate residential construction.

The expansion in public works is likely to continue, and it can be expected that the upswing in expenditure on plant and equipment will have a stimulating effect on building activity in the commercial and industrial sector.

Expenditure by enterprises on plant and equipment is likely to increase appreciably; this will again be due mainly to the desire for further rationalization—which in the previous two years firms had been trying to achieve mainly through internal reorganization.

Investment in stocks is again likely to contribute markedly to the expansion of the economy, particularly as enterprises will probably accelerate their restocking of raw materials and semi-manufactures.

The rapid increase in consumer expenditure is likely to continue during the coming months. The appropriations in the national budget estimates point to a rapid increase in public current expenditure. And the likelihood of a vigorous rise in private consumers' expenditure is suggested by the following main factors: a probable rise in the total number of hours worked ⁽¹⁾; the probability of a faster rate of increase in hourly wages as a result of the impending conclusion of a number of new wage agreements (more numerous than in 1965); the likelihood of an increased rate of growth of unearned incomes; and finally the possibility of an upturn in spending by private households as a reaction against the opposite tendency during the previous year.

⁽¹⁾ Number of wage and salary receivers times number of hours worked per head.

On these assumptions, it seems likely that there will be a definite and increasingly even expansion of industrial production. Although there are still some uncertainties surrounding the future of building output, it is quite conceivable that an improvement will set in here towards the end of the year. The trend of output in the services sector should be markedly upwards.

The anticipated increase in the total number of hours worked will probably continue for a time to take the form mainly of a lengthening of the working week. Nevertheless, the moderate downward trend in unemployment may continue.

Visible imports are likely to increase rapidly, particularly in the case of raw materials and semi-manufactures.

The trend of prices may be somewhat calmer than seemed likely a few months ago. The situation has changed here because, following the signature of a number of agreements between the two sides of industry, it now seems probable that costs will rise less sharply in the next few months. In addition, the apparently still considerable reserves of productivity and the continuing overall elasticity of production will have a restraining influence on prices.

Nevertheless, there are grounds for fearing that an adequate degree of price stabilization will not be achieved. In the first place, there is the fact that a particularly large number of new wage agreements are in the offing this year, and they may well raise costs substantially. Secondly, the vigorous expansion of demand will make it easier for firms to pass on cost increases which occurred in previous years and which are still cutting into their profit margins. Finally, structural cost-raising factors—particularly in the distributive sector—will continue to play their part.

The current account will doubtless tend to deteriorate further, even though the results for 1966 are likely to show a very substantial surplus.

In the light of these prospects, the quantitative estimates given in the last Quarterly Survey for the main figures for the whole year 1966 have been retained with only minor corrections to the estimated rate of growth for real gross fixed asset formation, the volume of total exports and the volume of total imports.

According to preliminary forecasts for the period beyond the end of the year 1966, the growth of the economy should continue rapidly in 1967. Although demand from abroad will certainly increase substantially—new expansionary factors here are the lifting of the United Kingdom import surcharge in the autumn of 1966 and the deliveries under the terms of the big contract recently awarded by the U.S.S.R. to the Italian motor vehicle and engineering industries—the expansion of domestic demand, particularly in capital expenditure, is likely to assume increasing importance as the mainspring of economic growth. Hence real GNP in 1967 will probably be at least 5 % higher than in 1966.

The elasticity of production should be sufficient to ensure a generally smooth growth of the economy. It is possible, however, that prices may start to rise more rapidly again. This would occur if there was any substantial acceleration in the growth of the major cost incomes and hence of the broad mass of incomes which are devoted almost entirely to consumption.

These prospects suggest that it must be the task of economic policy in the coming months to continue to support economic growth, but on a decreasing scale, and at the same time to do everything possible to clamp down further on the upward movement of costs and prices.

This means that the overall expansionary effect of budgetary policy should be progressively reduced by cutting the budget deficit and going over to non-monetary financing of the deficit. The total deficit of the various departments has already jumped from Lit. 89 000 million in 1964 to Lit. 1 165 000 million last year. Even if the upward trend stopped, the level would still be too high in the light of the prospects for the economy set out above.

In addition, an overall budgetary policy of this kind must include a check on the expansion of all expenditure which directly or indirectly stimulates the growth of consumer expenditure. At the same time, expenditure or tax concessions which favour investment—and particularly investment by private firms—should be maintained and, if necessary increased still further. This must be balanced, however, by a progressive reduction in the authorities' total cash deficit.

A cut in the budget deficit will probably soon become necessary from the point of view of capital market policy when an increase in the flow of private investment leads to a corresponding demand from firms for finance. If the demands of the public enterprises for capital are not by then adjusted to the changed circumstances—and if inflationary methods of financing are to be avoided—there will be a bottle-neck on the capital market which would seriously restrict investment. For this reason, incidentally, it is most important that early steps should be taken to assist the capital market.

A light rein can be used to guide credit policy for the time being, but everything possible must be done to prevent an excessive build-up of potential bank credit, with all the inflationary risks which that implies. Particular attention should be paid to the fact that the commercial banks, owing to the lack of other adequate possibilities, have invested the bulk of their funds—mainly short-term—in securities of varying maturity.

If the economy is to expand smoothly, it is particularly important that an appropriate incomes policy should be followed in the coming months. In view of the squeeze on profit margins in recent years and the consequent drop in profits available for ploughing back into the business, it is essential that the percentage growth in monetary cost incomes should be kept strictly within the limits of the percentage increase in productivity.

Should the upward trend of prices increase, it would be well to consider an immediate reduction in the remaining tariffs on imports from the rest of the Community, in order to exert a stabilizing influence on prices by making imports cheaper.

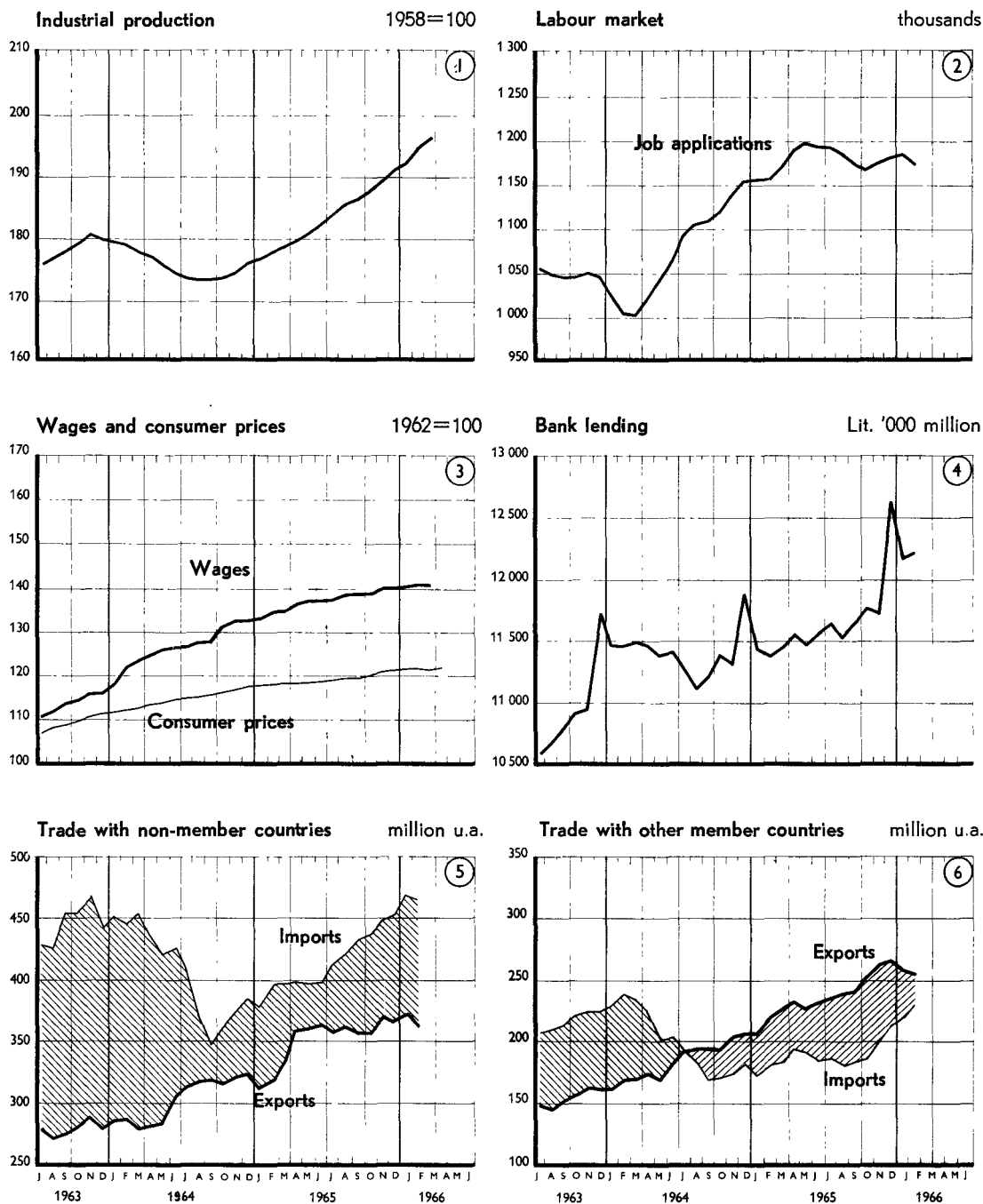
The economic policy followed by the Italian authorities lays most emphasis on those of the above requirements which have an expansionary effect. In the first quarter of 1966, for instance, some further steps were taken to promote investment: the contributions made towards interest payments and capital redemption on industrial investments in Southern Italy and Sicily were increased and some additional tax incentives were offered for investment in machine tools.

The proposed gradual ending of rent controls is likely to give quite a considerable stimulus to investment in residential construction; the Government's draft bill provides for the removal of controls in four stages of one year each starting on 1 January 1967.

In regard to incomes policy, a definite advance can be seen in the determination which has been shown in wage negotiations in the state-controlled sector of industry that the requirements of national economic policy shall be borne in mind in the next round of wage agreements.

On the other hand, it is impossible to reconcile with the needs of economic policy the fact that the national budget estimates for 1966 allow for a further increase in the deficit and for another very rapid increase in consumption-stimulating expenditure, while investment expenditure is actually to be reduced. It is important that the necessary change of course should be made here without delay, preferably to take effect in 1966, or—failing this—when the 1967 budget estimates are prepared. And there is still no sign of the long-promised measures to assist the capital market.

ECONOMIC INDICATORS



NOTES:

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

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

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

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

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

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

Italy

TABLE 1: Basic data (1965)

Total area ('000 sq. km.)	301.2
Total population ('000)	51 380
Density of population per sq. km.	171
Working population ('000)	19 199
Working population, breakdown by main sector (%)	
— Agriculture	25.8
— Industry	40.2
of which : Construction	10.1
— Services	33.9
Percentage share of gross domestic product	
— Agriculture	13.4
of which: Construction	39.5
— Industry	8.2
— Services	47.1
Gross product per capita (Lit.)	688 000

TABLE 2: Development of basic economic data

	% change by volume on preceding year							Volume indices (1958 = 100)	Contri- bution (in %) to 1964 GNP
	1959	1960	1961	1962	1963	1964	1965		
Gross national product	6.5	6.3	7.8	6.2	5.5	2.7	3.4	145.3	—
Industrial production	9.5	10.7	8.7	9.1	6.8	1.8	3.1	161.3	—
Total imports	11.8	37.3	14.6	16.4	22.4	- 5.1	0.9	240.1	15
Private consumers' expenditure	4.7	5.9	6.9	6.3	8.9	2.3	2.1	143.2	62
Public current expenditure on goods and services	4.4	4.0	4.8	5.4	5.1	4.0	3.7	136.0	15
Gross fixed asset formation	9.8	17.0	11.1	8.8	6.9	- 8.2	- 7.4	141.1	20
Total exports	18.4	18.9	16.2	12.3	6.9	11.7	19.9	263.0	18
Gross national product per capita	5.8	5.7	7.2	5.5	4.7	1.8	2.5	138.3	—
Gross national product per person gainfully employed	5.7	6.5	7.6	7.3	7.2	2.9	5.3	150.8	—

TABLE 3: Foreign trade (at current prices)

	% change on preceding year							Indices (1958 = 100)	Million u.a.	% of the total
	1959	1960	1961	1962	1963	1964	1965	1965	1965	1965
Visible exports										
Total	14.1	26.1	14.7	11.4	8.2	18.0	20.2	282.3	7 159.5	100
Intra-EEC	30.7	36.0	21.8	23.7	10.3	26.4	27.2	475.5	2 883.3	40.3
To non-EEC countries	8.9	22.3	11.8	5.8	7.0	13.4	15.9	221.6	4 276.2	59.7
Exports of food, beverages and tobacco										
Total	4.4	5.6	10.6	14.5	- 3.4	2.4	20.4	166.3	848.7	11.9
Intra-EEC	18.1	12.5	14.7	23.4	- 8.7	8.3	31.2	245.4	465.0	6.5
To non-EEC countries	- 3.7	0.4	7.4	6.5	2.1	- 3.3	9.4	119.6	383.7	5.4
Exports of raw materials and manufactures										
Total	16.6	30.7	15.5	10.9	10.2	20.5	20.2	311.5	6 310.8	88.1
Intra-EEC	36.3	45.4	23.9	23.9	15.6	30.4	26.5	580.0	2 418.3	33.8
To non-EEC countries	11.5	26.0	13.7	4.5	7.7	15.5	16.6	241.9	3 892.5	54.3
Visible imports										
Total	6.2	41.0	10.6	15.9	24.5	- 4.1	1.7	233.1	7 350.9	100
Intra-EEC	31.5	45.7	17.2	22.9	31.1	- 4.5	- 3.0	335.7	2 294.7	31.2
From non-EEC countries	- 0.8	38.4	8.1	13.0	21.5	- 3.9	3.9	204.6	5 056.2	68.8
Imports of food, beverages and tobacco										
Total	2.0	33.5	5.3	7.3	57.5	2.4	18.8	294.8	1 610.5	21.9
Intra-EEC	15.3	42.6	- 1.3	10.0	73.1	15.7	20.6	431.2	335.5	4.6
From non-EEC countries	- 0.2	31.8	6.6	6.8	54.4	- 0.6	18.4	272.2	1 275.0	17.3
Imports of raw materials and manufactures										
Total	7.1	42.4	11.6	17.5	19.2	- 5.5	- 2.3	220.1	5 740.4	78.1
Intra-EEC	33.6	46.0	19.2	24.1	27.8	- 6.6	- 6.1	323.4	1 959.2	26.7
From non-EEC countries	- 0.9	41.0	8.4	14.4	14.8	- 4.8	- 0.2	188.9	3 781.2	51.4

TABLE 4: Basic monthly indicators

	Year	Jan.	Feb.	Mar.	Apr.	May	June	July	Aug.	Sept.	Oct.	Nov.	Dec.
Industrial production (1958 = 100)	1964	177.9	171.7	178.2	178.4	169.5	167.7	179.8	128.6	175.8	181.5	173.8	171.9
	1965	167.6	166.9	181.9	178.6	181.5	175.4	191.6	139.8	187.9	191.1	189.7	190.7
	1966	184.8	182.2	203.6									
Building: domestic turnover of building materials (1958 = 100)	1964	178.5	169.8	188.3	183.6	195.3	195.3	193.3	181.7	197.6	182.9	156.4	169.2
	1965	160.8	136.8	173.8	160.8	166.7	196.3	192.3	183.4	184.7	185.6	185.5	180.2
	1966	142.7	129.3	177.6									
Private consumers' expenditure: turnover of department stores (1958 = 100)	1964	254	210	255	246	277	300	280	232	290	355	289	513
	1965	270	215	249	303	284	318	296	241	330	354	319	(538)
	1966	(307)	(229)										
Total visible imports (million u.a.)	1964	715.3	696.0	667.7	650.1	633.4	635.6	548.5	448.4	539.0	590.9	510.4	597.6
	1965	545.6	591.9	630.3	595.3	615.2	573.9	629.5	561.9	614.7	641.0	679.4	671.7
	1966	716.0	664.5	731.8									
Total visible exports (million u.a.)	1964	419.4	449.7	452.7	489.7	458.7	505.8	575.4	436.8	530.6	567.4	504.7	540.0
	1965	460.7	559.9	643.4	588.8	571.4	611.4	627.4	552.6	615.8	637.8	651.0	646.7
	1966	571.7	600.3	717.0									
Balance of trade (million u.a.)	1964	-296.0	-243.7	-213.3	-156.8	-171.0	-126.1	+ 27.0	- 0.3	- 8.5	- 20.5	- 5.1	- 50.9
	1965	- 84.9	- 32.0	+ 13.1	- 6.5	- 43.8	+ 37.5	- 2.1	- 9.3	- 1.1	- 3.2	- 28.4	- 25.0
	1966	-144.3	- 64.2	- 14.8									
Official gold and foreign exchange reserves (net, million u.a.)	1964	3 154.1	2 958.7	2 748.3	2 728.9	2 761.2	2 826.2	2 898.2	3 071.0	3 257.1	3 432.1	3 615.2	3 756.3
	1965	3 797.8	3 878.9	3 755.8	3 811.5	3 895.5	4 032.3	4 250.4	4 390.7	4 323.0	4 270.2	4 303.4	4 566.2
	1966	4 425.9	4 386.4	4 337.6	4 404.2								
Money supply (Lit. '000 million)	1964	11 058	10 961	11 096	10 953	11 118	11 264	11 308	11 239	11 379	11 434	11 702	12 465
	1965	11 984	11 861	12 077	12 225	12 522	12 687	12 885	12 803	13 108	13 227	13 420	14 495
	1966	14 029	13 933										

() Provisional figures.

Italy

NOTES

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

Table 1

- Present-in-area population (resident population less persons temporarily abroad). Average for year. Source : Istituto Centrale di Statistica.
- Working population in employment. Average for year. Source : Istituto Centrale di Statistica, "Rilevazione nazionale delle forze di lavoro—20 ottobre 1965".
- Breakdown of gross domestic product by factor cost.
- GNP at market prices.

Table 2

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

Table 3

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

Table 4

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

D. The Netherlands

The expansion of demand continued at a considerable rate in the first quarter of 1966 and also, as far as can be seen at this stage, in the spring, although total exports were sometimes at a low level. In any case visible exports in the first three months of 1966, partly, it is true, under the influence of certain fortuitous factors, were only 3 % up on the first quarter of 1965.

Domestic demand continued to rise, although its rate of growth slackened again somewhat after the acceleration which took place in the last quarter of 1965. There was a relatively marked seasonal slowing down in expenditure on building. Consequently, the increase in investment by enterprises in equipment and stocks was the most important factor in the expansion of gross fixed asset formation.

While public current expenditure maintained its rapid rate of expansion, private consumers' expenditure was temporarily slowed down by the disappearance of special factors—anticipatory purchases in expectation of tax increases—which had increased the propensity to spend in the fourth quarter of 1965. There was, however, a further substantial rise in the disposable incomes of private households, which gave support in the spring to a revival of the pronounced underlying expansionary trend of expenditure on consumption.

Despite the still very strained state of the labour market, the growth in domestic supply continued. According to the CBS Index, industrial production in the first quarter of 1966 was 6.9 % up on the corresponding period of 1965. The growth in imports was extremely vigorous, the volume of visible imports in January-March having been 13 % greater than in the first quarter of 1965.

The persistent strong pressure of monetary demand, the growing effects of the rise in costs—including repercussions of the raising of the rates of indirect taxes and of public service charges—and, lastly, a substantial increase in the price of some foodstuffs caused an acceleration of the rise in prices. The cost of living was on an average 7.1 % higher in the first quarter and 7.4 % higher in April than it had been a year earlier.

The current balance of payments showed a marked deterioration in the first quarter, which was admittedly to some extent attributable to the special factors which hampered the rise in exports. As at the same time there was a net outflow on capital account, the overall balance of payments for the first quarter closed with a deficit of Fl. 800 million.

There is likely to be a further very considerable increase in monetary demand during the remainder of 1966.

There will probably be a further and rather more marked rise in exports of goods and services. While the growth in capital expenditure might slow down some-

what, particularly owing to a smaller increase in investment in fixed assets by enterprises, public current expenditure will probably continue to expand fairly rapidly, and private consumers' expenditure is again likely to show a pronounced upward trend.

This being so, a continued growth in industrial production is to be expected. There might, however, be a slight slackening of the rise in imports, connected with less rapid building-up of stocks. There is not likely to be any easing of the labour shortage.

Despite a tightening of the measures of price policy, prices will doubtless continue to move upwards, since the overall state of demand encourages producers to pass on increased costs to their customers, and this gives rise to further cost increases. Despite a slight improvement in the trend in the coming months, the current balance of payments for 1966 as a whole is likely to show a substantial deficit.

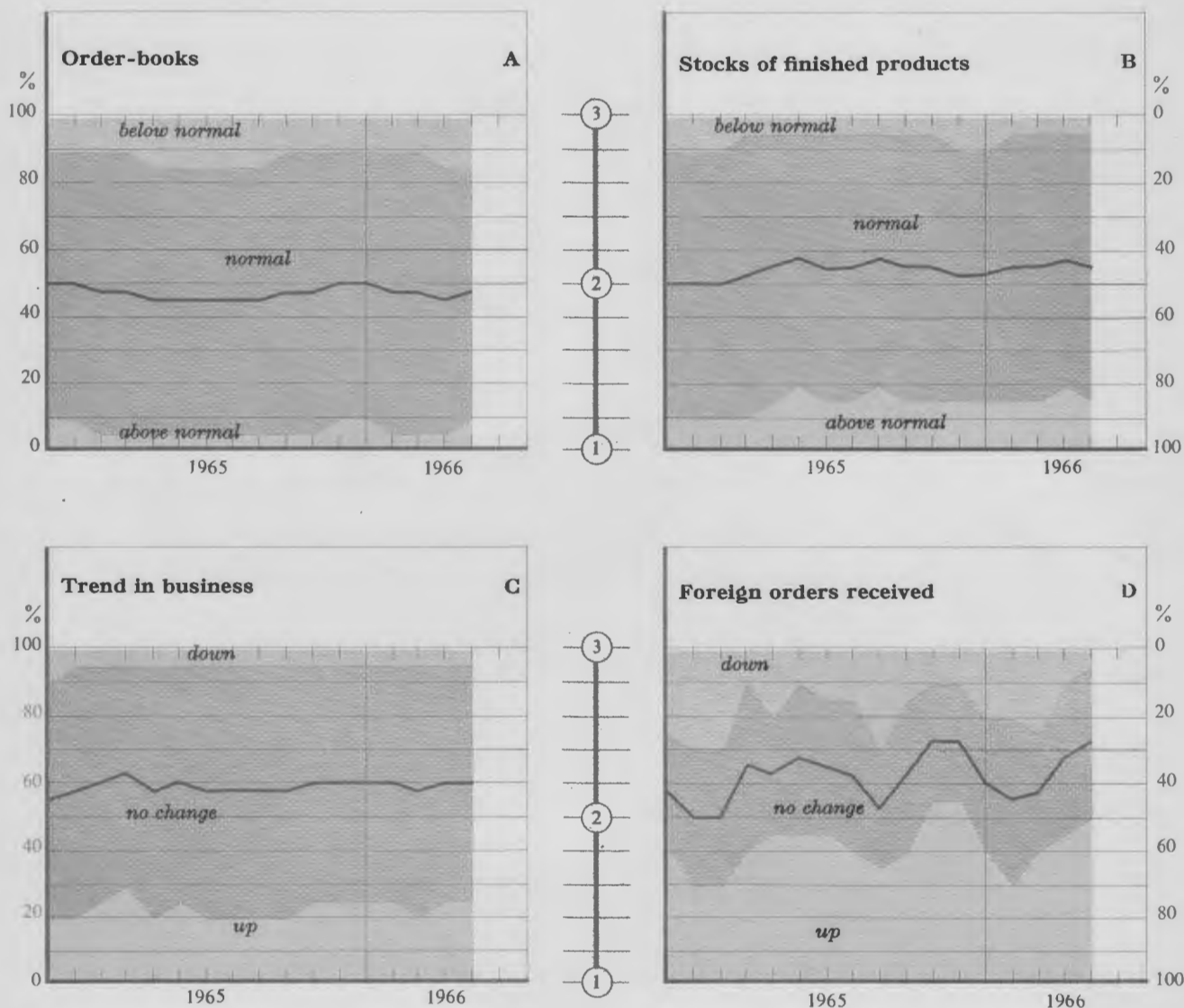
First impressions of the outlook for 1967—even on the basis of the present orientation of economic policy, which has recently, especially in the case of the budgets of the public authorities, been less inclined to reinforce the cyclical trend, and despite the restraining effect of financing difficulties on capital expenditure, particularly by enterprises and provincial and local authorities—do not point to a restoration of equilibrium. Further very considerable rises in public expenditure and in the incomes of private households will tend to support a further expansion in private consumers' expenditure, and demand from abroad is also likely to increase. The growth in the real gross national product from 1966 to 1967 is at present estimated at 3.5-4 %.

The prospect of a continuance of the inflationary pressures coupled with a possible decline in productive capital investment ought now to prompt the adoption of an economic policy which will at last give priority to the stabilization of prices and unit costs. For there is no doubt that, apart from the obvious economically and socially harmful domestic consequences of an inflation which advances steadily year by year (even if the outlook for the current balance of payments is at present temporarily regarded as somewhat more favourable, owing to the effect of special factors such as the extraction of natural gas but also as a result of a declining propensity on the part of enterprises to undertake capital investment), continuance of inflation could also lead, in the not-so-distant future, to a grave imbalance in foreign trade and payments and a serious hampering of economic growth.

1. Recent developments

There was clearly a very distinct slowing-down in the expansion of exports of goods and services in the first quarter of 1966. According to the customs returns, the value of visible exports in January-March was only 3 % up on the corresponding period of 1965 (year-to-year growth rate in the fourth quarter of 1965, 10.4 %).

BUSINESSMEN'S VIEWS ON THE INDUSTRIAL SITUATION



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

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

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

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

An important part was played in this by a decline in exports of agricultural products (mainly as a result of foot-and-mouth disease), especially in the case of deliveries to the other member countries. The total of the latter also showed a slight downward trend, partly owing to the completion of armaments deliveries.

Sales to non-member countries, on the other hand, which already showed a more marked upward trend in 1965, increased further, mainly owing to a sharp rise in deliveries to the United States and a brisk expansion in sales to the United Kingdom.

In April the year-to-year growth rate of visible exports (in terms of value) again reached 12.7 %. In contrast to the development of exports, the expansion of domestic demand was again very marked.

It is admittedly possible that the rise in expenditure on gross fixed asset formation, which had shown a more rapid upward trend in the autumn, may have slackened again somewhat after that, since there was a certain slowing-down in expenditure on building. The rate of increase of expenditure on house-building has presumably become more moderate. The expansion in public capital expenditure, however, appears to have continued at a lively pace. The expenditure of enterprises on plant and equipment—at least, judging by imports—likewise appears to have shown a further distinct upward trend, although a part was also played in this by purchases of means of transport.

There was a further increase in investment in stocks, mainly owing to the still very marked tendency to stockbuilding of raw materials and semi-manufactures at the production level.

The expansion of expenditure on consumption slowed down, though doubtless only temporarily. Public current expenditure, it is true, probably maintained its rapid rate of increase; but private consumers' expenditure does not appear to have shown any basic upward trend in the first quarter of 1966; on the contrary, it would seem to have been, although only slightly, below the exceptionally high level which it reached towards the end of 1965 under the influence of anticipatory purchases made in expectation of the increases in indirect taxes which came into force on 1 January 1966.

The rise in the consumption expenditure of private households, in comparison with the first quarter of 1965, amounted to 7.5 % in terms of value. The increase in volume, however, owing to the steep price rise, was considerably smaller, at 1.5 %. The underlying expansionary trend of consumption appears to have become more rapid again in the spring of 1966.

The income of private households again increased substantially, although somewhat less markedly than a year earlier. Collectively agreed wage-rates in the private sector rose by about 3.5 % from December 1965 to March 1966, with the result that agreed standard wages in the first quarter were 6.2 % up on the corresponding period of the previous year. The upward movement continued in April-May, the rise in real wages having undoubtedly been very considerable. Some of the new collective wage agreements concluded during this period resulted in rates of increase which clearly exceeded the "norm" regarded by the authorities as desirable for this year. This was the case for 15 % of the total number of employed persons. Consequently, at the end of May the author-

ities—after having temporarily suspended their approval of these agreements—fixed the maximum permissible increase in standard wage rates of 1966 at 7 %.

The total number of hours worked rose slightly, and there was a further appreciable increase in transfer incomes. In particular, pensions were increased in April by an average of 10 % retroactively from 1st January.

The adaptation of total supply to the expansion in demand took place very rapidly, in the case both of imports and of domestic production. Although the underlying expansionary trend of industrial production would appear to have slackened somewhat at the beginning of the year, industrial output, according to the CBS Index calculated in terms of production per working day, was still 6.9 % up on the previous year in the first quarter of 1966; in the fourth quarter of 1965 the year-to-year growth rate was 6.2 %.

The growth in production in the mining and non-metallic minerals industries and also in the power production sector was more marked than in manufacturing industry, where there was also a certain slackening of the rise in output of consumer goods. In the building sector, following the disappearance of special factors which had hampered growth in January and February, further substantial increases in production were achieved.

There has been hardly any change since the end of 1965 in the strained situation in the labour market. The seasonally adjusted figure for registered vacancies showed a slight decline up to May, while the number of unemployed remained at about the same level as in the first quarter. At the end of May the number of unemployed was about 38 000, representing an unemployment ratio (ratio of the number of unemployed to the total labour force) of about 0.9 %.

Imports of goods and services continued the dynamic trend which they had shown since the middle of 1965. A point worthy of note is that the increase in imports applies to all main categories of goods, including consumer goods, imports of which were already rising particularly fast towards the end of 1965. According to the customs returns, total visible imports in the first quarter of 1966 showed an increase of approximately 13 % by volume (15 % in value) in the first quarter of 1966, compared with the corresponding period of 1965.

Nevertheless, there was a further deterioration in the price situation, since demand was very lively and costs continued to exert an upward pressure. Wholesale prices for finished goods and basic materials rose distinctly more rapidly from December to February (by 3.2 % and 2.3 % respectively).

Important factors contributing to the rise in the level of consumer prices included a more pronounced upward movement of foodstuff prices and the repercussions of the increase in indirect taxes on various consumer goods. In addition, however, the prices of industrial finished goods and especially those of services again showed a pronounced upward trend. Thus the rise in the cost-of-living index from December 1965 to March 1966 was even greater (+ 3.2 %) than in the corresponding period a year earlier, when the price increase was also substantial (2.6 %). In the first quarter of 1966 the index was on an average no less than 7.1 % higher than in the first quarter of 1965, and in April the year-to-year increase was as much as 7.4 %.

The slackening in the growth of exports and the continued expansion of imports led to a distinct deterioration in the trade balance. According to customs returns the deficit in the first quarter was Fl. 1 700 million, against Fl. 1 200 million in the previous quarter and Fl. 900 million in the first quarter of 1965. The services balance may also have deteriorated somewhat. In any case, the balance-of-payments deficit on current account (on a transactions basis) in the first three months of 1966 came to Fl. 750 million (against a surplus of Fl. 13 million in the corresponding months of 1965). As there was also a slight deficit on capital account, the overall balance-of-payments in the first quarter showed a deficit of about Fl. 800 million.

National product and expenditure

	1963 ⁽²⁾	1964 ⁽²⁾		1965 ⁽²⁾		1966 ⁽⁴⁾
	At current prices (in Fl. '000 million)	% change on preceding year				
		Volume	Value	Volume	Value	Volume
Gross national product	52.34	+ 8.2	+ 16.2	+ 5	+ 11	+ 5.5
Imports ⁽¹⁾	26.09	+ 15.0	+ 18.1	+ 6.5	+ 7	+ 10
Private consumption	31.10	+ 5.7	+ 12.6	+ 7.5	+ 12	+ 4.5
Public current expenditure	7.90	+ 1.6	+ 16.8	+ 1.5	+ 13	+ 2.5
Gross fixed asset formation	12.37	+ 16.5	+ 23.6	+ 6.5	+ 11	+ 8
Exports ⁽¹⁾	26.36	+ 11.9	+ 14.4	+ 8	+ 10	+ 8

⁽¹⁾ Goods, services and factor income.

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

⁽³⁾ Commission estimates.

⁽⁴⁾ Commission forecasts.

Note :

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

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

The growth in internal liquidity was restrained in the first quarter of 1966 by the balance-of-payments deficit. The liquidity—expanding effect of the Treasury's transactions and the impulses emanating from the operations of the banking system with the economy and private individuals were, however, comparable with the influences exerted

in the corresponding period of 1965. There was in fact a further rapid increase in bank lending. The year-to-year rate of increase in the first quarter was no less than some 15 %. This, it is true, did lead to a very distinct reduction in the banks' available liquid funds, greater recourse by the banks to the central bank and—despite this—a distinct tightening of the money markets resulting in appreciable rises in interest rates.

In spite of a decline in issues of shares and bonds by the private sector, the rise in interest rates in the capital market was accentuated. This was largely due to the continued net capital outflow and the increased recourse to the capital market by the public authorities.

2. Outlook

There seems to be no need to make any very major change in the forecast given in the last Quarterly Survey concerning the trend of Dutch exports until the end of 1966. While it is true that the declines in rates of growth in the first quarter will slightly impair the results for the year as a whole, the underlying expansionary trend will doubtless reassert itself during the coming months.

Admittedly, demand from the Federal Republic of Germany, which takes some 28 % of the Netherlands' exports, will be at a relatively low level; but the prospects for increased sales to the other member countries remain favourable. The same is true of exports to non-member countries, which are likely to show a continued upward trend.

As regards the probable development according to categories of products, there may be a certain catching-up, mainly due to a revival of cattle and meat exports, in sales abroad of farm products. Furthermore, the recent trend of incoming foreign orders for industrial products, as reflected in the results of the CBS business survey, would appear to warrant the assumption that there will be a further growth in exports of these goods.

As to the factors which might influence the development of Dutch exports from the supply side, the position has not changed appreciably from that described in the last Quarterly Survey.

With regard to gross fixed asset formation, a further expansion seems certain, despite the increasing financing difficulties. In the case of public capital expenditure (at least that of the government) and expenditure on house-building, which have up to now increased fairly markedly, though in differing degrees, the growth should continue, but without becoming any faster. On the other hand, the trend of expenditure by enterprises on gross fixed asset formation is likely to be increasingly affected by a weakening of the expansionary factors hitherto operative, namely the growing scale of activity in the opening-up of natural gas resources and the purchase of ships and aircraft. With regard to the cyclical factors, too, there are many indications of a slackening of tempo. Businessmen, especially in industry, appear to be becoming somewhat less inclined to undertake capital investment, despite the rather greater capacity available in the building sector for industrial construction. The fact is that the self-financing possibilities of all except the biggest firms have been adversely affected, despite the de facto possibility,

until May, of partially passing-on cost increases to prices, by—in particular—the very marked rise in unit wage costs which has now been in progress for many years. Furthermore, recourse to outside financing has become more difficult and expensive, mainly owing to the considerably greater use made of the capital markets by the public authorities. The restrictive credit policy, too, although as yet still very flexible, is playing a part in this connection.

The very brisk investment in stocks during the last few months may be followed by a slight slackening. The process of building up stocks of raw materials and semi-manufactures has now been going on since mid-1965; there should therefore soon be a return to normal, especially as finance has become scarcer. The rapid rise in domestic prices is, however, hardly a factor conducive to a slackening in speculative stockbuilding.

Public current expenditure will probably continue to increase very rapidly. While the expansion might not be quite as pronounced as in the second half of 1965, it appears to be appreciably above the budget estimates, although the authorities intend to adopt economy measures, especially a temporary stop to new appointments.

Generally speaking, the trend of incomes of private households points to a further large rise in private consumers' expenditure. The level of employment is likely to rise further, and the increases in standard wage rates already approved by the authorities or submitted to them for approval, together with the wage drift which will in addition be accentuated as a result of the limit of 7 % imposed on the increase in standard wage rates, can be expected to lead to such a rise in wages per employed person in the private sector that the increase for the year as a whole may match that of last year (11 %).

An important factor in this connection is that in 1966 the general additional "holiday bonus", which is paid towards the middle of the year, was raised from 4 to 6 % of the annual wage. At the same time, wages in the mechanical engineering industry and the metal-producing and processing industry are going up for the first time by 2 % solely owing to the new sliding-scale agreements.

These rise in the disposable incomes of private households should, however, again be rather more strongly curbed by the progressive effect of taxation, as the repercussions of the reduction in income tax granted in mid-1965 gradually become less marked.

The impulses emanating from the expansion in overall demand will cause a further growth in domestic supply in the coming months. In view of the large order books and the new orders likely to be received it is, to be expected that the basic upward trend of industrial production in particular will continue at a very rapid rate. The physical obstacles to growth, especially the labour shortage, which are tending to slow down the rise, are not likely to be accentuated.

The expansion in imports might slacken somewhat during the year owing to a less rapid rise in purchases of raw materials and semi-manufactures and the gradual decline in special imports of means of transport (ships and aircraft).

The upward trend of prices will be restrained in the coming months owing to the fact that, after the measures adopted by the government in May, the rises in firms' internal costs can no longer be passed on to prices. But the high level and very rapid growth

of monetary demand—especially public demand and private consumers' demand—are likely to facilitate the passing-on to prices of the continuing rise in firms' outside costs. Furthermore, "autonomous" price-raising factors will still play a part as a result of the tax measures introduced at the beginning of the year and the adjustment of the scales of charges for certain public services. Lastly, some uncertainties remain with regard to the movement of prices for foodstuffs, although this year's harvests might prove better than those of 1965.

The pronounced deterioration in the trade balance which was observable in the first four months of 1966 might be followed in the coming months by the resumption of a rather more favourable tendency. Nevertheless, it appears certain that for the whole of 1966 the current balance of payments will show a substantial deficit.

A comparison of the prospects outlined above with those published in Quarterly Survey No. 1/1966 shows that the quantitative estimates then made of the percentage changes in the volume of supply and demand or of their main components do not need to be appreciably altered. With regard, however, to the rise in consumer prices and the state of the current balance of payments, it now appears certain that the results will be even more unfavourable than in 1965.

The first forecasts of the possible development of the Dutch economy in 1967 indicate that the situation may be characterised simultaneously by persistent and very marked inflationary tensions and by a certain decline in productive capital investment, unless the authorities adopt an economic and financial policy even more appropriate to the requirements of the cyclical situation. While it is true that, mainly owing to the effects of the natural-gas extraction on exports (expansionary) and imports (restraining) and owing to the decline in capital investment by the business sector, there may be some improvement in the current balance of payments, there will still be a very pronounced rise in domestic prices.

For in fact very strong pressures will again be exerted by foreign demand and even more—unless the measures concerning the government budget adopted at the end of May are reinforced—by consumer demand from private households and the current demand of the public authorities. Any further appreciable rise in the incomes which affect costs would, however, make it almost impossible for enterprises to maintain their level of capital expenditure, so that the shortage of internal and external means of financing might lead to a decline in such expenditure. As for public capital expenditure, especially that of the local authorities, financing problems will remain acute. It can also be assumed that expenditure on house-building, too, will show only a small rise over that in 1966.

On the other hand, the elasticity of production will be limited in relation to the expansion of monetary demand, especially owing to the shortening of working hours planned for the middle of the year. The Commission's staff at present estimate the possible growth in the gross national product from 1966 to 1967 at 3.5 to 4 %.

With regard to overall economic policy, the central bank recently somewhat accentuated its restrictive credit policy. On 2nd May it raised its discount rate from 4.5 to 5 %. True, this was a "technical" move in so far as money market rates had risen above the official discount rate, mainly owing to the tightening of bank liquidity, which,

in turn, is largely due to the rapid credit expansion. But a part was doubtless also played by considerations of economic policy, and particularly by the wish to confirm and maintain the higher cost of borrowing. Furthermore, the monetary authorities set the quantitative limit to the expansion in short-term bank lending in the May-August period in such a way that its observance would entail a slowing-down of the expansion in comparison with that envisaged for the period from January to April.

It still does not appear certain, however, that the banks will in fact observe the limit. Furthermore, there is the question whether the permissible credit expansion is still not too large in relation to what would be required for an effective stabilization policy. Lastly, the supervision of the increase in medium and long-term lending and also the supervision of the financial and credit institutions other than commercial banks could perhaps be further improved.

These questions appear all the more justified the more likely the prospects become of a more favourable turn in the current balance of payments, which would mean a cessation of the pressure exerted on bank liquidity by the balance-of-payments deficits. There is also the question whether the restrictive credit policy could not be made more selective, to the disadvantage of consumer credit and of lending for the purpose of financing wage and price increases and speculative stocks but in favour of credit for productive business investment.

Still more important than a more effective credit policy—which always, even when selective, hampers productive investment—would be a tightening of public budgetary policy, which at present not only itself has the net effect of giving far too expansionary a stimulus but also impedes credit policy.

Actually the net stimulus provided by the public authorities as a whole, which—although less than the result for 1965—was in any case already set too high in the budgets for 1966 in relation to the requirements of a stabilization policy, is again going beyond the amount estimated. This is particularly because, with the high level of overall spending and the quickening rate of public capital investment, the intended slowing-down of the rise in outlay on goods and services simply cannot be achieved to a sufficient extent. The “austerity” measures already announced in May—namely, the suspension of the placing of orders for public capital expenditure until 1 October 1966, the cessation of new appointments of civil servants until the end of 1966, the search for possibilities of economizing and the trimming of the expenditure of the public authorities—do not appear to make any fundamental change in the situation.

The year 1967 might well be characterized by the same phenomena unless the authorities decide really to moderate the growth in public capital expenditure and genuinely to curb the expansion in current expenditure and unless the deficits are appreciably reduced. In this connection attention should be drawn to the danger which might arise if—as has long been announced—the wage tax were in fact lowered again at the beginning of 1967. For then, owing to the fillip given to private consumption, the volume of demand would continue to be excessive and the government budget deficit would rise even more, and also the already existing financing problems would be aggravated; the scale of monetary financing could then become dangerous, unless on the other hand there were a really drastic cut in capital expenditure by enterprises.

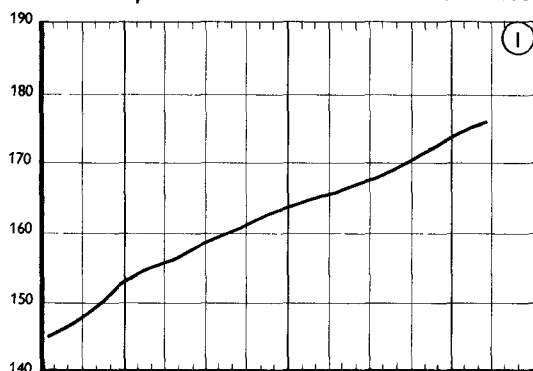
It does in fact look as if the tendency of the public authorities' transactions to reinforce the cyclical trend will continue into 1967. Consequently, energetic counter-measures would appear to be urgently needed.

So long as, owing to the excessively high level of overall monetary demand, the state of over-employment persists, even greater efforts in the field of incomes policy are not likely to be sufficiently successful in curbing the growth in consumption and cost incomes. True, the authorities have now restricted the rise in wage rates in 1966 to an amount regarded as permissible, namely 7 %, so that wage increases going beyond this will no longer be approved. Welcome though such efforts are in themselves, it is not possible, in the circumstances outlined, to be confident that the wage drift, and especially the various kinds of "grey" and "black" wage increases, will not cause the expansion in actual earnings to exceed the—already too high—limit set.

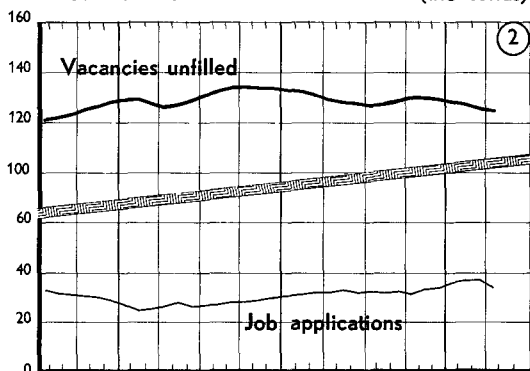
As for price policy, the measures adopted in May, which are mainly aimed at preventing the passing-on of increases in wage costs to prices, may well be expected to have certain psychological effects and to help to moderate wage claims. But the dangers which may result if such measures are kept in force for any considerable length of time must not be overlooked. Direct price controls have not made the need for recourse to the classical instruments of anti-cyclical policy any less urgent; indeed, they call for an orientation of economic policy—especially in the field of public finance, where, as already mentioned, a reduction of the deficits of the public administrations is necessary—which will at last be appropriate to the aim of achieving a genuine stabilization of prices and costs.

ECONOMIC INDICATORS

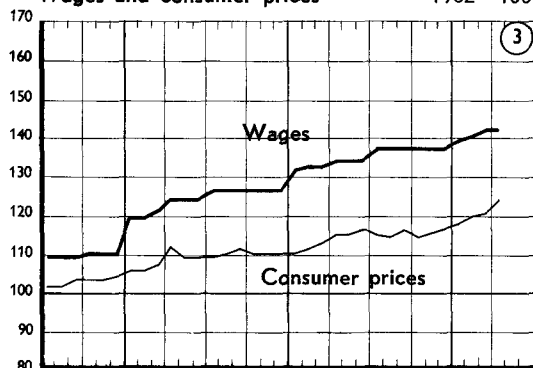
Industrial production 1958=100



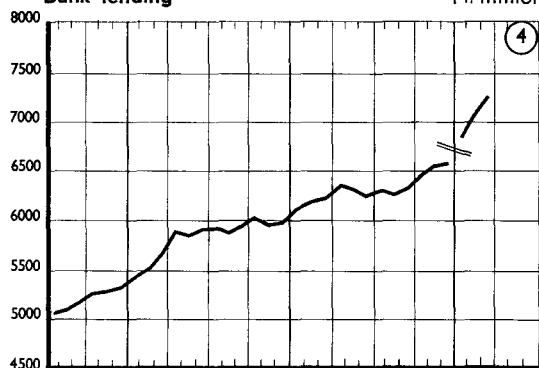
Labour market (thousands)



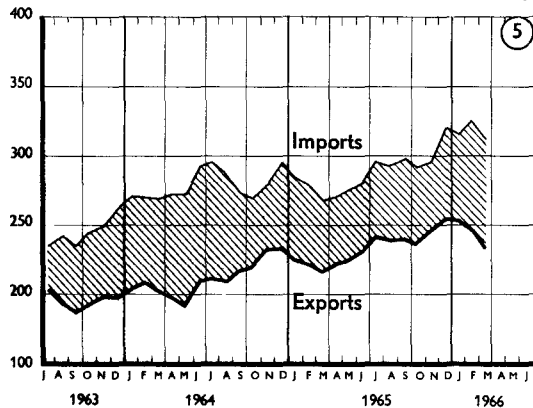
Wages and consumer prices 1962=100



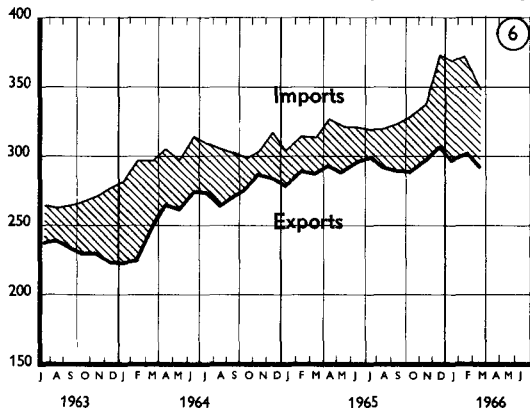
Bank lending Fl. million



Trade with non-member countries million u.a.



Trade with other member countries million u.a.



NOTES:

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

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

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

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

Graph 4. Short-term bank advances. Revised series as from 1.1.1966.

Graphs 5 and 6. Series adjusted for seasonal and accidental variations (moving averages of 3 months). Exports fob, imports cif. Conversion at official exchange rates. 1 unit of account = 0.888671 gm. of fine gold = US \$1 at the official rate of exchange.

Netherlands

TABLE 1: Basic data (1964)

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

TABLE 2: Development of basic economic data

	% change by volume on preceding year							Volume indices (1958 = 100)	Contri- bution (in %) to 1964 GNP
	1959	1960	1961	1962	1963	1964	1965		
Gross national product	+ 5.2	+ 8.9	+ 3.5	+ 3.8	+ 3.1	+ 8.6	+ 5.0	145	—
Industrial production	+ 9.0	+10.1	+ 4.2	+ 4.8	+ 4.6	+ 9.5	+ 6.0	159	—
Total imports	+13.8	+17.3	+ 5.8	+ 7.5	+ 9.1	+15.3	+ 5.9	202	49
Private consumers' expendi- ture	+ 4.6	+ 6.4	+ 5.8	+ 6.5	+ 6.6	+ 6.2	+ 7.4	152	58
Public current expenditure on goods and services	- 1.2	+ 6.6	+ 4.4	+ 5.1	+ 4.7	+ 1.7	+ 1.6	125	15
Gross fixed asset formation	+12.0	+11.6	+ 6.7	+ 4.4	+ 2.0	+16.5	+ 6.5	176	25
Total exports	+11.5	+13.3	+ 3.0	+ 6.2	+ 5.9	+12.2	+ 8.2	178	49
Gross national product per capita	+ 3.7	+ 7.6	+ 2.2	+ 2.4	+ 1.7	+ 6.8	(+ 3.5)	(131)	—
Gross national product per person gainfully employed	+ 4.0	+ 6.7	+ 1.8	(+ 0.9)	(+ 1.8)	(+ 7.1)	(+ 3.4)	(127)	—

() Provisional figures.

Netherlands

TABLE 3 : Foreign trade (at current prices)

	% change on preceding year							Indices 1958 = 100	Million u.a.	% of the total
	1959	1960	1961	1962	1963	1964	1965	1965	1965	1965
Visible exports										
Total	+12.1	+11.7	+ 6.9	+ 6.5	+ 8.2	+17.0	+10.1	199	6 396	100
Intra-EEC	+19.4	+15.8	+10.9	+10.0	+17.3	+22.1	+10.2	267	3 564	55.7
To non-EEC countries	+ 6.9	+ 8.4	+ 3.6	+ 3.2	- 0.6	+11.2	+10.0	151	2 832	44.3
Exports of food, beverages and tobacco										
Total	+14.4	+ 5.3	+ 0.8	+ 6.9	+ 9.3	+ 9.5	+13.0	176	1 568	24.5
Intra-EEC	+26.9	+ 6.1	+ 3.1	+10.0	+12.1	+12.8	+19.7	231	972	15.2
To non-EEC countries	+ 3.4	+ 4.4	- 1.8	+ 3.3	+ 5.8	+ 5.1	+ 3.6	126	596	9.3
Exports of raw materials and manufactures										
Total	+11.2	+14.2	+ 9.2	+ 6.3	+ 7.9	+19.6	+ 9.2	208	4 828	75.5
Intra-EEC	+16.1	+20.7	+14.3	+10.0	+19.4	+25.6	+ 7.1	283	2 592	40.5
To non-EEC countries	+ 8.1	+ 9.6	+ 5.2	+ 3.2	- 2.4	+13.1	+11.9	159	2 236	35.0
Visible imports										
Total	+ 8.7	+15.0	+12.8	+ 4.6	+11.6	+18.2	+ 5.9	206	7 471	100
Intra-EEC	+15.3	+18.6	+21.1	+ 6.7	+14.9	+19.0	+ 8.7	263	3 987	53.4
From non-EEC countries	+ 3.9	+12.2	+ 5.8	+ 2.5	+ 8.3	+17.4	+ 2.9	165	3 484	46.6
Imports of food, beverages and tobacco										
Total	+ 9.4	+ 3.4	+ 5.9	+ 6.3	+15.5	+16.2	+ 3.5	177	988	13.2
Intra-EEC	+ 9.5	+16.4	+41.5	- 7.0	+11.8	+22.0	+13.1	282	225	3.0
From non-EEC countries	+ 9.3	+ 1.2	- 1.0	+10.0	+16.3	+14.9	- 1.2	159	763	10.2
Imports of raw materials and manufactures										
Total	+ 8.5	+17.2	+14.0	+ 4.3	+11.0	+18.6	+ 6.3	211	6 483	86.8
Intra-EEC	+15.6	+18.8	+20.0	+ 7.6	+15.0	+19.0	+ 7.8	262	3 762	50.4
From non-EEC countries	+ 2.3	+15.6	+ 7.7	+ 0.7	+ 6.1	+18.0	+ 4.2	167	2 721	36.4

TABLE 4 : Basic monthly indicators

	Year	Jan.	Feb.	Mar.	Apr.	May	June	July	Aug.	Sept.	Oct.	Nov.	Dec.
Industrial production (1958 = 100)	1964	146	151	154	154	158	153	138	141	154	167	168	164
	1965	157	159	159	163	166	164	145	147	165	177	179	174
	1966	165	168	173	177								
Investment (Fl. million)	1964			3 295			4 017			3 899			4 078
	1965			3 787			4 301			4 222			4 640
	1966												
Building (Fl. million)	1964			1 362			1 682			1 783			1 613
	1965			1 545			1 814			1 993			1 854
	1966			1 587									
Private consumers' expenditure (1958 = 100)	1964	157	146	159	158	173	160	181	161	166	182	173	193
	1965	175	157	173	184	187	180	204	174	185	199	200	230
	1966	190	166	190									
Total visible imports (million u.a.)	1964	589	569	549	640	562	623	636	499	559	623	567	630
	1965	554	564	631	614	577	617	665	537	620	676	625	793
	1966	625	626	759	701	630							
Total visible exports (million u.a.)	1964	452	446	440	479	455	491	484	405	561	552	505	538
	1965	477	489	532	506	501	554	543	438	596	594	557	611
	1966	499	470	572	570	544							
Balance of trade (million u.a.)	1964	- 137	- 123	- 109	- 161	- 107	- 137	- 152	- 94	+ 2	- 76	- 62	- 92
	1965	- 77	- 75	- 99	- 108	- 76	- 68	- 121	- 98	- 24	- 82	- 68	- 182
	1966	- 126	- 156	- 188	- 131	- 86							
Official gold and foreign exchange reserves (million u.a.)	1964	1 860	1 841	1 833	1 802	1 817	1 786	1 869	1 879	1 960	1 965	2 069	2 084
	1965	2 075	2 094	2 069	2 083	2 036	2 010	2 042	2 053	2 065	2 088	2 120	2 058
	1966	1 970	1 972	2 002	(1 950)								
Money supply (Fl. '000 million)	1964	14.31	14.31	14.29	14.51	14.99	15.08	15.10	15.10	15.13	15.01	15.27	15.45
	1965	15.53	15.56	15.67	16.05	16.62	16.81	17.01	17.04	16.89	16.89	16.97	17.15
	1966	17.09	17.07	17.04	17.50								

Netherlands

NOTES

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

Table 1

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

Table 2

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

Table 3

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

Table 4

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

E. B.L.E.U.

Belgium

The expansion of overall demand and production slackened again somewhat in the first quarter of 1966, following the marked activity observed in the autumn of 1965.

In the first place, the underlying rate of growth of effective external demand decreased very noticeably, due mainly to a certain falling-off in exports to non-member countries. Secondly, domestic demand, reacting after the measures taken at the end of 1965 to forestall the impending increase in indirect taxation, increased very slowly at times.

Gross fixed asset formation by enterprises continued to expand—at a moderate rate—and public investment even showed a sharply increased upward trend. Despite the fact that the special factors already mentioned were no longer applicable, investment in stocks also gave a considerable stimulus to economic growth.

The increase in consumer spending eased off slightly, however. In fact private consumers' expenditure—despite further rapid increases in personal incomes—has lost some of its impetus for the time being. This is mainly due to a return to normal in the pattern of spending.

The slackening of the rate of expansion and certain structural weaknesses of demand were reflected in the trend of domestic production, with the result that, according to the INS index, industrial production increased by only just 2 % over the corresponding level in the first quarter of the previous year. The rate of expansion in imports likewise tended to slacken temporarily.

Conditions in the labour market continued to ease slightly, though no general relaxation was noticeable. This was one of the reasons for the further increase in production costs and prices. In addition there were the after-effects of the increase in indirect taxation and the rise in world prices of certain raw materials, as well as fortuitous increases in the prices of some agricultural products. The general retail price index was no less than 5.2 % higher in April/May than a year earlier.

According to customs returns there was a deficit of Bfrs. 200 million, on the trade balance in the first quarter. There was a substantial deficit on current account, and the overall balance of payments showed a deficit—though only a moderate one—despite considerable net imports of capital.

The slackening of economic development is unlikely to continue for the rest of the year. Firstly, a certain recovery in the growth of exports is to be expected. Secondly, domestic demand should give more of a stimulus to the economy than in the last few months. At the same time, public current expenditure will probably pick up again,

and public capital expenditure should continue to expand vigorously. Private consumption, which slackened in the first quarter, should also pick up again a little, while private capital investment is likely to continue to increase at its present moderate rate.

Production will continue to rise and industrial output will probably rise rather more rapidly. Expansion in the building and construction industry should also continue. Finally, imports will probably tend to increase more sharply.

In spite of the anticipated increase in the rate of growth of production, the trend towards a slight easing of the situation on the labour market—which has predominantly structural causes—should continue.

The upward movement of prices, will probably be maintained, though probably not at quite the same rapid rate as in the earlier part of the year.

The first forecasts for the year 1967 indicate a possible rate of growth of the real Gross National Product of about 3.5 %; the main argument in favour of this is the expectation of a somewhat livelier increase in business investment. Once again there is a danger that consumer expenditure may increase too rapidly, and that costs and prices may continue to rise—although perhaps not quite so sharply as in 1966.

As far as the latest stabilization measures taken by the authorities are concerned, it is regrettable that public current expenditure and private consumers' expenditure are not yet being curbed more vigorously. If the authorities had followed the advice of the Council of the Community in 1964, and particularly in 1965, instead of pursuing a strongly expansionary policy in public expenditure, with considerable deficits even in the ordinary national budget, there would certainly not have been such a sharp rise in costs and prices as has now occurred, and there would have been no need for emergency measures.

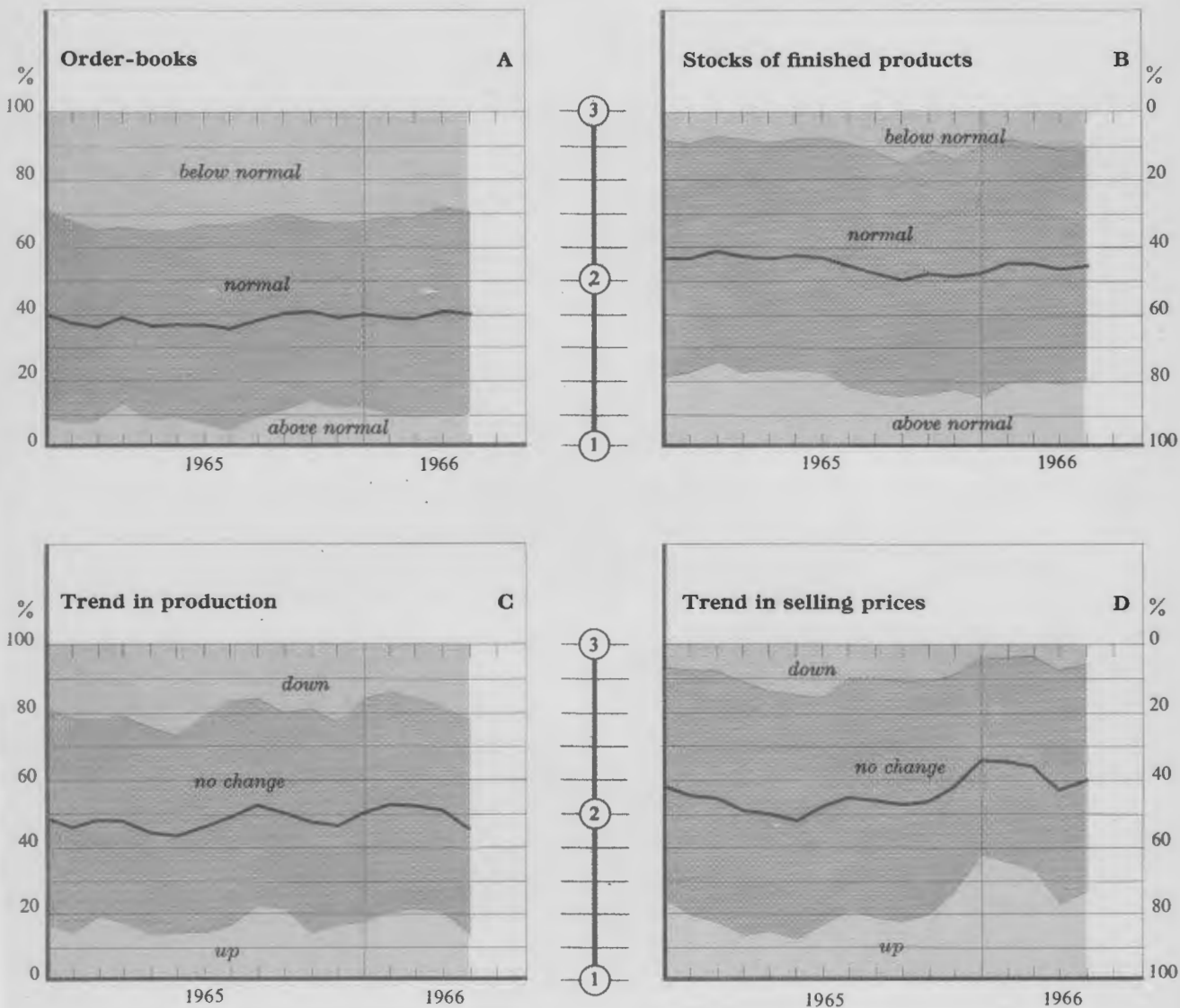
These emergency measures—like the general price freeze—will only be of use if more effective measures are introduced at the same time to reduce the overall deficit in public expenditure and to put the financing of the deficit on to a really firm basis, and if the monetary and credit policies do in actual fact restrict adequately the expansion of money supply.

1. Recent developments

The increase in the export of goods and services in the first quarter of 1966 appears to have been only moderate. According to customs returns, visible exports increased by 5 % over the corresponding period of the previous year, compared with a year-by-year growth rate of 14.4 % in the fourth quarter of 1965.

The main factors responsible for this slowdown were a temporary fall in sales to other member countries, particularly to Federal Germany, a considerable slackening in

BUSINESSMEN'S VIEWS ON THE INDUSTRIAL SITUATION



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

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

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

the rate of growth of export to EFTA countries, and a decline in deliveries to the developing countries. It is difficult to say at the moment whether, and to what extent, the pressure of domestic costs and prices has contributed to this slackening process.

Domestic demand continued to expand, but the rate of growth slowed down again a little after the acceleration in the autumn.

However the rate of growth of expenditure on gross fixed asset formation—when seasonally adjusted—does not seem to have declined. In the first place, business investment, thanks mainly to the continuing expansionary trend of investment in construction, has gone on increasing at the same moderate rate as in previous months. Secondly, public investment appears to have risen considerably, mainly because of a sharp increase in expenditure by subsidiary regional bodies, while the tendency toward expansion in residential construction is now confirmed.

Investment in stocks also seems to have given a further noticeable stimulus to growth, despite the fact that the speculative factors which operated towards the end of 1965 are no longer present; in particular, stocks of raw materials and semi-manufactures appear to have increased.

The growth in consumer expenditure, which speeded up considerably towards the end of 1965, slowed down—probably only temporarily. Judging from the incomplete data available, this also seems to be true of public current expenditure, which only rose very slightly on the whole from the high level already attained. Private consumers' expenditure also increased at a slower rate, mainly because the anticipatory purchases made in the last months of 1965 were followed by a partial swing in the other direction in the first quarter of 1966.

The monetary incomes of private households continued to rise fairly rapidly. Agreed wages rose rapidly because the sliding scale was brought into play more frequently. The number of hours worked also rose slightly, and the increase in transfer incomes was considerably accelerated by new regulations introduced at the beginning of 1966 on old age pensions and family allowances.

The rise in domestic supply slowed down again somewhat during the first quarter of 1966 after the marked acceleration which occurred in the last quarter of 1965. Above all the growth trend in industrial production became less vigorous. According to the gross INS index, the year-to-year rate of increase in the first quarter of 1966 was 1.9 % compared with 2.2 % in the previous quarter.

The decline in the rate of expansion of industrial production is due principally to a less vigorous increase in the production of durable consumer goods and of basic materials and semi-manufactures. The upward trend in the production of non-durable consumer goods and capital goods continued to be quite marked.

Building output seems to have risen again since the beginning of 1966—taking seasonal adjustments into account—following the increased activity in the second half of 1965.

The increase in production was achieved mainly as a result of considerable progress in productivity. Largely for this reason the tendency for the labour market to ease was maintained, but the movement was still very slight. In May the unemployment rate, expressed as the ratio of the number of those seeking employment, receiving benefit and fully or partly able to work, to the total number registered for unemployment insurance, was no more than 1.2 %. The slight rise in the unemployment figures was due to structural factors even more than to recent economic trends.

The growth of imports, which had speeded up in the latter part of 1965, tended to slow down—again probably only temporarily—in the first quarter of 1966. According to customs returns the year-to-year growth rate of visible imports was 13 %, compared with 14 % in the previous quarter.

The rise in prices continued, and at the retail level it actually accelerated. Apart from the pressure of demand, particularly of overall consumer expenditure, the factors responsible for this were a continuing if somewhat slower rise in unit labour costs, the gradual effect of the increase in indirect taxation, the rise in price of imported raw materials and semi-manufactures, and an exceptional increase in the price of some agricultural products, particularly potatoes. The retail price index for the first quarter of 1966 exceeded the level for the corresponding period of the previous year by 4.4 %; in April/May the year-to-year rate of increase was actually 5.2 %.

The trade balance as shown by the customs returns, deteriorated slightly. After a surplus of Bfr. 200 million in the last quarter of 1965, there was a deficit of Bfr. 200 million in the first three months of 1966, compared with a credit balance of Bfr. 4 400 million in the first quarter of 1965.

Although the services balance was very favourable, the balance of current payments for the first quarter of 1966 closed with a deficit of Bfr. 1 500 million. As in the previous quarter, there was a deficit on capital transactions on government account and a further surplus in private capital transactions mainly as a result of direct foreign investment. The balance of payments as a whole showed a deficit of Bfr. 800 million in the first quarter.

This is reflected in the currency reserve situation as follows: from December 1965 until the end of March 1966 the net foreign assets of the National Bank decreased by Bfr. 3 100 million, while those of the other institutions increased by Bfr. 2 300 million.

Thus, while transactions with the rest of the world tended to reduce domestic liquidity, bank advances to industry and private individuals continued to be an important factor in expansion. Despite the disappearance of the additional credit requirements engendered by the anticipatory buying at the end of 1965, bank lending increased by no less than 4 % between the end of December 1965 and the end of April 1966. This was due not only to the actual trend of the economy, but also to the fact that price increases in domestic as well as world markets encouraged speculative measures, particularly in stock-building.

Transactions by the Treasury again helped to increase domestic liquidity. Although taxation revenue was better than the estimates and there was some reduction in the deficit, public expenditure continued to be financed by recourse to the money market

in the first few months of the year. Certain difficulties were encountered in placing the government loan of Bfr. 10 000 million which was floated during May.

Interest rates in the money and capital markets rose again after the end of 1965.

National product and expenditure

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

⁽¹⁾ Goods, services and factor income.

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

⁽³⁾ Commission estimates.

⁽⁴⁾ Commission forecasts.

Note :

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

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

2. Outlook

It is hardly likely that the falling-off in the growth of overall demand observed in the first quarter will continue in the coming months.

The slackening in the expansion of the export of goods and services is probably only temporary. The considerable drop in deliveries to the developing countries was probably largely fortuitous. What is more, the noticeable slackening in sales to the remaining non-member countries, in particular to the EFTA countries, may well be followed by a more lively trend in the coming months, at least judging from the level of demand in these countries. Finally, as far as the member countries are concerned, there have not as yet been any changes in the favourable prospects for expansion.

It should also be borne in mind that in most export industries there is no shortage of productive capacity to stand in the way of a more rapid increase in exports. On the other hand the trend of domestic prices and costs is not exactly favourable to the development of exports. Therefore, while the expansion of exports may be expected to increase, the rate of growth is unlikely to be particularly fast.

At the same time, however, domestic consumer demand will probably make a bigger contribution to the growth of the economy than in the last few months.

As far as gross fixed asset formation is concerned, the growth rate of investment expenditure by enterprises is unlikely to rise faster. In many traditional businesses there is no incentive to undertake additional capital investment, given the level of profits and current margin of idle capacity. Thus investment in rationalization and the execution of investment projects by foreign firms will once again be the real motive force behind the slight overall tendency towards expansion.

On the other hand public capital expenditure will doubtless continue to increase rapidly, although the difficulties of financing, particularly for subsidiary regional bodies, introduce an element of uncertainty. Finally, there is unlikely to be any slackening of investment in residential construction.

The increase in investment in stocks will probably be somewhat slower. Stocks of many raw materials and semi-manufactures have already been replenished, and the National Bank's credit squeeze will have its effect.

Consumer expenditure should again increase rapidly however. There will doubtless be a further acceleration in the rate of public current expenditure, and the rate of increase of private consumer spending will probably rise again as soon as the pendulum has swung back again from the reaction which followed the anticipatory purchases at the end of 1965.

Consumption will naturally not develop as strongly as it did in 1965 under the stimulus of the increase in employees' income. The increase in the volume of employment (the total number of hours worked) is likely to remain limited on account of the reserves of productivity which were built up during the lull in economic activity. Moreover the upward trend in rates of pay as a result of wage settlements could slow down somewhat if the slight tendency of the labour market to ease were confirmed. But there is unlikely to be any substantial slackening in the upward movement of workers' wages, as the sharp rise in prices will affect wages on the sliding scale.

In addition it seems that the steady expansion of transfer incomes—in this context mention should be made of the new regulations on old age pension schemes for workers, employees and the self-employed, which are now before parliament—will largely neutralize the effects of the factors making for a downturn.

The increase in overall demand which is to be expected in the coming months will no doubt be reflected in the development of domestic supply. Industrial production in particular could show somewhat livelier rate of growth than in the first few months of this year, mainly as a result of a recovery in the output of consumer goods and semi-manufactures. Activity in building and construction should also increase.

With regard to imports, a rather more dynamic development is likely following the temporary slackening observed in the first quarter.

Prices, particularly in private consumption, will tend to show a marked increase. This is due to the high level of monetary demand, which is increasing particularly fast in the consumption sector, but mainly to the continuing increase in unit labour costs to the higher prices paid for imported raw materials and to the after-effects of increases in indirect taxation and in the tariffs of public transport undertakings.

The first tentative forecasts for the development of the economy in 1967 suggest an increase in the real GNP of about the same size as in 1966 (3.5 %).

This forecast is based principally on the assumption that the investment expenditure by enterprises will increase rather more vigorously this year, mainly as a result of a partial recovery of profit margins of industrial concerns in particular, provided that the upward trend of wages really slows down, and that productivity increases along with production. The remaining components of domestic demand—public expenditure and private consumption—are likely to expand very sharply in any case. Finally, external demand will again provide a marked stimulus to the economy.

The extent to which the opportunities for increasing exports and achieving a satisfactory external equilibrium can be grasped—to offset the increase in imports which is likely to result from the trends in the domestic economy outlined above—will of course depend also on the achievement of internal equilibrium.

The various economic measures recently taken or announced by the National Bank and by the Government underline their intention both to check the cost-price spiral and to achieve a satisfactory growth in business investment particularly by improving facilities for financing on the capital market.

Thus the National Bank, faced with a rapid increase in bank lending to business firms and private individuals, found itself obliged to re-impose the quantitative restrictions on credit expansion which had been suspended in July 1965. Exhortations to the banks to exercise moderation in credit expansion have clearly been of no avail. Now the National Bank has called upon the banks to limit the increase in loans granted in 1966 to 12 % of the total amount of credit outstanding on 31 December 1965 and not to exceed an increase of 6 % in the first six months. This quantitative restriction is valid for all loans, except cash advances to firms operating in other countries. In addition the National Bank has called on the banks to apply special restrictions to the expansion of credit for financing property transactions, hire purchase, speculative stocks and personal loans. Should expansion limits not be observed by the banking system as a whole, the National Bank could find itself obliged to re-introduce the system of minimum reserves. Moreover the National Bank always reserves the right to use those weapons which it has at its disposal as lender of last resort against any bank which disregards these recommendations.

Lastly, the National Bank has raised the discount rate from 4.75 % to 5.25 % with effect from 2 June 1966, to reinforce the effect of the quantitative limitation on bank

credits. Another reason for this measure is the need to adapt official rates of interest to conditions on the discount market.

The government has also taken or announced various measures intended to check the rise in prices. The authorities have therefore ordered a general freezing of the prices of goods and services for at least three months as from 6 May. It is also proposed that a voluntary decrease in producer prices and gross margins in the wholesale trade, in imports and in the retail trade should be achieved by negotiation with the interests concerned. In addition consideration is being given to a lowering of customs tariffs and an enlargement of tariff quotas as a means of reducing the price of imports. The possibility of reducing indirect taxation on a certain number of products which play a key part in the family budget is also being considered. Special supervision of the markets will ensure that the tax relief is in fact passed on to consumer prices.

The Government's budgetary policy is aimed at restricting the rise in public current expenditure and transfer expenditure, so as to keep the deficit on the ordinary budget down to Bfr. 6 000 million. In particular it has been decided to postpone new school building programmes for a year and to rationalize the educational system. Various measures in regard to health insurance will ease the burden on the state. It is also intended to limit increases in expenditure by semi-governmental bodies.

The Government has taken several measures aimed at achieving a more satisfactory growth of productive investments. As regards funds for financing company investment, the authorities have decided to introduce a tax reform reducing the rate of the withholding tax on securities (*taux du précompte mobilier*) from 27 % to 20 %. A Bill has also been drafted which will entitle the deposit banks to include industrial debentures in their portfolios for a certain period. The Government has also tabled a Bill to provide considerably greater support under the schemes for encouraging investment in hard-hit areas by adjusting the laws passed in 1959. Finally it is proposed to increase tax exemption for "popular" savings and to give certain concessions to wage-earners.

On the whole this appears to be a constructive economic policy, provided that it is only the beginning of a continuing process of stabilization, which will attack the root causes of inflation.

This is particularly true of the prices' policy which must not merely be a policy concerned solely with prices on the indexes. Price-freezing, of course, attacks only the symptoms and not the disease.

This policy can have a steadying effect on the costs spiral in a country where almost all wages are governed by a sliding scale. It can also act as a general psychological check on speculation by managements and consumers attempting to anticipate the rise in prices.

But there are dangers in a prices policy like the one that has just been introduced by the authorities. It can result in genuine stabilization measures being postponed or inadequately applied, so that the price-freeze, which can only be justified as a short term emergency measure, is prolonged. A long-term policy of price controls can have very serious effects on the functioning of the economy—particularly on the distribution of resources between consumption and investment and on the structure of investment.

Some of the measures announced by the government—reduction of indirect taxation on certain goods, changes in the tax levied at source on securities—will actually tend to increase the national deficit. The same is true of the recently announced decisions on old age pensions. And the distinct upward trend in public capital expenditure increases the overall budget deficit.

In such circumstances dynamic action is needed—if necessary by statutory amendment of previous commitments—to limit increases in public expenditure or bring about a sharper rise in revenue, where it does not seem feasible to limit expenditure. On the revenue side, more effective measures should perhaps be taken in regard to the direct taxation of income, which is at a lower level and yields a smaller revenue than in most other industrial countries. It goes without saying that restraints on expenditure and increases in revenue must affect the mass incomes devoted almost exclusively to consumption, but not private saving and investment.

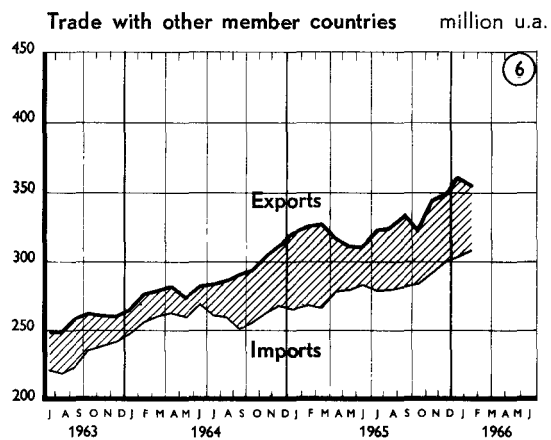
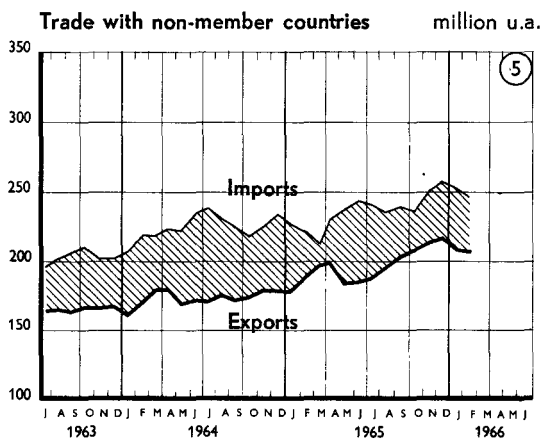
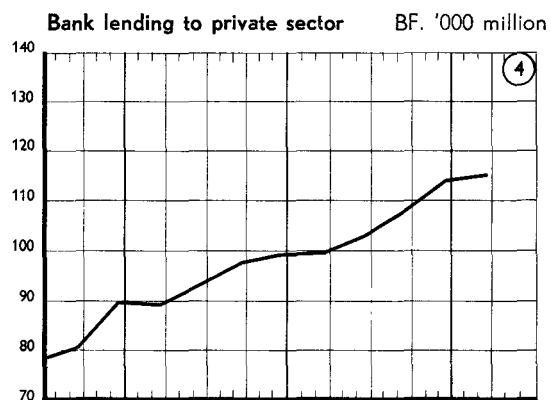
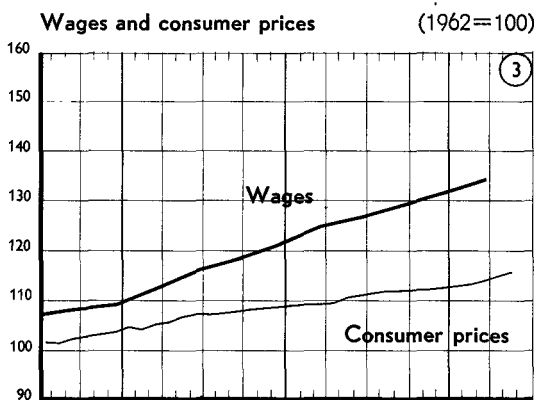
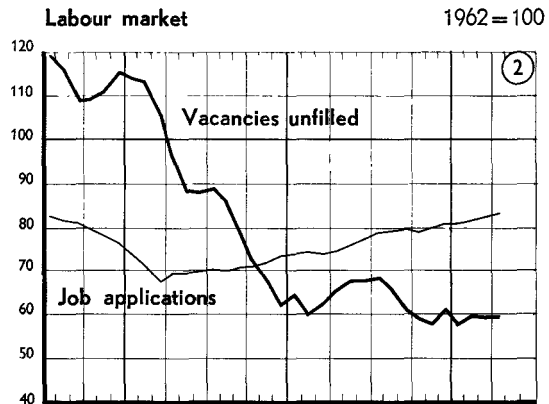
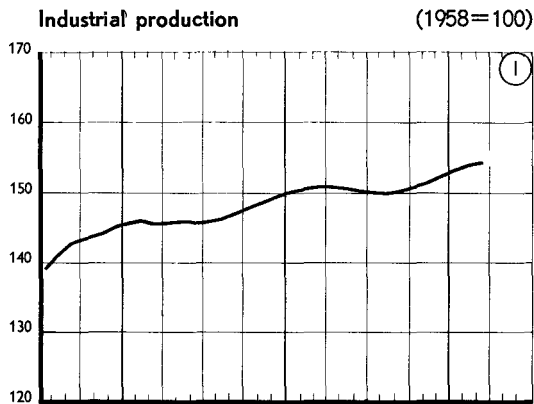
A really anti-inflationary budgetary policy would have to produce not only a reduction in the deficit on the ordinary budget for 1966 by comparison with 1965, but also a considerable reduction in the overall deficit. It would be just as important—in fact even more important—to finance the deficits only out of funds drawn from domestic saving.

It is essential that the credit squeeze should be carried through efficiently. The question arises as to whether 12 % per annum is not too high a level for the permissible expansion of credit; whether there is any guarantee that the banks will in fact remain within the bounds set; whether bank liquidity should not be directed by means of the minimum reserve policy to ensure that the expansion of credit is limited.

Here as well, if the authorities are unable or unwilling to do without large influxes of capital because of the long-term development needs of the production system and productivity, or on other grounds, and if compensatory exports of capital cannot be effected, then their own monetary and credit policy must provide the necessary compensation; this means that, for the sake of combating inflation, it must be even more restrictive than would otherwise be necessary.

Again, it is only possible to give a very cautious judgment at present on the measures which the government is planning to stimulate industrial investment. The aim of speeding up the growth of business investment is commendable in view of the needs of middle-term growth and the necessity of modernizing the country's industrial structure. But the measures planned must be in line with the current need for stabilization of the economy. Hence it will be necessary to offset the additional stimulus to demand which may result from the authorities' increased support for business investment by operating a tighter credit and budgetary policy in other spheres.

ECONOMIC INDICATORS



NOTES:

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

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

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

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

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

Graphs 5 and 6. B.L.E.U., series adjusted for seasonal and accidental variations (moving averages of 3 months). Exports fob, imports cif. Conversion at official exchange rates. 1 unit of account = 0.888671 gm. of fine gold = US \$1 at the official rate of exchange.

Belgium

TABLE 1: Basic data (1964)

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

TABLE 2: Development of basic economic data

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

TABLE 3: Foreign trade (at current prices)

	% change on preceding year							Indices (1958 = 100)	Million u.a.	% of the total
	1959	1960	1961	1962	1963	1964	1965	1965	1965	1965
Visible exports										
Total	+ 7.9	+14.7	+ 3.9	+10.2	+11.9	+15.5	+14.2	209	6 382	100
Intra-EEC	+10.5	+25.2	+ 9.7	+17.7	+19.6	+19.0	+12.8	287	3 947	61.8
To non-EEC countries	+ 5.7	+ 5.3	- 1.7	+ 1.9	+ 1.6	+10.3	+16.5	145	2 435	38.2
Exports of food, beverages and tobacco										
Total	+ 0.5	+ 6.3	+15.6	+29.6	+29.6	+ 3.2	+31.5	281	430	6.7
Intra-EEC	+14.8	+11.8	+18.7	+31.2	+30.7	+ 5.2	+31.6	361	318	5.0
To non-EEC countries	-18.9	- 4.4	+ 8.7	+25.7	+26.8	- 2.1	+31.3	174	112	1.7
Exports of raw materials and manufactures										
Total	+ 8.4	+14.9	+ 3.4	+ 9.2	+10.9	+16.4	+13.1	205	5 952	93.3
Intra-EEC	+10.4	+26.1	+ 8.9	+16.7	+18.8	+20.1	+11.4	281	3 630	56.9
To non-EEC countries	+ 6.9	+ 5.6	- 2.0	+ 0.9	+ 0.7	+10.8	+15.8	144	2 322	36.4
Visible imports										
Total	+ 9.8	+15.0	+ 6.6	+ 8.0	+12.2	+15.9	+ 7.6	203	6 373	100
Intra-EEC	+10.9	+16.8	+12.7	+ 8.9	+15.5	+17.5	+10.1	288	3 473	54.5
From non-EEC countries	+ 8.8	+13.3	+ 1.0	+ 7.1	+ 8.8	+14.0	+ 4.8	173	2 900	45.5
Imports of food, beverages and tobacco										
Total	+ 6.6	+ 1.6	+ 0.1	+11.0	+ 9.0	+16.8	+15.2	176	826	13.0
Intra-EEC	+13.2	+ 4.2	+ 7.4	+ 3.2	+17.2	+16.3	+22.5	217	339	5.3
From non-EEC countries	+ 3.4	+ 0.1	- 4.0	+15.9	+ 4.3	+17.2	+10.6	156	487	7.7
Imports of raw materials and manufactures										
Total	+10.4	+17.1	+ 7.6	+ 7.6	+12.7	+15.7	+ 6.6	208	5 548	87.0
Intra-EEC	+10.6	+18.4	+13.3	+ 9.4	+15.4	+17.6	+ 8.9	240	3 134	49.2
From non-EEC countries	+10.2	+15.9	+ 1.9	+ 5.6	+ 9.6	+13.4	+ 3.7	177	2 414	37.8

TABLE 4: Basic monthly indicators

	Year	Jan.	Feb.	Mar.	Apr.	May	June	July	Aug.	Sept.	Oct.	Nov.	Dec.
Industrial production (1958 = 100)	1964	141	138	144	151	137	149	127	136	151	161	148	150
	1965	141	140	156	151	145	148	123	139	155	160	153	157
	1966	143	142	159									
Investment (1961 = 100)	1964	116.3	134.1	138.9	147.9	153.0	152.3	126.2	134.1	147.3	144.8	152.9	149.7
	1965	121.1	125.8	141.8	162.8	161.1	165.8	117.7	151.1	152.9	158.0	145.0	160.3
	1966												
Building (1962 = 100)	1964	92.8	108.2	109.5	124.5	112.6	126.0	99.0	111.0	125.2	125.9	116.2	103.9
	1965	86.3	82.1	107.0	117.5	111.4	121.4	79.9	116.8	121.4	120.5	96.9	102.3
	1966	68.1	97.3	117.6									
Private consumers' expenditure (1961 = 100)	1964	116.7	116.0	118.2	122.1	123.9	124.4	125.6	123.4	122.2	125.2	126.1	129.8
	1965	125.3	126.5	130.3	133.3	133.5	134.2	134.5	132.4	131.6	133.7	135.5	139.0
	1966	133.0	135.1										
Total visible imports (million u.a.)	1964	492	475	481	515	479	513	486	419	480	512	491	536
	1965	455	474	539	552	506	514	506	452	541	554	570	609
	1966	500	547	607									
Total visible exports (million u.a.)	1964	451	449	468	490	426	484	453	377	477	520	491	502
	1965	482	520	571	507	478	548	509	428	580	546	575	617
	1966	503	528	629	562								
Balance of trade (million u.a.)	1964	- 41	- 26	- 13	- 23	- 53	- 28	- 33	- 42	- 3	- 8	0	- 34
	1965	+ 27	+ 46	+ 32	- 45	- 28	+ 34	+ 3	- 24	+ 38	- 8	+ 5	+ 8
	1966	- 7	- 19	+ 22									
Official gold and foreign exchange reserves (million u.a.)	1964	1 796	1 794	1 795	1 789	1 812	1 788	1 796	1 816	1 834	1 870	1 954	1 992
	1965	2 000	2 006	2 002	2 026	2 010	2 000	2 010	2 023	2 018	2 010	2 010	1 996
	1966	1 968	1 946	(1 966)	(1 952)								
Money supply	1964	271.2	270.1	274.3	276.1	282.0	287.1	282.7	282.2	285.1	286.4	285.2	298.7
	1965	290.4	290.4	294.2	300.3	303.0	310.6	306.3	303.2	307.9	308.6	310.4	320.0
	1966	311.3	308.5	316.0									

Belgium

NOTES

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

Table 1

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

Table 2

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

Table 3

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

Table 4

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

Grand Duchy of Luxembourg

In the first quarter of 1966 and the subsequent spring months the tempo of economic activity in Luxembourg was again very subdued.

Demand from abroad provided only a weak stimulus, owing to a decline in exports of iron and steel products to non-member countries.

Among the components of gross fixed asset formation, the only one to display a definite expansionary tendency was public expenditure. Private consumers' expenditure, on the other hand, although slackening somewhat at first, showed a further distinct increase.

The trend of domestic supply, and especially of industrial production, reflects the slowing-down of exports and the slackening tempo of capital expenditure. Imports, on the other hand, appear to have risen at about the same rate as in the preceding months.

The level of excess demand in the labour market is so high that the tendencies to a levelling-off of production have as yet led to no really appreciable easing of the strain.

The forces tending to push up prices have not yet weakened appreciably; the slightly slower rise in the cost-of-living index is probably due mainly to seasonal influences.

In the coming months, on the assumption, in particular, that there will be a rise in the exports of the newly-established industries and that the increase in public capital expenditure will be at least as rapid as it has been recently, overall demand can probably be expected to show a somewhat livelier trend.

In the field of economic policy the Luxembourg authorities should try to take even more energetic action to keep costs and prices stable. In the absence of compensatory measures the appreciable rise in transfer expenditure, in particular, could further accentuate the imbalance in the public finances and help to maintain the inflationary tensions.

1. Recent developments

The revival in foreign demand for the products of the iron and steel industry observable in the last months of 1965 did not continue in the first quarter of 1966. There was in fact a slight decline in the volume of iron and steel exports in comparison with the fourth quarter of 1965, despite a further increase in deliveries to other EEC member countries, and the figure was also not quite up to that for the first quarter of 1965. As a result, however, of a slight rise in export prices, the value of exports of iron and steel products probably remained unchanged. Moreover, the chemical firms recently es-

tablished in Luxembourg may well have increased their sales abroad. This being so it is possible that the underlying trend of total exports in the first quarter of 1966 may nevertheless have been slightly upwards.

Expenditure on gross fixed asset formation, adjusted for seasonal variations, appears to have remained around the level reached towards the end of the year. There was, it is true, a further upward trend in public capital expenditure, but capital expenditure by enterprises, especially in the iron and steel industry, is hardly likely to have increased. There was probably also only a very small rise in the amount spent on house-building.

National product and expenditure

	1963 ⁽²⁾	1964 ⁽³⁾		1965 ⁽³⁾		1966 ⁽⁴⁾
	At current prices (in Lfrs. '000 million)	% change by volume on preceding year				
		Volume	Value	Volume	Value	Volume
Gross national product	27 496	+ 6.5	+ 10.5	+ 1.5	+ 3	+ 2.5
Imports ⁽¹⁾	23 753	+ 9.5	+ 12	— 0.5	+ 0.5	+ 3
Private consumption	16 641	+ 5.5	+ 9.5	+ 3	+ 7	+ 3.5
Public current expenditure	3 484	+ 2.5	+ 6	0	+ 6	+ 3
Gross fixed asset formation	8 826	+ 1	+ 7.5	— 18	— 16	— 6.5
Exports ⁽¹⁾	22 198	+ 13	+ 15.5	+ 4.5	+ 3	+ 5

⁽¹⁾ Goods, services and factor income.

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

⁽³⁾ Commission estimates.

⁽⁴⁾ Commission forecasts.

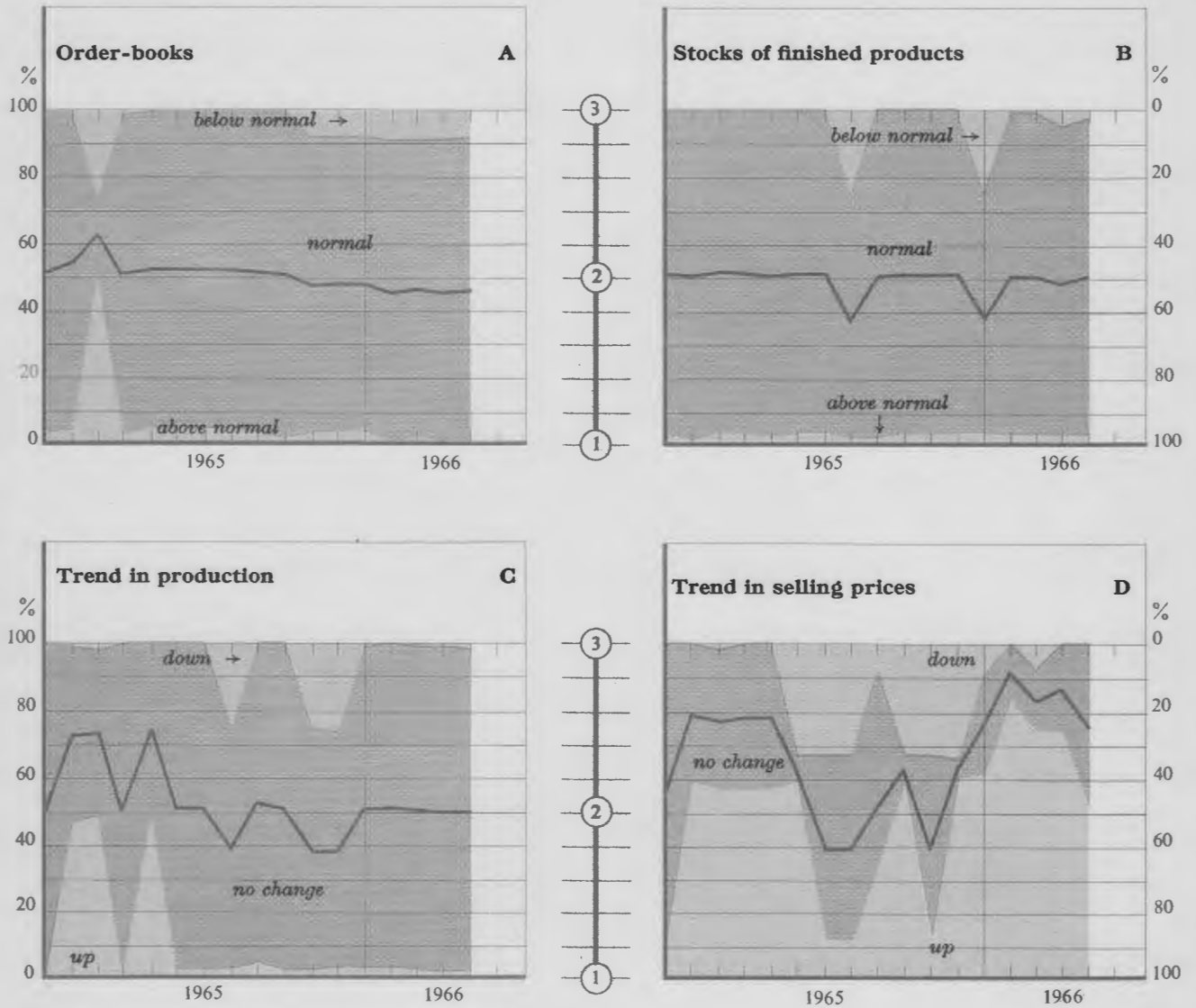
Note :

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

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

With regard to the development of private consumers' expenditure, the upward movement appears to have remained fairly brisk in the first months of 1966, even though it has for about a year been rather less steep than in 1964. Although the growth in the disposable income of private households was slowed down by the absence of any further

BUSINESSMEN'S VIEWS ON THE INDUSTRIAL SITUATION



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

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

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

rise in the level of employment (total number of hours worked), per capita wages and salaries in the business sector continued their relatively rapid increase, especially owing to the implementation of the sliding wage scale in December 1965 and the effect of the law of 12 June 1965 raising the wages for night work and for difficult, dangerous and unhealthy work. It should also be borne in mind that this law contains provisions calling for equal pay for men and women workers and the adjustment of wages and salaries to the movement of the cost of living. Moreover, the increase in transfer incomes, which was still slow at the beginning of the year, has since accelerated owing to the effect of the laws reforming accident disability pensions. Lastly, the adjustment of income tax rates to the cost-of-living index may already have given a stimulus—although only a slight one—to the expansion in expenditure on consumption by private households.

The growth in domestic supply, which had become distinctly faster in the last quarter of 1965, is hardly likely to have gathered any further momentum in the subsequent months. Indeed, if seasonal and fortuitous factors are disregarded, it looks as if industrial production again declined slightly in the first quarter of 1966. In fact, according to the official index—which does not yet, however, include the production of some newly-established branches of industry—it was as much as 4 % below its level for the first quarter of 1965. A similar tendency, although less pronounced, was observable in the building industry.

Imports, on the other hand, showed a further rise, mainly owing to increased purchases of durable consumer goods.

The situation in the labour market, characterized by over-employment, did not change appreciably; there is still an acute labour shortage outside the traditional industries.

Mainly owing to the seasonal movement of prices for foodstuffs, the general cost-of-living index rose again during the spring after having declined in the winter. In April/May it was 2.6 % above its level in the corresponding period of 1965 (after having still been 3.3 % up in the first quarter). It would appear, however, that the official index does not accurately reflect the actual trend of consumer prices, which, on the contrary, is probably still clearly upwards.

2. Outlook

Despite the reduction in order books for iron and steel products, total exports may well continue to rise in the coming months.

With regard to the products of the iron and steel industry, sales prospects are only relatively favourable within the Community; deliveries to non-member countries, while not likely to decline further, mainly owing to the probable development of demand from the United States, can hardly be expected to show any fundamental recovery in the coming months. On the other hand, an increase in the exports of the newly-established industries can certainly be expected, and also probably a rise in exports of services, so that it seems quite likely that there will be a growth—although modest—in the value of total exports of goods and services in the coming months.

Total expenditure on gross fixed asset formation is hardly likely to rise appreciably before the end of the year. While the expansion in public capital expenditure will continue, there will probably not be any rise in house-building, and fixed investment by enterprises, especially on plant and equipment, may for some time be hesitant.

The expansion in expenditure on consumption, on the other hand, will continue and might even accelerate later in the year. Indeed, public current expenditure is likely to rise appreciably as a result of the government's intention to increase the number of civil servants owing to the introduction of the 42-hour week for public employees and as a result of the rise in salaries due to certain reforms or to sliding-scale wage clauses. Private consumer's expenditure will probably be influenced by the more dynamic trend of transfer incomes. Thus, for instance, the proposed reform of the Old Age Pension System may provide a new stimulus if the law in question is passed during the coming months. Furthermore, the growth in the other incomes of private households is hardly likely to slow down, even though the level of employment will probably remain stable.

With regard to the development of domestic supply, no very considerable growth is to be expected, mainly owing to the effects of the increase in the paid annual holiday. To judge by the national index, industrial production might remain stationary during the coming months. Imports, on the other hand, will probably continue to increase, mainly owing to an expected further rise in purchases of consumer goods.

The situation in the labour market is not likely to change appreciably between now and the end of the year.

The price level may well continue to rise at about the same rate as hitherto, apart, of course, from seasonal variations such as have affected the movement of the cost-of-living index in recent months. Most of the main cost-increasing factors, such as wage increases in excess of the rise in productivity and the upward tendency of import prices, would in fact appear to have lost little of their force. The fact that monetary public and private demand provide the necessary margin makes it all the easier for them to affect prices.

There is no need, in view of the prospects described above, to make any major change in the quantitative forecasts of the development of the volume of supply and the main components of overall demand for the whole of 1966 which appeared in the last survey. At the most the growth in private consumption might prove to be a little greater and that in total exports somewhat smaller than was previously assumed.

For Luxembourg it is of course particularly difficult, if not impossible, in view of the structure of its production, to make, at the present stage, anything like a reliable forecast of the prospects for the coming year. It is advisable in this case, as a first working hypothesis, to pay attention mainly to the longer-term growth trend. On the assumption of a moderate increase in demand for steel in the world markets and a certain quickening of the tempo of capital investment in industry, the gross national product in terms of constant prices may in fact grow by about 3 %.

The prospects for demand both from the public authorities and from private households do not suggest that the expansion of total monetary demand will remain

within the limits of the increase in real output. On the contrary, there are many indications that the tendency to internal disequilibrium, with the concomitant increases in costs and prices, will continue.

The economic and financial policy at present pursued by the Luxembourg authorities should be better adjusted to the present requirements of anti-cyclical policy, especially as regards stabilization of prices and unit costs. It is true that anti-cyclical policy in Luxembourg cannot alone bring about an adequate degree of stabilization so long as price-raising influences are operating from abroad via import prices. But steps should at least be taken to prevent domestic inflationary tendencies from facilitating or even contributing to the rise in prices.

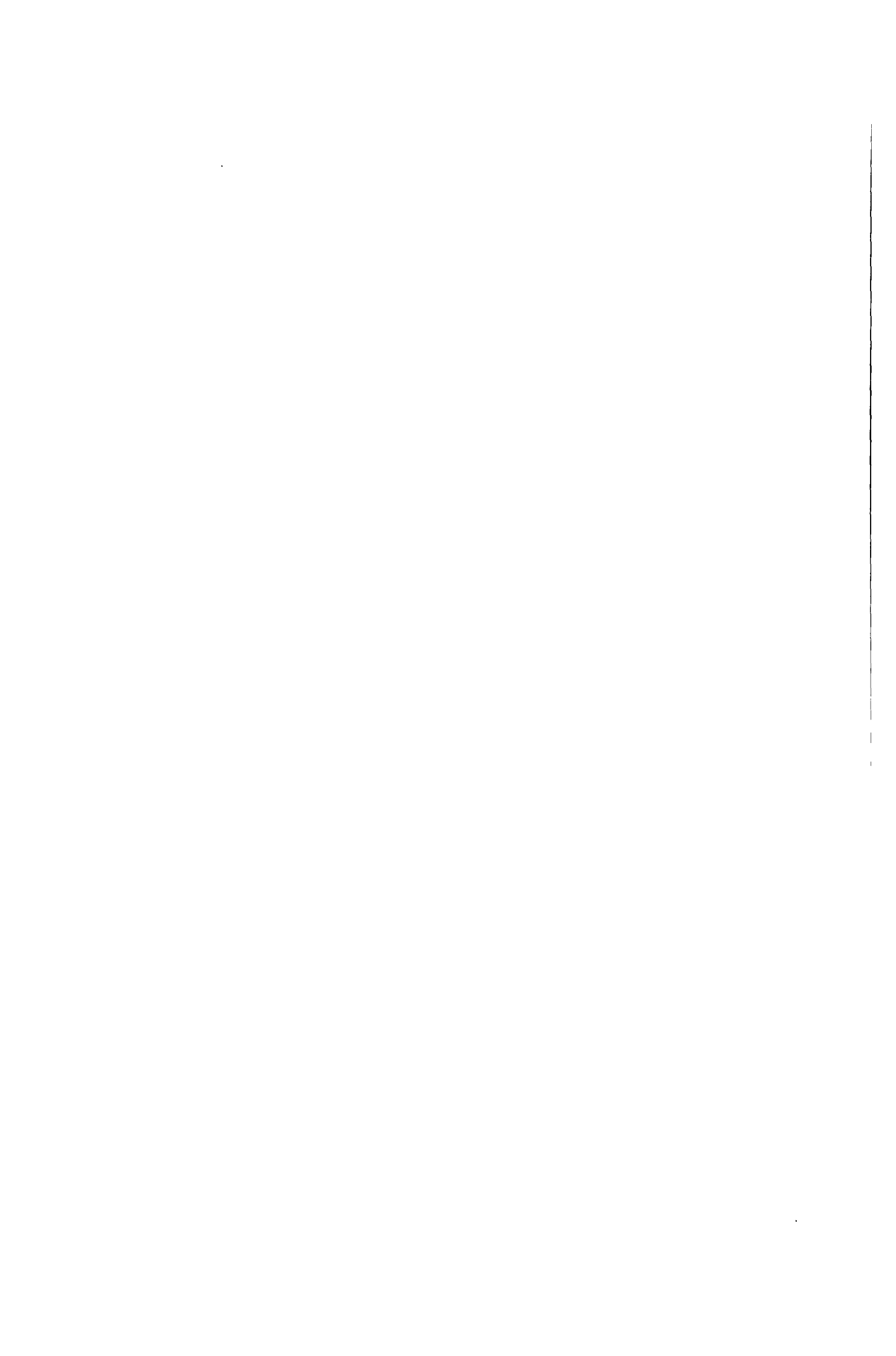
The appreciable increase in transfer expenditure, which is to some extent already taking effect, will doubtless further aggravate the disequilibrium in the government finances in 1966 and 1967; unless compensatory measures are taken, the inflationary tensions may, if anything, be accentuated by the more rapid growth in government expenditure and perhaps also by the way in which it is financed, especially as expenditure by local authorities also still appears to be rising excessively.

The price-raising effect produced by the pressure of demand is, in addition, being strongly reinforced from the cost side by various measures, especially the repercussions of the regulations introduced at the end of April substantially increasing the length of the paid annual holiday of workers in the private sector.

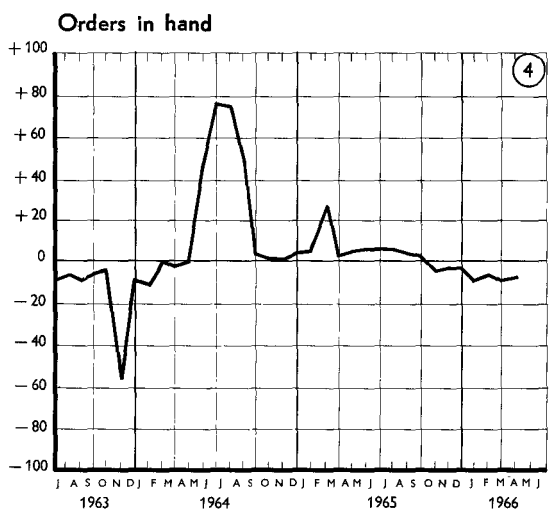
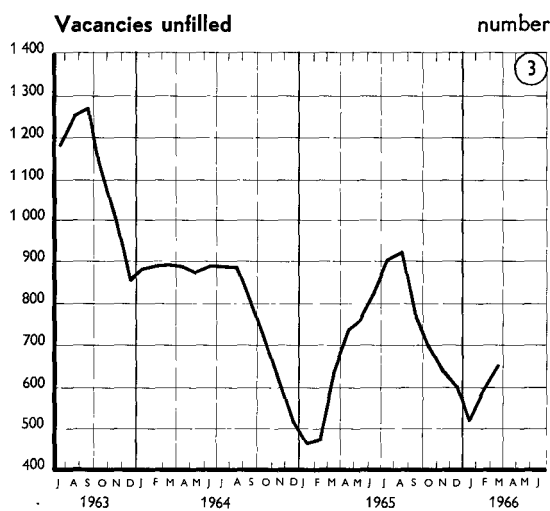
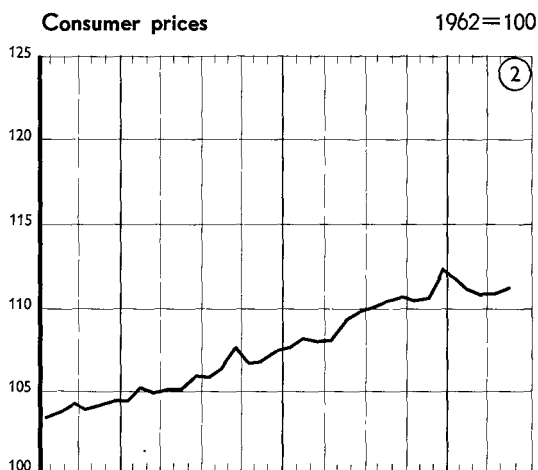
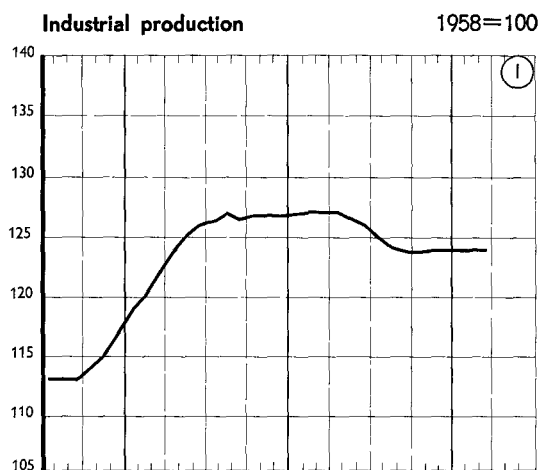
Under these circumstances, the authorities ought primarily to endeavour to bring the overall deficit of the public authorities down again to a level which can be financed with the long-term funds becoming available within Luxembourg from domestic savings without unduly impairing the supply of capital to the economy or compelling it to have recourse to capital imports which, in the present economic situation, have an inflationary effect.

In so far as these policy aims are not achieved through a slowing-down of the expansion in public expenditure (the rate of increase of outlay on goods and services and transfer expenditure, in particular, ought now to be considerably more moderate than hitherto), new measures might have to be taken to augment revenue. The de facto index-linking of income tax to the movement of prices is, however, rather the contrary of what is required in order to combat inflation.

Moreover, greater caution is necessary with regard to all measures which encourage the rise in production costs. The recent establishment of an Economic and Social Council might facilitate the authorities' task in this field.



ECONOMIC INDICATORS



NOTES:

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

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

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

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

Graph 4. Source: EEC business survey.

Grand Duchy of Luxembourg

TABLE 1: Basic data (1964)

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

TABLE 2: Basic monthly indicators

	Year	Jan.	Feb.	Mar.	Apr.	May	June	July	Aug.	Sept.	Oct.	Nov.	Dec.
Industrial production (1958 = 100)	1964	115	117	125	129	131	130	123	122	126	127	125	124
	1965	125	129	121	130	132	129	124	116	125	125	127	121
	1966	120	121	120									
Crude steel production ('000 m.t.)	1964	356	357	375	402	372	389	396	365	391	412	361	383
	1965	383	379	388	392	391	377	397	353	395	392	377	372
	1966	369	354	380	367	353							
Building (1958 = 100)	1964	48	57	83	103	106	109	110	96	98	95	73	63
	1965	48	55	82	103	110	102	105	100	96	93	76	58
	1966	45	53	91	96								
Workers employed in the iron and steel producing industry and in mining ('000)	1964	23.5	23.6	23.7	23.9	24.0	24.0	24.1	24.1	24.2	24.2	24.3	24.3
	1965	24.2	24.1	24.0	24.0	24.0	24.0	24.0	24.0	24.1	24.1	24.1	24.1
	1966	24.0	24.0	23.8	23.8	23.8							
Retail prices (1958 = 100)	1964	106.8	107.6	107.2	107.4	107.5	108.3	108.3	109.2	110.3	109.3	109.3	109.9
	1965	110.2	110.5	110.3	110.3	111.6	112.3	112.6	113.0	113.2	112.9	113.1	114.7
	1966	114.7	113.8	113.4	113.6	114.1	114.9						

NOTES

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

Table 1

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

Table 2

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

