

EUROPEAN ECONOMIC COMMUNITY

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INFORMATION MEMO

The EEC Commission has just published its Quarterly Survey (No. 3/1965) of the economic situation in the Community.

The Survey describes the main features of the economic situation in the Community in the second quarter and the summer months. It also examines for the Community as a whole and for the various member countries the outlook for the remaining months of 1965 and for the full year 1966.

Annexed to the Survey is the text of the opinion concerning the preliminary economic budgets for 1966, adopted by the Short-term Economic Policy Committee on 8 July 1965.

With regard to the overall situation, the Commission points out that economic expansion in the Community continued in the second quarter and also in the summer months, as far as can be judged from the incomplete statistics at present available.

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

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

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

Stock-building did not on the whole contribute greatly to economic activity.

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

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

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

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

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

Prices continued to rise, although the faster pace of growth in intra-Community trade did much to achieve a better balance between supply and demand; the value of intra-Community trade in the second quarter, as shown by customs returns for imports, was 11% up on a year

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

ago. Consumer prices rose more rapidly, but this was largely due to exceptional factors such as the increase in food prices occasioned by the bad weather; apart from this there was again little upward movement of prices except in the Federal Republic of Germany and the Netherlands.

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

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

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

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

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

In view of the way the business situation has been developing since the beginning of the year, and the prospects for the rest of 1965, the forecasts published for this year in the last Quarterly Survey, No. 2/1965, are still valid: real gross Community product should increase by almost 4% over 1964, and industrial production (as defined in the index of the Statistical Office of the European Communities) by about 4.5%.

The Commission considers that an appreciable level of economic growth can again be expected in 1966. Although the present prospects for the world economic situation suggest that exports from the

Community to non-member countries may increase somewhat less rapidly, internal demand should expand more vigorously than in 1965, a slight slackening in the pace of growth in the Federal Republic of Germany being more than offset by more pronounced increases in Italy and France.

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

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

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

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

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

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