

EUROPEAN
ECONOMIC
COMMUNITY
COMMISSION



DIRECTORATE-
GENERAL
FOR ECONOMIC
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AFFAIRS

**THE ECONOMIC SITUATION
IN THE COMMUNITY**

1

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1964

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EUROPEAN ECONOMIC COMMUNITY

COMMISSION

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I. THE OVERALL SITUATION

In the fourth quarter of 1963 and, as far as can be seen, in the first months of 1964 also, economic expansion in the Community continued unabated.

Overall demand in money terms again increased considerably. The growth of merchandise exports to non-member countries was very steady: in the fourth quarter the figure was 7 % above the corresponding figure in the previous year (in terms of value). Meanwhile internal demand maintained the same dynamic trend as hitherto. The growth of investment expenditure even speeded up, with investment in building tending to rise vigorously, thanks to the favourable weather and greater numbers employed, and investment in capital goods also showing an overall advance, but with clear variations from country to country: in Italy there was a relatively small increase and in France a tendency towards stability, while in the Federal Republic of Germany there were unmistakable signs that investment expenditure was gathering momentum. There has been practically no slackening in the expansion of private consumers' expenditure: in the Netherlands and Belgium it speeded up more or less strongly; in the Federal Republic of Germany it continued to be smooth, and in Italy and France the pace, though still rapid, was steadier. In general, public expenditure on goods and services also increased appreciably. In the Community as a whole the growth of consumption in real terms probably did not weaken.

Industrial production increased faster: the seasonally adjusted index of the Statistical Office of the European Communities rose by 3 % between the third and fourth quarters, compared with 0.5 % between the second and third. In the fourth quarter

the gross index of production was 7 % higher than a year earlier ; as the rise in numbers employed was slight (particularly in industry), productivity must have risen a little faster.

A vigorous expansion of raw materials imports was the chief factor in an acceleration of the already fast growth of imports. Imports of goods from non-member countries in the fourth quarter were 11.5 % above the level of a year earlier. As the expansion of exports continued to be somewhat weak, the trade balance deteriorated further. In the fourth quarter the deficit was \$650 million, or \$265 million more than in the corresponding quarter of 1962. The total official gold and foreign exchange reserves of the member countries increased by only \$81 million. Since the net foreign exchange position of the commercial banks deteriorated by a greater amount than this, the overall payments balance probably closed with the first deficit experienced for some considerable time.

Rising price trends continued, although in some member countries—France and Italy—some weakening of the previously particularly strong upthrust was to be noted. As against this, prices climbed more rapidly in Belgium and especially in the Netherlands. The upward push stemmed mainly from the continuing strains on the internal markets caused by the difference between the expansion of overall demand in money terms and the slower expansion of supply—and also from the closely related factor of increasing wage costs per unit produced. To this must be added the effects of the higher world market prices which were paid during the period under review for various raw materials, and of the special price movements which affected certain foodstuffs (particularly meat).

The further economic outlook in 1964 has not changed substantially from that described in the last Quarterly Survey (4|1963). In certain respects, however, the latest developments and the further policy measures that have meanwhile been taken mean that the trend is undergoing some change of emphasis.

In the first place external demand is sure to develop at least as dynamically as forecast, the more so now that tax reductions have been decided on in the United States, while in the United Kingdom a definite acceleration of business activity has become apparent and is already having an appreciable effect on the propensity to import.

Domestic demand in France, and perhaps also in Italy, is likely, thanks to the stabilization policies being applied, to reflect a somewhat slower rise in private consumers' expenditure than was forecast at the end of 1963. In the Netherlands on the other hand consumption will most likely grow more rapidly, and in Belgium private

consumers' expenditure will tend to expand at the accelerated pace observed in the last quarter of 1963. In the Federal Republic of Germany the expansion of consumption will probably remain modest, at any rate for the time being.

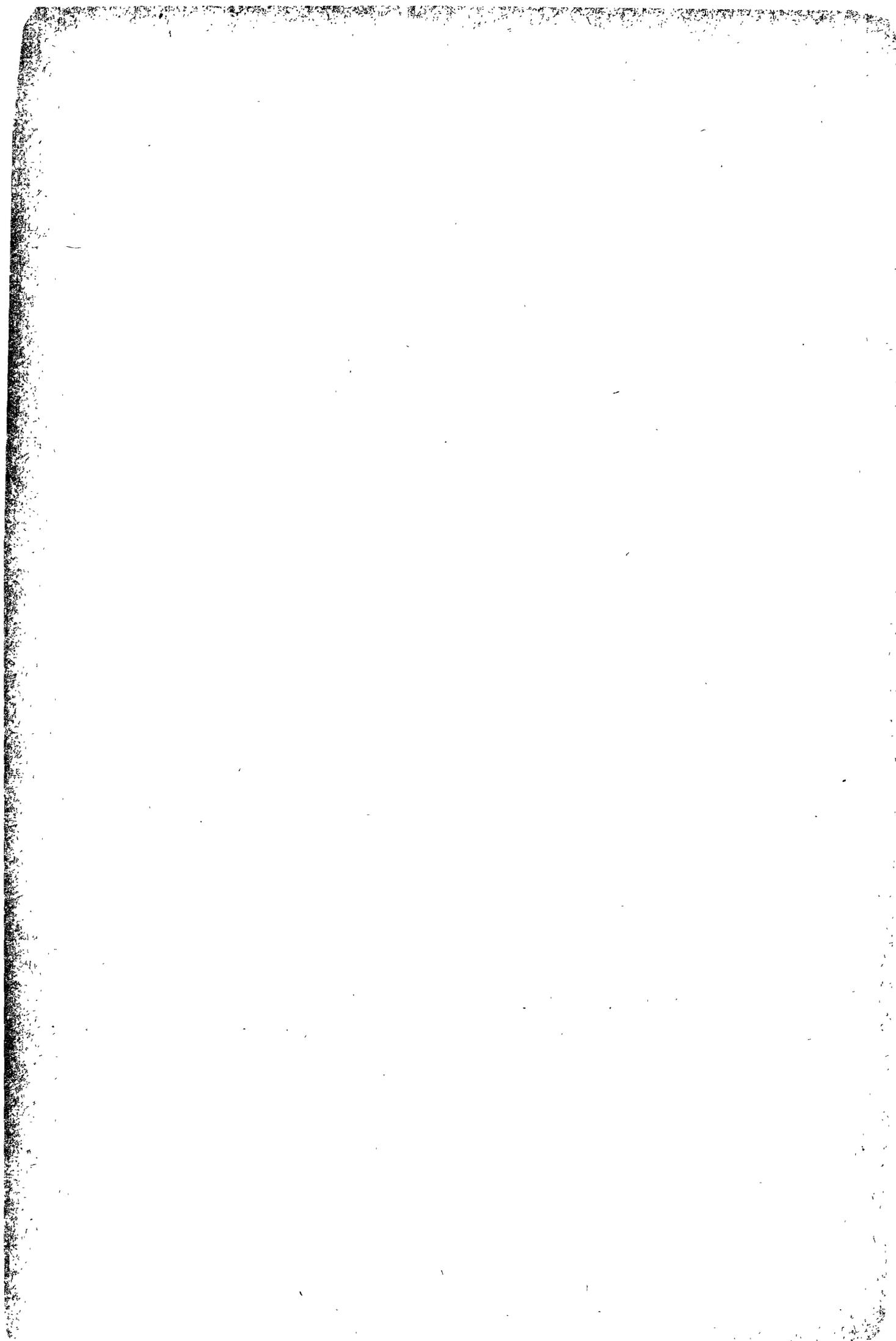
Investment also will continue to rise appreciably. This applies in particular to building and construction, especially housing, and to stocks. Investment by enterprises in plant and equipment will rise faster in the Federal Republic of Germany, roughly maintain its pace of growth in Belgium and increase appreciably in the Netherlands, where however it is likely to slow down clearly towards the end of the year. In France and Italy expansion of investment by enterprises will probably continue to be no more than modest.

On the supply side also quite rapid growth may again be expected, and some increase over the rates forecast is probable. Furthermore, in sharp contrast with 1963, building activity in the early months of the year was favoured by the weather. All in all, therefore, a growth of about 5 % in the real gross Community product between 1963 and 1964 could be forecast instead of the 4.5 % predicted at the end of 1963. Industrial production could increase by 7 %.

Import forecasts for 1964 may also need to be revised a little upward. The trade balance will probably continue to deteriorate quite appreciably and the current account will be in deficit.

Despite this, and despite the fact that stabilization measures have meanwhile been stepped up in varying degrees in all member countries except the Federal Republic, where this has not yet appeared to be necessary, the outlook for the price trend later in 1964 is still unsatisfactory. True, the pace of price rises in France and in Italy may well slacken further; but in the Netherlands further vigorous increases seem to be imminent and in Belgium the price rise will continue, tending to be rather faster than at the same period of 1963. There is danger of another speed-up in the Federal Republic of Germany.

In these circumstances the struggle against inflationary imbalances must continue to be in the forefront of anti-cyclical policy in the Community. As this struggle obviously cannot be successful if carried on in isolation, it must be given a Community framework. Although on the whole the measures taken by those responsible for economic policy in the member countries are on the right lines—they correspond with what the Commission, the Economic Policy Committee and the Monetary Policy Committee have repeatedly suggested—there is still need for stricter and more co-ordinated action. The Commission will make appropriate proposals on this matter to the Council.



A. Recent developments

1. Demand

In the first quarter of 1963 and the early months of 1964 there was a quite considerable further expansion of overall demand. Within this expansion internal demand again rose more rapidly than external demand, at least in the fourth quarter.

In fact external demand—in the sense of the actual exports of goods and services to non-member countries—continued to grow quite steadily as the economic situation in a number of non-member countries registered a very distinct improvement. Customs returns in terms of value show that in the final quarter of 1963 Community exports of goods were 7 % higher than in the corresponding period of the previous year, after year-to-year growth rates of 6.5 % in the third and 7 % in the second quarters. In any case the available figures have for some time now pointed to a somewhat more vigorous recovery in new orders, and this may have slightly accelerated the expansion of exports in the early months of 1964. Since the level in the corresponding period of 1963 was relatively low because of the extreme winter weather, this would mean high year-to-year growth rates.

By and large, the trends of economic activity outside the Community described in the last Survey continued in the final months of 1963 and early in 1964.

Expansion was maintained in the United States. The real gross national product, seasonally adjusted, rose 1.5 % between the third and fourth quarters of 1963. This was due in particular to a further increase in private consumption, now accompanied by a very appreciable rise in investment. However, industrial production practically ceased to expand: after adjustment for seasonal factors, it was less than 1 % higher than in the third quarter. The trend in exports of goods from the Community to the United States also failed to register any great expansion.

The trend of Community exports to the EFTA countries was more dynamic. Deliveries to the United Kingdom went up particularly vigorously and were 18 % higher in the fourth quarter than in October-December 1962. This is a clear reflection of the recovery which has been going on for a year in that country, where the real gross national product was 5 % and industrial production 7 % higher in the fourth quarter of 1963 than at the same period of the previous year.

In the fourth quarter there was only a limited rise in the Community's exports to the developing countries as a whole. This was mainly attributable to the slackness of exports to Algeria and Tunisia. Exports to the associated countries and territories were also weak. As against this, exports to the overseas countries of the sterling area

showed a distinct increase. In fact it seems as though the increase in foreign exchange available to the developing countries as a result of higher raw materials purchases by the industrial countries and the marked advance of world market prices has already been reflected in heavier imports. The same factors may have contributed to the pick-up—albeit a small one—in the Community's exports to Latin America.

Community exports to non-member countries

(% change in values on preceding year)

Exports to	1962	1963				1963
	compared with previous year	1st quarter	2nd quarter	3rd quarter	4th quarter	compared with previous year
United States	+ 9.5	— 6	+ 8	+ 7.5	+ 7.5	+ 4.5
EFTA	+ 4.5	+ 1	+ 9	+ 4.5	+ 9	+ 6
including :						
United Kingdom	+ 0.5	+ 3	+ 9	+ 5	+ 18	+ 8.5
Developing countries	— 8.5	— 6.5	+ 6	+ 6.5	+ 4.5	+ 2.5
including :						
Associated overseas countries and territories	— 19	— 7.5	+ 20.5	+ 21.5	+ 3	+ 8
All non-member countries	+ 1	— 2.5	+ 7	+ 6.5	+ 7	+ 5

The development of external demand continued to go hand in hand with a vigorous expansion of internal demand. Thus the growth of gross fixed formation in the Community as a whole again increased. In particular the weather, which was more favourable than in the previous year, led in most member countries to a distinctly higher rate of investment in building and construction, especially in housing. Investment in plant and equipment also continued to grow in the Community as a whole, although quite slowly. Expansion was not inconsiderable, and was strongest in the Netherlands and Belgium. In Italy too there was again some increase, and in the Federal Republic of Germany the appreciable improvement in the climate of investment as a result of the improved profit situation and expanding external demand began to have an effect on the investment expenditure of enterprises. In France the expansion of investment by industry was not very great; private industry even continued to tend towards stagnation.

In all member countries the stabilization measures inhibited the letting of public contracts, although with varying intensity, but public investment expenditure was not yet affected and continued to rise quite strongly.

In recent months investment in stocks has on the whole been a strong factor in demand. To judge by the trend of imports, stocks must already have been increased considerably in several sectors.

Consumers' expenditure continued to expand rapidly. In particular the growth of public expenditure on goods and services was still very vigorous in the fourth quarter. Private consumers' expenditure in the Community as a whole in the last three months of 1963 was probably almost 10 % higher than a year earlier. Within this expansion there have been some new trends of development which will probably be felt even more strongly in 1964 : on the one hand a certain slowdown in the very strong growth of consumption in Italy and France, and on the other a speed-up in Belgium and particularly in the Netherlands. In the Federal Republic of Germany the growth of private consumers' expenditure in the fourth quarter continued to be quite moderate.

The expansion of private consumption can in large part be ascribed to the large wage increases. In Italy particularly the rise in wages continued to be very strong, although there was some temporary easing due in the main to seasonally conditioned price reductions in autumn, which slowed down the rise in the cost of living and kept wage increases based on the sliding scale within narrower limits. In France also the wage thrust weakened, although it was still vigorous. In the Netherlands, on the other hand, wages recently rose very strongly following the collective agreements concluded in the autumn. In this connection it is evident that in January 1964 the rises were sharper than had been foreseen. In Belgium also a certain acceleration of the upward thrust of wages can be noted. Only in the Federal Republic of Germany was the pace at which wages and salaries rose still relatively moderate.

The expansion of private consumers' expenditure was encouraged in the Netherlands, and at times perhaps in Italy and France, by a decline in the propensity to save, a phenomenon often to be noted in periods of rising wages.

The rise in consumption was especially marked for high quality goods, with retail traders achieving large increases in their sales of these higher priced goods. However, the expansion of sales of private motor-cars in the Community as a whole around the turn of the year was appreciably weaker, particularly because of developments in France.

2. Production

In the fourth quarter of 1963 and also in the early months of 1964 internal demand in most member countries was expanding at a fairly rapid pace. The mild winter also

made it possible to maintain a high level of production in the sectors dependent on the weather.

In agriculture the period under review has brought little of note to report, at any rate in connection with crops; thanks to the weather, the production of vegetables during the autumn was quite good. Livestock production was not up to the level of the corresponding period of the previous year: in most member countries the production of meat and milk was down and there were even shortages of pigmeat.

The growth of industrial production speeded up between the third and fourth quarters. The seasonally adjusted index of the Statistical Office of the European Communities (without building and food, beverages and tobacco) rose 3 % between the third and fourth quarters, compared with 0.5 % between the second and third. The gross index was up 7 % on the fourth quarter of 1962.

The acceleration was most marked in the Federal Republic of Germany, reflecting in particular the rapid expansion of external demand in that country. In Belgium too production expanded faster. If however the rather longer-term development trends are considered, the rise in production continued to be strongest in France and Italy. In the Netherlands, where a speed-up was already noticeable in the third quarter, growth continued at roughly the same pace in the final months of the year. In the Grand Duchy of Luxembourg a revival of the growth of production did not occur before the beginning of 1964, when there was a definite improvement in the iron and steel situation.

A breakdown by branch of industry shows that an increase in the pace at which production was growing occurred mainly in the basic materials industries: the recovery made by iron and steel production in the fourth quarter was the first for a long while to be worthy of note. Production in the investment goods industries in the Community as a whole went up slightly, but the growth rate in the Federal Republic of Germany was still fairly slow despite the livelier inflow of orders, while in France the trend of production continued to be hesitant. Production in the consumer goods industries, particularly in France and Italy, continued to advance rapidly.

Since in the building industry the fall-off in production usual at the time of year was hardly noticeable because of the relatively mild winter, it was possible to make good the output lost at the beginning of 1963. However, despite the considerably increased numbers in employment in most member countries, supply still lagged behind demand, and the building backlog at the turn of the year 1963/64 was even higher than a year earlier.

Activity in the services sector was quite lively in the final months of the year: internal waterway traffic and road transport were hardly hampered by frost. The rapid expansion on the other services branches continued.

In the fourth quarter the numbers in paid employment increased relatively little, particularly in industry. Although the speed-up of production was partly due to the weather, there were therefore quite considerable advances in productivity.

The very marked labour shortages in the Community as a whole continue to be the chief impediment to a more rapid increase in production. In fact strains on the labour market continued unabated in all member countries. This factor and the mild weather resulted in a very low level of unemployment throughout the winter months—particularly in building and allied trades.

3. The balance of the markets

Between the third and fourth quarters the pressure of total demand led not only to speedier expansion of production but also to a further quite rapid rise in Community imports. Customs returns show that the value of goods imported from non-member countries in the fourth quarter was up 11.5 % (figures for volume are not yet available) on the same period in 1962. The growth of imports into France and the Netherlands gathered further momentum, and in Italy it continued very high, although it perhaps slowed down a little. Comparison with a year earlier shows that the increase in these countries was as much as 20 %, while imports into the Federal Republic from non-member countries hardly exceeded the level of the previous year despite higher purchases of raw materials. In this case, however, a part was played by changes in government imports.

The commodity breakdown of the still incomplete import figures for the last quarter of 1963 indicates that imports of raw materials increased more rapidly than before. But imports of other products, although no longer expanding as vigorously as hitherto, continued to be lively.

As might be expected from the composition of total imports, the share of the developing countries increased appreciably in the final months of the year, while that of the industrial countries, although still rising, grew somewhat less rapidly. This is attributable among other factors to a tendency for imports from Great Britain—a country where expansion at home seems to be making it increasingly difficult to raise the level of exports—to flatten out.

Trade between the member countries again rose at an accelerated pace between the third and fourth quarters. In October-December its value was 18 % higher than a year before.

Community imports from non-member countries

(% change in values on preceding year)

Imports from	1962 ⁽¹⁾	1963				1963
	compared with previous year	1st quarter	2nd quarter	3rd quarter	4th quarter	compared with previous year
United States	9.5	9	16	14	15	13
EFTA	11.5	9	16	14	11.5	12
including :						
United Kingdom	19	15	24	21	12	17
Developing countries	7	9	6.5	8	10	8
including :						
Associated overseas countries and territories	4	3	0	0	9	3
All non-member countries	8	7.5	11	12.5	11.5	10.5

⁽¹⁾ Excluding purely statistical corrections made to the import figures in France and the Federal Republic of Germany.

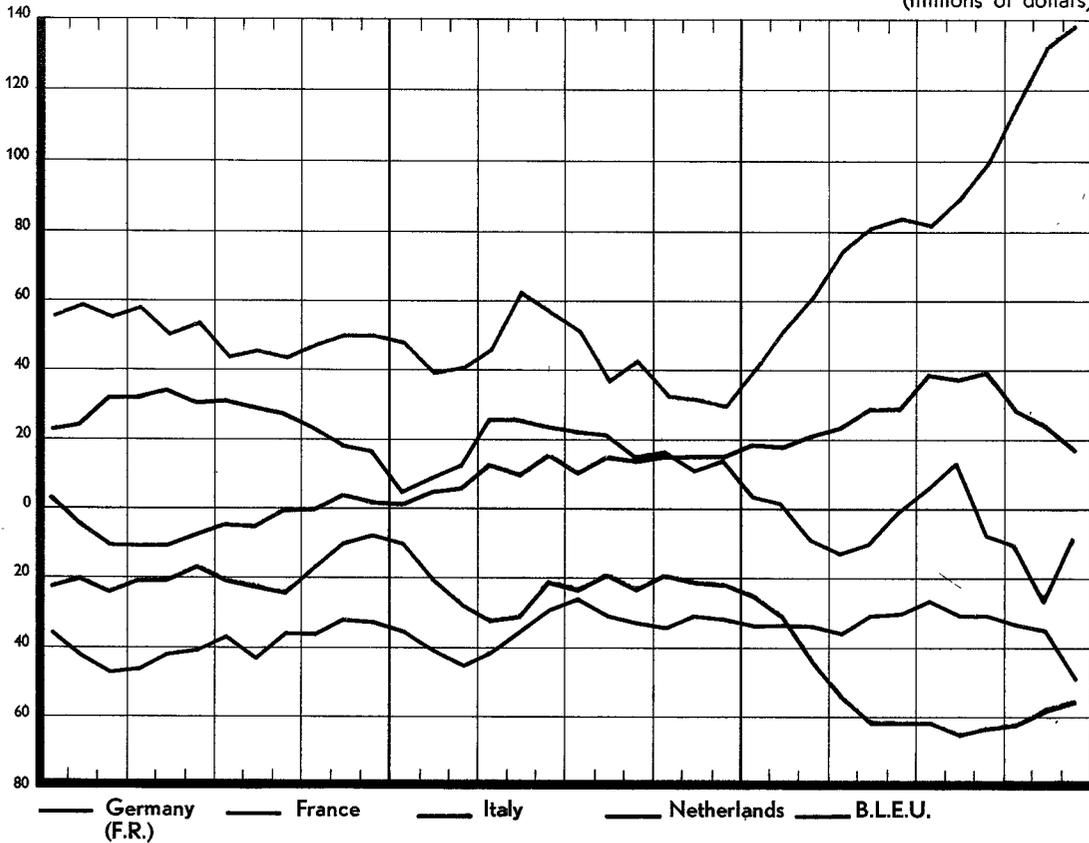
The vigorous expansion of trade within the Community is partly an expression of the economic imbalances which appeared in the first half of 1963 and became more acute in the final months of the year. Thus French and Italian imports in the final quarter of 1963 were up 29 % and 31 % respectively on the corresponding period of the previous year. In the Benelux countries too, especially the Netherlands, the strains became acute in the fourth quarter and led to an appreciable increase in purchases from other Community countries. In that last quarter of 1963 the Netherlands and Belgium imported 22 % and 19 % more than in October-December 1962.

This extra demand caused a sharp rise in exports from the Federal Republic of Germany, which were 25 % higher in the fourth quarter than in the corresponding quarter of 1962. On the other hand purchases by the Federal Republic from Community countries were down; in the fourth quarter of 1963 they were 1 % lower than a year earlier⁽¹⁾.

⁽¹⁾ When allowance is made for adjustments affecting the whole year which were included in the figures for the fourth quarter.

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

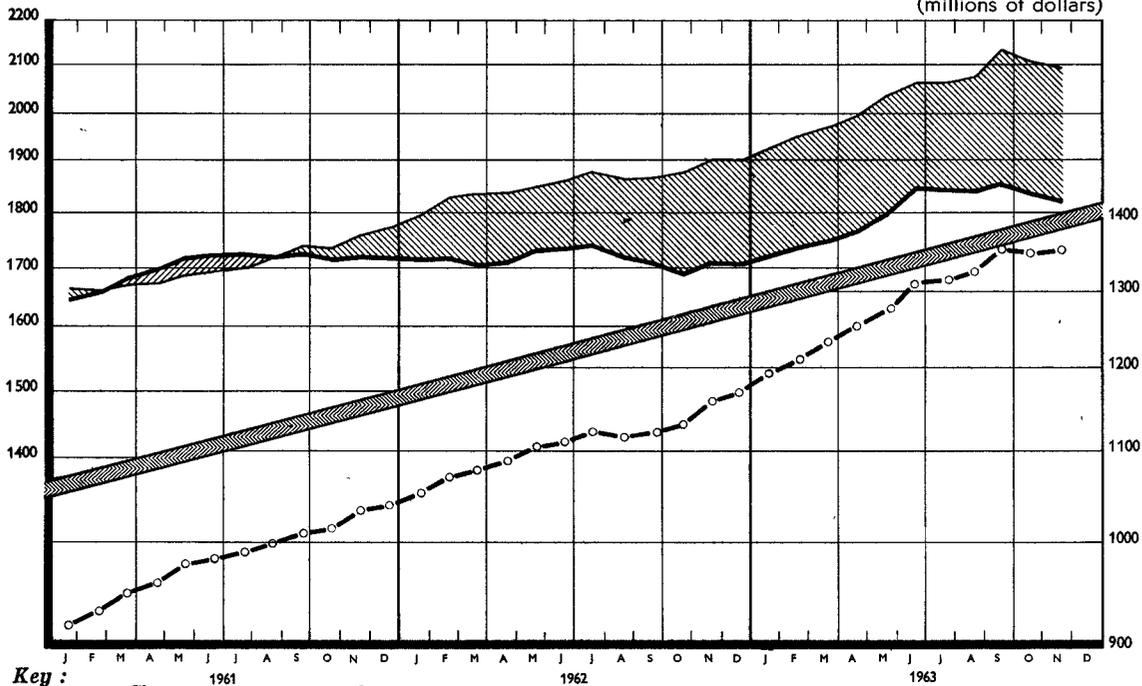
(millions of dollars)



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

2. — TRADE WITH NON-MEMBER COUNTRIES

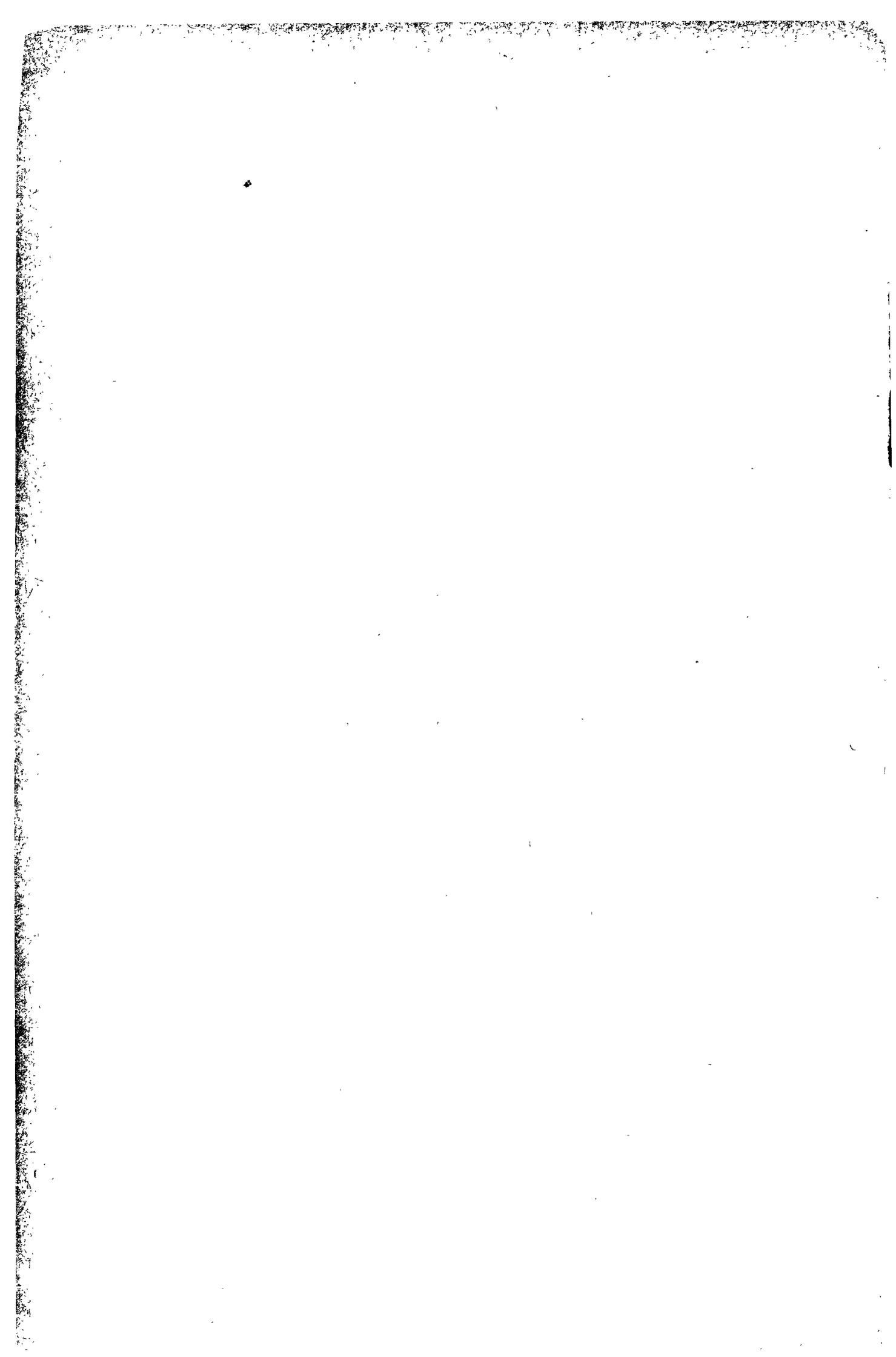
(millions of dollars)



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

Note: Series adjusted by SOEC for seasonal and accidental variations. Exports fob, imports cif. Conversion at official exchange rates.

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



As to the balance of the individual member countries in intra-Community trade, the Federal Republic's surplus went up further, while the French and Italian balances again deteriorated. In the Netherlands also the deficit rose appreciably, and even in Belgium there was a slight decline in the surplus, which however was still considerable.

In the Community as a whole the price level in the fourth quarter of 1963 and the first two months of 1964 was quite clearly rising, but there were certain changes in trend. Thus in France and Italy the price rise, which had been very rapid until the autumn, weakened slightly in the fourth quarter. As against this, fairly vigorous price increases were still occurring quite recently in the Netherlands. In Belgium the price rise continued at the accelerated pace it has followed since the middle of 1963, and in the Grand Duchy of Luxembourg prices began to move upwards again after a short period of relative stability at the turn of the year. In the Federal Republic of Germany, too, where the price level had shown little further change up to the beginning of the autumn, upward pressures seem to have been coming to the fore again.

In all member countries prices for industrial finished goods have risen distinctly—in the Netherlands even more rapidly than before. With these goods the cyclical factors making for higher prices were reinforced in the fourth quarter by the appreciable increase in the cost of imported raw materials. To this must be added higher world market prices for certain tropical beverages (coffee, tea), which in some cases rapidly affected the cost of living. The price of various agricultural products also rose in all Community countries; in Belgium, in the Netherlands, and till the end of 1963 in Italy the rise was quite sharp. Pigmeat and beef in particular went up, partly because of certain special factors (the pig cycle, and excessive slaughter of calves some while ago). Prices and tariffs in the services sector again rose quite sharply as a result of earlier and current increases in wage costs.

All in all the cost of living in January was up on the corresponding level of the previous year by 6.5 % in Italy, 4.8 % in France, 4.5 % in the Netherlands, 4.4 % in Belgium, 4.1 % in the Grand Duchy of Luxembourg and 2.6 % in Germany.

Since in the fourth quarter visible imports increased more than exports, the Community's trade balance deteriorated further. Customs returns show that there was a deficit of about \$650 million, \$265 million heavier than in the fourth quarter of 1962. There is therefore likely to have been a severe weakening of the Community's overall current account position. In addition, the balance of capital transactions in the fourth quarter probably showed its first deficit for a long period. This was mainly because of greatly increased official exports of capital from the Federal Republic of Germany.

The fact that despite this the gold and foreign currency reserves of the monetary authorities in the member countries again rose (by some \$81 million) is explained by transactions of the commercial banks, which as usual in the final months of the year ran down their net foreign exchange position to strengthen their internal liquidity (window

dressing). In the first two months of 1964 official gold and foreign currency reserves declined by \$240 million.

In general, internal liquidity continued to expand quite appreciably in the period under review. In some countries this was due to developments in the balance of payments : in the Federal Republic of Germany, at any rate, there was an increase in the influx of funds from transactions with abroad, due mainly to the continuing improvement of the current account position and to increased net inflows of private capital. The increase in official exports of capital did not affect internal liquidity during the period, and in aggregate the Central Government budgets showed a deficit on transactions of the type which affect the internal situation. In France and the Netherlands also the balance of payments helped to increase the supply of liquidity. The same can be said of Belgium, where however the direct and indirect increases in the Government's foreign indebtedness, used as a means of financing the budget deficit, were a factor in the situation. In Italy on the contrary the sharp deterioration that has occurred in the balance of payments since September has had a restrictive effect on internal liquidity.

On the other hand, the cash operations of the public authorities in Italy made a very considerable contribution to expansion, the more so as the heavy Treasury deficit was financed exclusively from Central Bank resources. Even in the Federal Republic of Germany there was, as already stated, a shortage of liquidity at home despite higher payments to abroad. In general the expansion of public expenditure in the Six was still considerable in the fourth quarter, despite attempts made to curb it in some countries. France in any case was able in the fourth quarter to make a very distinct reduction in the hitherto extremely rapid rise in the Treasury's cash deficit.

In any case there is an impression in some member countries, particularly Italy and France, that the internal liquidity position has become more strained, especially where enterprises are concerned. One reason is that the supply of money has been rising more slowly at a time when the increased turnover of the national economies and, above all, rising wages were causing a considerable expansion of the demand. To this must be added the contraction of the capital market in Italy and direct price controls in France. The resulting lively demand for bank credits was met only to a limited extent.

In fact money and credit policy in all member countries, except the Federal Republic of Germany, has been tightened up to a greater or lesser extent; quantitative limits on credit expansion have been maintained or reintroduced in France and the Netherlands. In Belgium the same aim has been pursued by a sort of gentleman's agreement, and in France, Belgium and the Netherlands Bank rate has been increased. In Italy, as already mentioned, it was particularly the deficit in the balance of payments which increasingly influenced the ability of banks to grant credit. Moreover, the Central Bank has become more reticent in the matter of rediscounting. In the period under review, the conditions for hire purchase credits in the Netherlands, and more recently in Belgium, were also made more stringent; a proposal for similar action was laid before the Italian Parliament.

The tighter credit policy in fact began to produce some results, although it was undermined by the Treasury deficit and the way this deficit is financed in Italy, and although banks in France and the Netherlands on occasion at least overstepped the limits set for expansion of credit.

Except in the Federal Republic of Germany, interest rates both on the money and capital markets rose more or less distinctly, the rise on the capital market in France being however very slight.

B. Outlook

The economic outlook for 1964 has not yet changed very materially from that described in the last Quarterly Survey for 1963. It is particularly the quantitative forecasts for the Community as a whole which seem to require a slight revision.

The outlook for exports to non-member countries is substantially unchanged. The prospect of a continuing upswing in business in the leading industrial countries outside the Community still points to some acceleration of Community exports in 1964.

It is still, for instance, reasonable to assume that there will be a 5 % growth in the real gross national product of the United States. Even though the budget provides for some slowdown in public spending, this is offset by the very expansionary effects of the tax reduction decided on in March; this reduction, instead of being spread over two years as originally planned, is now being made in 1964, and its direct effects will consequently be concentrated mainly on the second half of that year. In the United Kingdom the latest economic indicators show that a very brisk spurt is occurring in business activity, to which investment by enterprises has of late been contributing once again; imports have already speeded up greatly. Finally the improved foreign exchange situation in the developing countries should mean that their purchases from member countries rise more rapidly.

The outlook for the development of internal demand still suggests that expansion will be greater this year than last.

In the field of gross fixed asset formation, which as a whole will doubtless show a fairly distinct increase over 1963, the trend of investment in plant and equipment is beginning to show decided differences from one country to another. In the Federal Republic of Germany, the Netherlands and Belgium this class of investment is clearly expanding, even though in the Netherlands a weakening of the propensity to invest is to be expected towards the end of the year, largely as a result of the economic policy being followed in that country (acceptance of large increases in unit costs coupled with limitation by the State of price rises to a level lower than that of the increased unit costs, and restrictions on credit). At the same time investment by enterprises in France is still hesitant, and growth in Italy has been modest compared with 1963. In construction, the outlook remains practically unchanged: the considerable expansion of building will continue. The more restrictive attitude of governments to public investment contracts is likely to affect mainly the expansion of outlay on civil engineering work. On the whole however, gross fixed asset formation in 1964 might increase somewhat faster than was first forecast,

at any rate by volume. This will be due principally to investment in construction having been heavier thanks to the much milder weather in the early months of the year, and to the livelier trend of equipment investment in the Federal Republic.

Investment in stocks, too, should increase more strongly than could be foreseen at the end of 1963, especially if it is further stimulated by increasing world market prices for raw materials.

As to consumers' expenditure by households, the most recent developments and the latest prospects seem to confirm the overall forecasts established at the end of 1963. It is true that the last figures received for France and Italy indicate that the expansion of consumption will probably not only be less speedy than in 1963 but perhaps even somewhat slower than was to be expected before the anti-inflation policy in these countries was tightened up; in particular the previously very strong upward development of total income from wages has recently tended to slacken a little in these countries. But in the Netherlands the upward price push resulting from the autumn agreement seems to be stronger than was originally expected, and in Belgium also earned income might rise rather more rapidly. In these two countries the increase in private consumers' expenditure will therefore be greater. On balance this should mean that the rise in this class of expenditure should, for the Community as a whole, more or less correspond to the previous forecasts.

The growth of domestic supply might speed up somewhat more than was initially to be expected. First, the pull exerted by demand is perhaps on the whole somewhat stronger than it was, and secondly, the elasticity of supply over the complete year could be slightly higher than forecast as a result of greater rises in productivity and more favourable weather at the beginning of the year. One factor affecting the trend of productivity is that demand has recently become stronger precisely in those fields which still had relatively high reserve capacity (iron and steel and certain investment goods).

On the whole the present forecast for the growth of the gross Community product between 1963 and 1964 in real terms is about 5 % (instead of 4.5 %). The growth rate of industrial production (as defined in the index of the Statistical Office of the European Communities) could be as high as 7 % (instead of 6 %).

Everything still indicates, however, that in the coming months overall demand (in money terms) and supply from domestic sources will continue to develop in line with differences in the level of economic activity from country to country ⁽¹⁾; for the Community as a whole the development will be unbalanced internally and externally, with all the consequences this implies for prices and the balance of current payments.

⁽¹⁾ On this point see especially the individual country reports which follow.

Supply and utilization of goods and services (1)

	1962 (2)	1962 (3)	1963 (3) (4)	1964 (4) (5)
	At current prices (in \$ '000 million)	% change by volume on preceding year		
Gross Community product	225.7	5.0	4	5
Private consumption	137.6	6.1	5	5
Public current expenditure	32.1	6.7	4.5	3.5
Gross fixed asset formation	51.6	6.3	4	6.5
Balance exports (6) less imports (6) (in 0'000 m.)	+ 1.5	+ 1.2	+ 0.2	- 0.2

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

(2) At 1962 prices, average exchange rates for 1962.

(3) At previous year's prices, previous year's exchange rates.

(4) Commission estimates.

(5) Commission forecasts.

(6) Goods, services and factor incomes.

True, endeavours by the various member Governments to ensure stability, coupled with the underlying trends in the various countries, will in the long run narrow the differences within the Community, and the rise in prices is likely to be on the whole somewhat smaller; but the overall picture remains one of price inflation, with persistent if slower price increases in Italy and France, a speedier upward thrust of prices in the Netherlands and, to a lesser extent, in Belgium, and the danger of a fresh acceleration of the upward movement in the Federal Republic of Germany.

The disequilibrium in the Community's external trade situation will also continue and will probably tend to become more acute. Imports from non-member countries will perhaps rise even more rapidly than was foreseen at the end of 1963. In any case the Commission's staff at present expect that the deficit on the Community's merchandise trade will increase by at least \$700 million (from \$3 000 million to about \$3 700 million) between 1963 and 1964. The current payments account might deteriorate on a similar scale, and can in any case be expected to show a considerable deficit.

The authorities in the member countries and the Community institutions responsible for current economic policy are still confronted with the task of establishing (or

re-establishing) the internal and external equilibrium of the Community. Unless this is done, there will be a serious risk of the competitive position of the Community as a whole worsening considerably further—so far, in fact, that it might become necessary to take measures which could lead to a slump.

The Community must therefore endeavour to ensure that in the long run it will have a moderate surplus on current account. For the Community, as one of the most highly industrialized areas in the world, to be a net capital importer should not be considered as a normal and permanent state of affairs. Its surpluses on capital account have hitherto been due less to inadequate exports of capital than to excessive inflows. This state of affairs cannot of course be permanent; it reflects certain imbalances in the international currency and payments situation, and these will have to be remedied. Success in the efforts being made in all quarters to remedy the situation—and here the Community too must make its contribution, not least by further stepping up its capital exports—will contribute strongly to the reduction of the Community's surplus on capital account. If the competitive position of the Community were then too gravely weakened and the current account therefore did not show the necessary surpluses, the Community would find itself in a position of structural deficit in its overall balance of payments, and the main result of this—as experienced in other countries shows—would be seriously to handicap longer-term economic growth.

Even though the situation differs in detail from one member country to another, measures to restore the Community's internal and external balance are a Community task. This is the more so as the aim must be to replace the strains which at present exist between the levels of economic activity within the Community by a harmonized and smooth development. In all member countries except the Federal Republic of Germany, where the better internal balance makes this unnecessary, these measures must aim at the rapid abolition of excess demand and stabilization of prices and unit costs. To the extent that this policy is successful, there ought to be a reduction in the surpluses again being experienced by the Federal Republic, since these of course are largely due to the excessive pull of demand from the other Community countries. However, the Federal Republic of Germany itself can and must take action to help reduce a surplus position which endangers its own internal stability; one way of doing this would be to encourage imports from the other member countries, particularly of those agricultural products of which they are in a position to supply sufficient quantities. It is clear that this would also have a direct influence in helping to keep German prices stable.

Anti-cyclical measures in the member countries threatened by inflation must succeed rapidly enough to prevent stability in the Federal Republic being undermined by the effects of over-large external surpluses on internal liquidity and on the business situation. If this happened, the Federal Republic would no longer be able to make any contribution to ensuring the stability of its partners but would even hamper their efforts to keep the economy on an even keel by itself introducing further inflationary trends.

In this connection it must at the same time be noted that the Federal Republic is in no way bound just to stand by and wait for stabilization in the other Community countries. It could perhaps bring fiscal policy, possibly even monetary policy, to bear in an attempt to neutralize a further rise in liquid funds from abroad. An endeavour might be made to absorb inflowing liquidity, for instance by issuing special shorter-term public securities and organizing the re-export of the funds thus withdrawn from the market.

If carried out properly, the reduction of excess demand in the member countries where there is inflationary pressure cannot in itself cause any recession but at most some slowdown in real economic growth. This is a sacrifice without which neither rapid stabilization nor, in the long run, satisfactory and balanced economic growth is possible.

It must still be said that the emphasis in the Community's stabilization policy should be placed on fiscal policy. One reason is that all experience and principles of modern economics and economic policy in handling long-term trends show this to be the procedure which promises the greatest success; a second reason is that the budgets of public authorities themselves have very materially contributed to the present difficulties, and a third reason is that when fiscal policy is the instrument chosen, the danger of its action being self-defeating because of increased capital inflows from abroad is less than when monetary and credit measures are used. True, the familiar idea that fiscal policy is always an entirely "good" instrument for coping with the danger of awkward international movements of capital and that credit policy and even interest policy are "bad", is certainly an over-simplification. For of course a stringent anti-inflationary fiscal policy also has a restrictive effect on the internal liquidity situation and so gives actual interest rates an upward twist. Its effect is, however, not so direct and strong as that of a restrictive credit policy, particularly when the latter has simultaneously to place even sharper restraints on credit because the State, for instance, is doing nothing to apply an anti-inflationary policy in connection with its spending and the financing thereof.

A policy of budget restraint is therefore in any case still urgently required in all the Community countries except the Federal Republic of Germany. A consideration which, in the light of the economic situation and its foreseeable development, further justifies the call for maintenance of such a policy is that stabilization based entirely on measures in the credit field would inevitably place more severe restrictions on the directly productive investments of enterprises—and in most member countries expansion in this sector already tends to be none too rapid. In the Federal Republic fiscal policy must not be such that it acts as a brake on business activity, but here too it would be wise to maintain the policy of strict limitations on expenditure.

Nor should the emphasis of a restrictive fiscal policy be exclusively or predominantly in the field of public investment; its first aim should be to slow down the expansion of public expenditure on goods, services and transfer incomes, including subsidies.

In any case in France, Belgium and particularly Italy the efforts so far made to reduce the deficit of Treasury operations must be continued. In the Netherlands also stricter limits on the growth of state expenditure are certainly to be recommended. If the expansion of production is not slowed down sufficiently in these member countries, it might even prove necessary to resort to tax measures in order to reduce the expansion of internal demand in monetary terms.

In Italy particularly, and in Belgium too, it is also necessary that the entire financing of whatever deficits are left should as rapidly as possible be put on a sound footing, i.e. they should be financed by internal savings instead of by further calls on the Central Bank or external credits.

However, it will not be possible to achieve stabilization in the member countries suffering from inflationary pressure unless fiscal policy is supplemented by a restrictive credit policy. In other words, all member countries except the Federal Republic of Germany must continue their efforts to keep the expansion of the volume of credit within very narrow limits, and in the Federal Republic the present rate of expansion must in any case not be allowed to increase substantially.

As already stated in earlier Surveys, it would seem that the possibilities of effectively countering inflation in the Community by using the "classical" instruments of economic policy are greater today than they were previously. In the first place the current payments account has deteriorated appreciably and in recent months has even had a constricting effect on reserves of foreign exchange and internal liquidity. Secondly, there has been a shift in the border-line beyond which there would be extra influxes of capital that would disorganize the limitation of internal liquidity and the structure of interest rates. Obviously the authorities responsible for economic policy in the Member States must keep their eye on this line—not only in the interest of the international monetary and payments situation but also in their own interest, since such inflows undermine the measures taken to ensure stability.

It must further be remembered that some movements of private capital are certainly not made because of the rates of interest but on other grounds, such as lack of confidence in the general or the economic policy or the currencies of other countries, fiscal considerations and differences in tax rates, the force of attraction of the relatively dynamic development of economic activity in the Community, etc. If differences in interest rates were the predominant factor, it would, for instance, be inexplicable why Switzerland, with its very low rate, has in fact such high inflows of capital.

The increased possibilities of action referred to above are in part attributable to developments in the business situation and in interest rates and to the policies on interest

rates followed outside the Community, in part to specific measures against disturbing movements of capital. Thus interest rates have risen or been deliberately increased in a number of non-member countries, particularly the United States, where short-term borrowing has also been affected. In this connection mention should also be made of rises in Bank rate in Denmark, Sweden and, recently, in Great Britain. Moreover in the United States, the most important country from which private capital is flowing out at an excessive rate, special measures have been proposed (Interest Equalization Tax), and these had considerable effects even before the measures came into operation. At the same time the expansion of business and the better outlook for profits brought about in the United States by the lowering of taxes will channel an increased share of the country's savings into investment at home. Long-term interest rates in the United States might perhaps also show a stronger tendency to rise as the boom progresses, especially if those responsible for the country's credit policy should find it necessary to take a somewhat more cautious line in order to obviate the danger of cost and price rises.

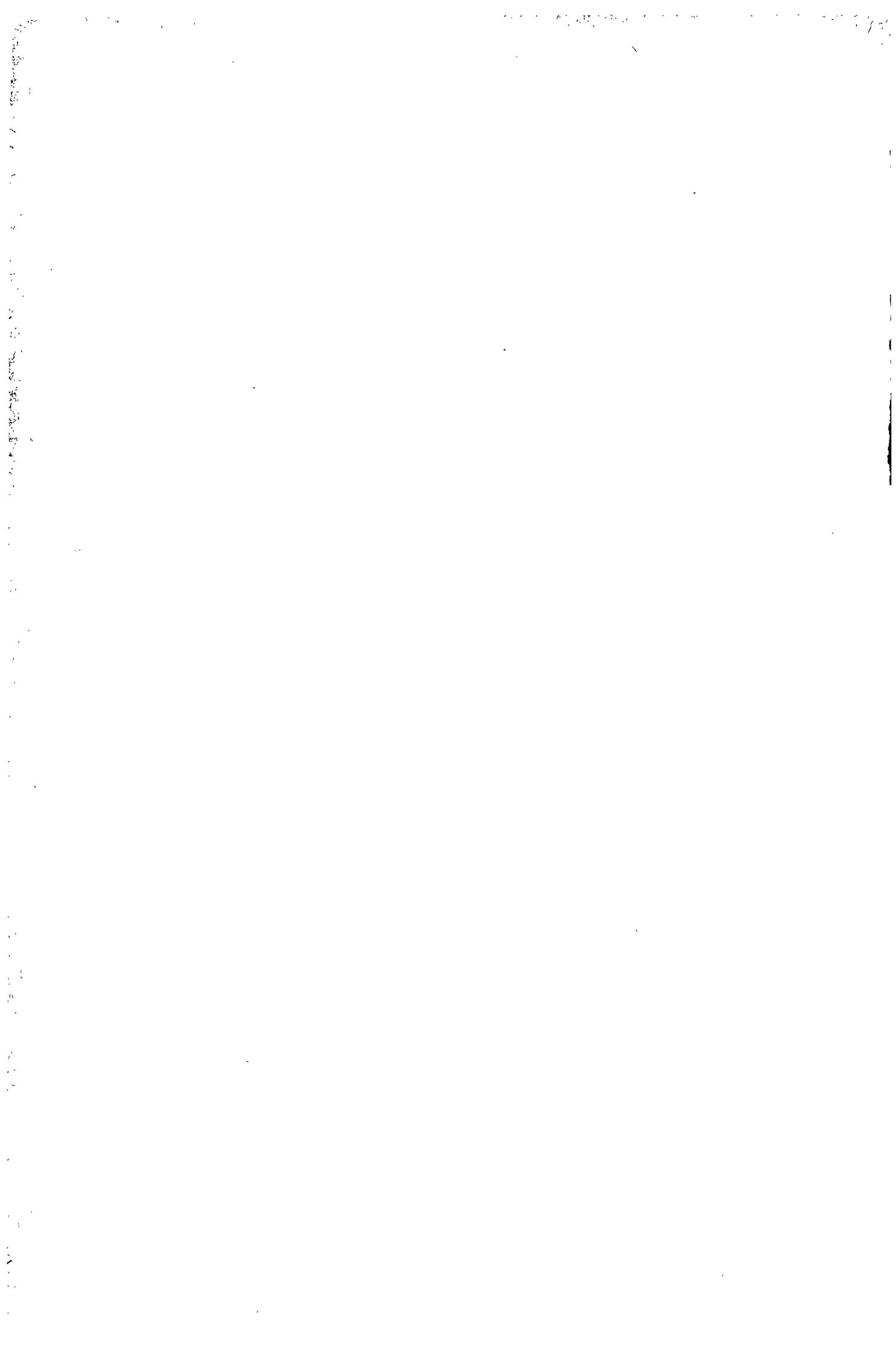
On the Community side it is clear that the more effective any anti-inflationary measures prove to be, the more successfully will they frighten off all that capital which has tended to flow in only because of the inflationary boom in the Community.

If, despite all this, the capital account should continue to show high surpluses, the Community might have to adopt a policy which would take the balance of payments problem into account as fully as was compatible with action to encourage the export (and conversely, perhaps, to discourage the import) of longer-term capital and short-term money. It would not, however, be possible to interpret "taking the balance of payments into account" as meaning that the Community should continue to put up with inflationary trends at home and a constant deterioration in the balance of current payments.

It should, moreover, be pointed out that, if there is to be a stringent policy of stabilization and stability in the Community, the maintenance of liberalism in external trade has to be one of the elements in it, particularly because this liberalism contributes to internal stability by sharpening the competition of goods from non-member countries. The deterioration which has occurred in the Community's balance on current account should not be used as an argument for any protectionist pressure. Restoration of the trade balance and, with it, of the Community's current payments is in no way a problem of trade policy but entirely a question of economic policy. In fact, elimination of excess demand might well prove to be all that is needed to ensure that the Community regains a satisfactory competitive position.

The extent to which the policy of overall restraint proves successful will determine the conditions for achieving an incomes policy which should lead to the stabilization of price levels and keep the Community's industries sufficiently competitive.

In connection with economic policy in the Community, reference should moreover be made to the Economic Policy Committee's memorandum of 7 February, which is based on a thorough discussion of the economic budgets of the member countries and of the forecasts made by the Commission's staff. The Commission has accepted the Committee's proposals on economic policy in the Community and recommended them to Governments. The memorandum is published as an annex to this Survey.



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

A. Federal Republic of Germany

Economic expansion became noticeably livelier in the fourth quarter of 1963 and—as far as can at present be ascertained—in the early months of 1964 also. This was largely due to exports. Although investment in plant and equipment has increased only moderately to date, the uninterrupted vigour with which investment in building and construction has been expanding has meant a marked rise in total gross fixed asset formation. Investment in stocks too, seems once again to be making an increased contribution to the growth of total demand. While expenditure by the public authorities rose sharply again, private consumption remained on the whole relatively steady because of the slower rise in incomes and the continued high rate of saving.

Domestic supply probably increased its rate of growth. In the last quarter of 1963—according to the Federal Statistical Office's index of production per working day—industrial production was 5.3 % higher than in the same quarter of 1962, whereas the year-to-year growth rate for the third quarter has been 3.4 %. Imports, however, probably dropped slightly. Prices continued to edge upwards, chiefly because of further price increases in the building sector and for farm products, but also because of higher rents and higher prices for some services.

The surplus on trade achieved a new record in the fourth quarter—DM 2 840 million. Official reserves of gold and foreign exchange rose about DM 1 000 million.

Developments in recent months mean that expansion in 1964 should be if anything more vigorous than previously forecast. The impact of foreign demand has become stronger. Enterprises' propensity to invest is clearly on the increase. Housing and public investment in construction may be expected to go up as strongly as before. Public expenditure on goods and services is again likely to expand markedly. On the other hand, the growth of private consumption may well be quiet for some time to come.

In spite of manpower reserves being at a very low ebb, the domestic supply of goods and services should remain fairly elastic. The rate at which imports expand may well speed up somewhat again. Prices—except on the building markets and in the services sector—may at first remain relatively stable. The surplus on current foreign transactions will presumably show a further increase.

On the whole, these prospects are much the same as were forecast in the last Quarterly Survey (4/1963). Especially in view of the improved prospects for the expansion of external demand and of investment, industrial production (not adjusted for differences in the total number of working days in the year) may go up about 6 % and gross national product in real terms by 5 to 5.5 %.

1. Recent developments

The powerful upsurge in the exports of goods and services has continued and even gathered speed in recent months. Customs returns show that exports of goods in the fourth quarter of 1963 were some 15 % up on the last quarter of 1962 in terms of value and 16.5 % in real terms (compared with growth rates of 12.6 % and 13.6 % in the previous quarter). In January the value of deliveries abroad was as much as 28.7 % higher than in January 1963, when exports had been kept relatively low by bad weather and the American dockers' strike.

Internal demand maintained a high level, but expansion has not yet speeded up noticeably. There was an upward trend in aggregate gross fixed asset formation. To judge by turnover in the typical investment goods industries, investment in plant and equipment does not seem to have picked up much by the end of the year despite a marked improvement in the investment climate. The expansion of investment in building and construction, however, continued to be vigorous.

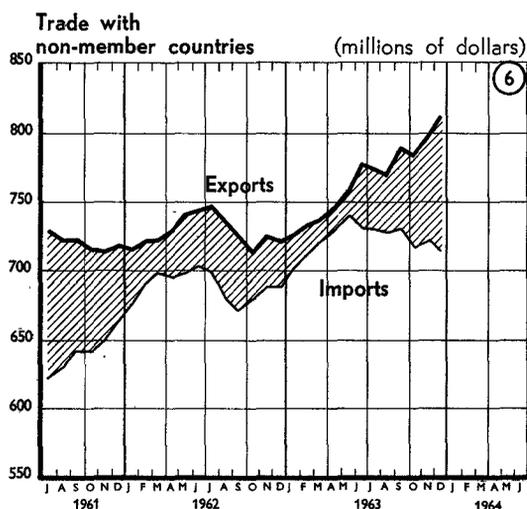
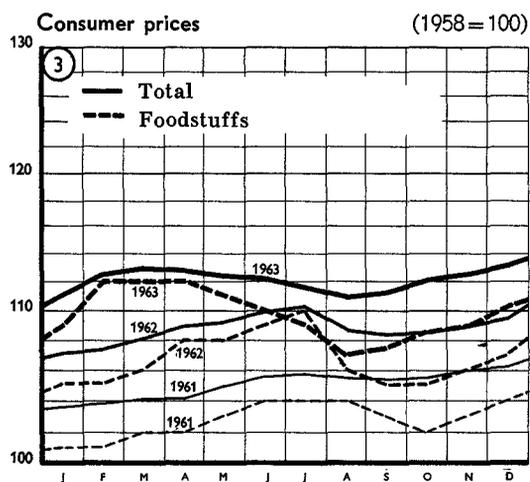
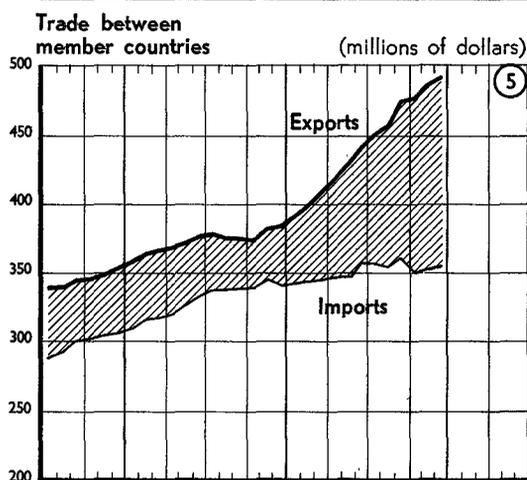
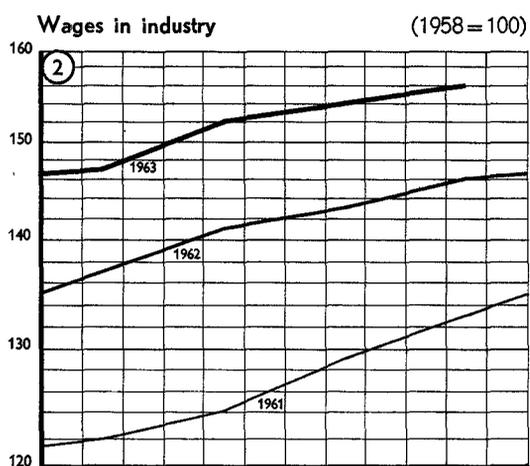
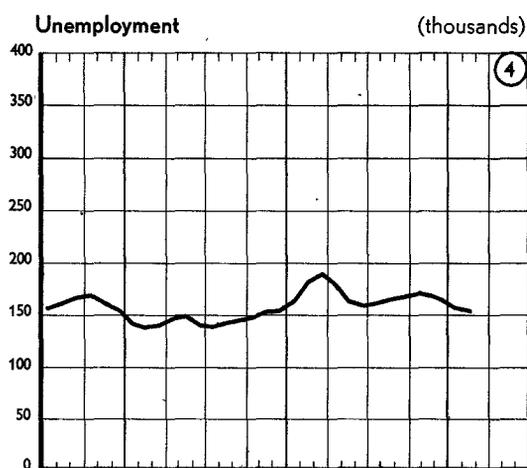
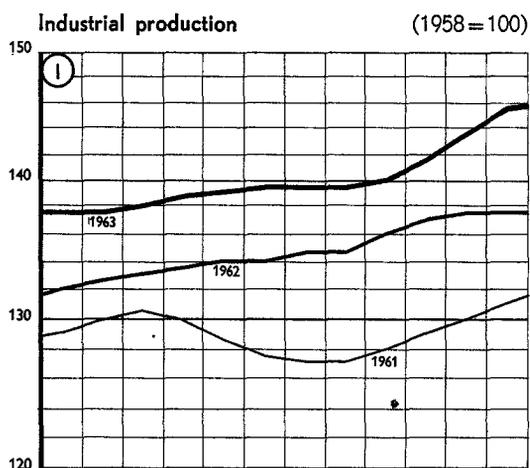
The tendency to replenish stocks of raw materials that has been observed for some time appears to have been reinforced. At any rate, imports of raw materials in the last quarter of 1963 were about 15.5 % by volume higher than in 1962, as against a year-to-year growth rate of 11 % over the third quarter. Stocks of manufactured goods with wholesalers and retailers seemed also to be markedly bigger, though this was probably partly a result of sales in some sectors not coming up to expectations.

Whereas public expenditure on goods and services grew apace once again, the growth of private consumption continued to be fairly quiet. In the fourth quarter the index of turnover in the retail trade was only about 4.5 % in value and a bare 2 % by volume higher than in the corresponding period of 1962, and in January 5.5 % and 3.6 % above the corresponding figures for January 1963 (4.5 % and 3.5 % in the third quarter).

This development is partly due to the slackening of the pace at which wages and salaries were rising, though the high rate of saving by households played an important

FEDERAL REPUBLIC OF GERMANY

ECONOMIC INDICATORS



NOTES :

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

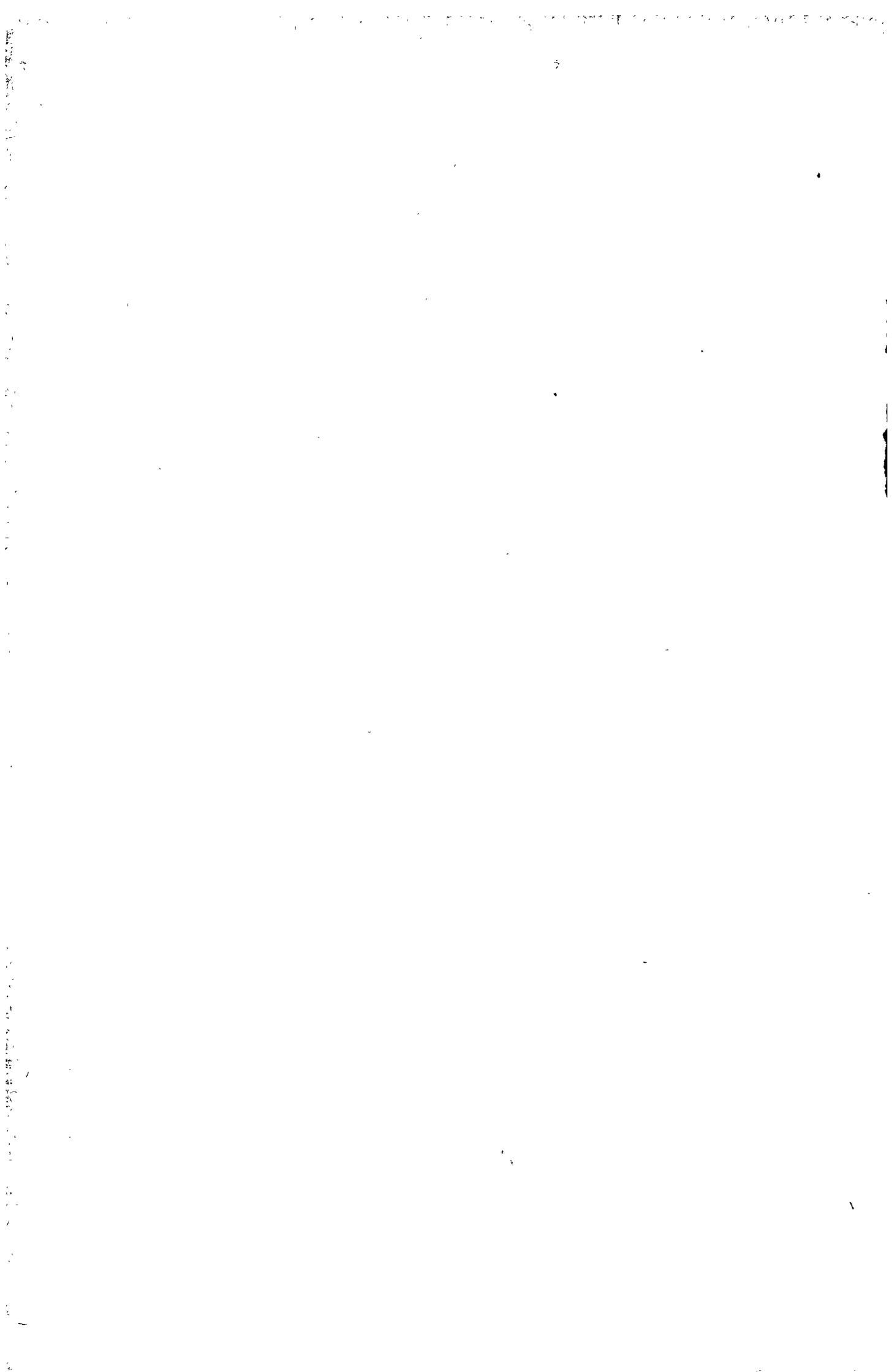
Graph 1 : Estimated trends based on SOEC seasonally adjusted data. Excluding construction, food, beverages and tobacco.

Graph 2 : Index of average hourly gross earnings.

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

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

Graphs 5 & 6 : Series adjusted by SOEC for seasonal and accidental variations. Exports fob, imports cif. Conversion at official exchange rates.



part too. The level of agreed wages in the last quarter of 1963 was 4.8 % above the 1962 figure (as against a 5.2 % increase in the third quarter). With allowance made for the greater number of workers in paid employment (about 1.7 % more than in the fourth quarter of 1962) and for the rise in transfer incomes, net mass incomes were a good 6 % up on the previous year.

Mainly because of good weather, the seasonal increase in unemployment at the beginning of the year was noticeably less in 1964 than in 1963. The unemployment figure at the end of February—about 298 000—was almost 113 000 lower than a year before. The number of construction workers drawing bad-weather pay, who are not included in the unemployment figures, was also considerably lower than a year before. At the same time the large number of vacancies, at 569 000 a record for February, indicates that the labour market is again under increased pressure.

Supply has of recent months been growing slightly faster, all the increase coming from domestic production. In the fourth quarter the Federal Statistical Office's index of production per working day was 5.3 % and in January 1964 9.7 % higher than a year earlier (the increase in the third quarter had been 3.4 %); production of investment goods has also gone up recently.

In comparison with domestic supply, imports of goods and services showed very little increase. Although raw material imports rose sharply, customs returns in the fourth quarter showed imports of goods to have been only 1.8 % in value and 3 % by volume higher than in the fourth quarter of 1962 (in the third quarter the figures had been 11.2 % and 11.4 %). In January the year-to-year growth rate for the value of merchandise imports rose again to 15 %, but it should be remembered that the level of imports a year earlier had been exceptionally low.

The overall level of prices in the fourth quarter moved upwards. While industrial producer prices remained more or less steady — in January they were 0.8 % higher than a year earlier — agricultural producer prices showed a marked increase that was only partly due to seasonal factors. Building prices also rose again, though much less rapidly. The cost-of-living index kept rising, principally as a result of dearer food, higher rents and the heavier cost of certain services; in January 1964 it was 2.6 % above the January 1963 level.

Within the balance of payments, the surplus on current account rose steeply in the fourth quarter. The surplus on trade reached a new peak at DM 2 840 million. The balance of current transactions, which includes services and unrequited payments, closed with a surplus of DM 2 060 million, against deficits of DM 555 million in the previous quarter and of DM 648 million in the fourth quarter of 1962.

There was a deficit of DM 1 240 million, however, on the overall balance of payments because net exports of capital (including the residual items not covered by statistics but excluding changes in the banks' foreign exchange position) totalled DM 3 300 million; this was chiefly due to official payments to abroad being unusually high when compared with recent quarters and with the longer-term trend. While the foreign exchange position of the banks deteriorated by DM 2 220 million as a result of the normal repatriation of foreign holdings at the end of the year, the Bundesbank's gold and foreign exchange reserves went up by DM 970 million. The overall increase in gold and foreign exchange reserves (Bundesbank and other banks) in 1963 was therefore DM 1 890 million, against a fall of DM 410 million in 1962.

Supply and utilization of goods and services

	1962 ⁽²⁾	1962 ⁽²⁾	1963 ⁽³⁾	1964 ⁽⁴⁾
	At current prices (in DM '000 million)	% change by volume on preceding year		
Gross national product	354.8	4.2	3.2	5.5
Imports ⁽¹⁾	65.3	11.4	8.3	7
Private consumption	203.8	5.8	2.7	3.5
Public current expenditure	52.9	11.9	6.3	5
Gross fixed asset formation	90.0	5.5	1.8	7.5
Exports ⁽¹⁾	68.9	4.2	9.8	10

⁽¹⁾ Goods, services and factor income.

⁽²⁾ *Wirtschaft und Statistik*, January 1964.

⁽³⁾ Commission estimates.

⁽⁴⁾ Commission forecasts.

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

Despite the deficit on the balance of payments, bank liquidity benefited from further helpful developments in the fourth quarter. Official payments abroad, most of which are not financed from money in internal circulation, considerably in excess of the deficit on the balance of payments and—even more important—the budgets of the central public authorities showed increased deficits in those cash transactions which exert an influence on the internal situation.

The expansion of bank advances to trade and industry fell off in the fourth quarter in comparison with the previous year, particularly in the case of medium- and long-term credits. Loans to public bodies, on the other hand, rose considerably.

2. Outlook

The economic prospects for the rest of the year are essentially the same as forecast in the last Quarterly Survey (4/1963).

Foreign demand may if anything provide a rather stronger stimulus than originally expected. New industrial orders from abroad have been coming in more quickly in recent months. In the fourth quarter of 1963 they were 23 % up on the fourth quarter of 1962 and 7 % higher than foreign sales, which were themselves very high already (in the third quarter the figures were 22 % and 1 % respectively).

The expansion of gross fixed asset formation will presumably be stronger in the coming months. Enterprises have been showing a greater inclination to invest. New domestic orders for machinery were 20 % higher in the fourth quarter than a year before, though still 6 % below domestic sales (in the third quarter, orders were 8.5 % up on 1962 and at the same level as sales). The corresponding figures for electrical goods were as high as + 16 % and + 5 % (+ 18 % and + 2 % in the third quarter). According to the survey carried out by the Institute for Economic Research (IFO) at the end of 1963, industry will invest about 5 % more in 1964 than it did in 1963. Most of the increase will go on rationalization schemes.

This seems to be confirmed by the fact that orders in the industrial building sector are relatively quiet in comparison both with last year and with current orders for investment goods, although for a few months the trend has again been distinctly upward. As regards investment in other building and construction, expansion may be expected to continue at its present high level because of the exceptionally large carry-over of unfinished projects from last year, particularly in housing, where the backlog at the beginning of 1964 had reached the figure of 775 000 units. In the case of public projects, there is likely to be a considerable expansion of construction for transport purposes and also of other public building work. Licences issued in this sector during the fourth quarter represent a 9.3 % increase over the corresponding figure of a year earlier (in terms of cubic content of the buildings), against the 5.5 % of the preceding quarter.

Investment in stocks may also provide further stimulus, since the rise in world prices for raw materials and the improved economic outlook may induce managements to increase their holdings of raw materials and semi-manufactures.

The strong expansion of public authorities' expenditure on goods and services should continue, though the pace may slacken a little as a result of efforts to curb rising expenditure in coming months.

Private consumption may well grow a little more quickly, but on the whole it should be fairly quiet. The rise in agreed weekly wage rates is not likely to be very great at first. It remains to be seen, however, whether actual earnings will not increase a great deal faster than agreed wages as employers have to compete more and more keenly for labour. Moreover, the rise in mass incomes will be helped along by a sharp rise in transfer incomes. Finally, increased earnings may well lead self-employed persons to increase the pace at which they withdraw profits from their businesses.

The likelihood of a decidedly vigorous expansion of demand means that labour shortages may become more serious again in the coming months. Available reserves of manpower are very low, and the shorter working hours and longer holidays expected to result from the next round of negotiations may be offset only partly, if at all, by overtime. Furthermore, the recruitment of additional foreign labour is becoming increasingly difficult.

However, the supply of goods and services should be relatively elastic, since business investment in rationalization over the past years may lead once more to great advances in productivity. At any rate, industrial production will probably maintain the significant rate of expansion attained once again in recent months.

The expansion of imports should pick up again somewhat, though price increases in some of the major supplier countries may possibly act as a brake, particularly in the case of some manufactured goods.

For a while, prices in general should remain rather stable, except on the building market, though here too there appears to be some possibility that the rise in prices may flatten out. Consumer prices, however, may move slightly upwards, particularly as a result of autonomous price increases (in rents, etc.) and higher prices for services.

The discrepancy between the growth of exports and that of imports will probably lead to a further sizeable increase in the surplus on current account.

As these prospects for economic growth in 1964 are broadly the same as forecast in the last Quarterly Survey (4/1963), the conclusions drawn with regard to policy remain largely unchanged. In general, policy for dealing with current developments in the Federal Republic during 1964 ought not to be excessively restrictive, but it should certainly not be expansionary. As price stability is the aim, the first care should be to keep government spending in check, and it would in particular be advisable to show greater caution in approving any public expenditure which has a direct or indirect influence on the building markets.

In the long run, too pronounced a rise in the surplus on current foreign transactions will doubtless cause the price situation to deteriorate once again. As the surplus derives chiefly from developments in intra-Community trade, reducing it is mainly a task for anti-inflationary policy in the other member countries. However, some contribution can be made by Germany itself. The Federal Republic should begin by using every means available to it under the Treaty to facilitate extra imports—including farm imports. Imports could also benefit if the public authorities placed more orders than hitherto with foreign suppliers. Further, “Buy German” clauses should for the time being at least be left out of agreements to supply credits and capital assistance to developing countries.

Those responsible for policy might also consider whether it would not be possible to put a brake on the net inflow of capital into Germany—by encouraging exports of money and capital and by any other means.

3. The economic situation in West Berlin

Economic expansion in West Berlin was maintained in the fourth quarter of 1963, though on the whole it was rather less lively than in the Federal Republic. Foreign demand in particular exercised a much weaker stimulus on growth. Exports of goods, despite a slight increase, were on the whole only slightly higher than in the fourth quarter of 1962. Expenditure on gross fixed asset formation, on the other hand, continued to go up quickly, public investment in building and construction expanding with particular vigour. Private consumption continued to move upwards. The value of retail sales was 5.4 % higher in the fourth quarter of 1963 than a year earlier (against a third-quarter increase of 5 %).

Strain on the labour market seems to have eased but slightly. True, unemployment in February at about 16 400 was almost 400 higher than the year before, but this is probably due mainly to the seasonal rise of unemployment in outdoor occupations—chiefly building and allied trades—which had taken on many more workers during 1963.

The growth of industrial production seems to have levelled off slightly from the third to the fourth quarter. In the fourth quarter of 1963 production was only a bare 2 % higher than in the corresponding period of 1962. The overall increase in 1963 was a bare 3 %.

The balance of merchandise trade with the Federal Republic deteriorated again in the last quarter of 1963, after a temporary improvement in the third quarter. The overall result for 1963 was a deficit of DM 130 million against a surplus of DM 66 million in 1962.

Consumer prices in recent months tended to rise again, mainly because of dearer food and services. The cost-of-living index was 2.7 % higher in January 1964 than in January 1963.

The economic outlook for the rest of 1964 may be said to be very favourable. It is true that the flow of new orders to West Berlin industry in the fourth quarter of 1963 was only slightly higher than a year earlier and only 2 % above sales (in the third quarter orders were up 6 % but were 6 % below sales); it must however be borne in mind that experience has shown that upswings in the Federal Republic carry through to West Berlin too, but with a certain delay. The propensity to invest of enterprises seems also to have been livelier, mainly under the influence of tax incentives. Finally, it should not be overlooked that marginal capacity in the Berlin economy is generally narrower than in the Federal Republic, mainly because of the manpower bottleneck. This gives special importance to the efforts being made to increase elasticity of supply—particularly the efforts to recruit foreign labour—as one result will be the improvement of the longer-term conditions for growth.

B. France

The rather rapid expansion of the economy continued in the fourth quarter of 1963. As far as can be judged, growth was maintained in the early months of 1964.

Exports expanded further. Domestic demand also advanced, though it seems as if the direct and indirect effects of stabilization policy are tending to reduce the pace of expansion, at least in public current expenditure and private consumers' expenditure.

Supply continued to expand in lively fashion. In the fourth quarter industrial production was 8.5 % higher than a year before. At the same time imports were rising—and exceptionally fast.

These developments in demand and supply, and even more the introduction of direct controls, combined to cause a distinct slackening in the upward movement of prices.

The rapid increase in imports was reflected in a further considerable deterioration of the trade account, which in the fourth quarter showed a deficit of \$77 million in dealings with countries outside the franc area (as shown in customs returns). Gold and foreign exchange reserves went up, nevertheless, by a further \$135 million.

The Government continued, and stepped up, its stabilization efforts. Measures taken or announced in the field of budget policy and of monetary and credit policy will certainly result in a more marked tendency for the expansion of demand to slow down.

There is in fact likely to be not only a rather less lively development of exports, which in any case was to be expected, but also an increase in investment expenditure that will continue to be no more than modest and a somewhat more marked slowdown in the expansion of private consumers' expenditure.

This development of demand could bring about a rather slower growth of production in some branches, but it is the expansion rate of imports which is most likely to diminish.

In view of these prospects for demand and supply, the return to equilibrium will not be achieved in the near future. The trade balance is likely to deteriorate further, though more slowly than in the past, and the upward tendency of prices may

remain rather appreciable—as would be evident once price controls were lifted. It is therefore essential that efforts to attain stability should be continued and intensified.

Despite the likelihood of a somewhat more pronounced reduction in the growth rate of demand, there is no cause to amend substantially the forecasts made at the end of 1963. Expansion in the last months of the year was so rapid that in fact a 1964 growth rate of some 5 % in real gross national product can still be expected, and a good 6 % in industrial production.

1. Recent developments

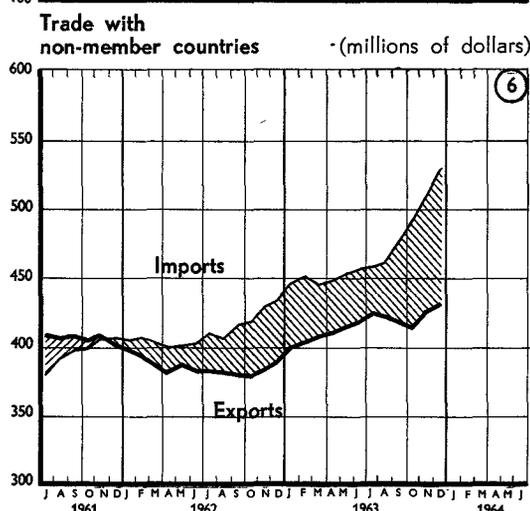
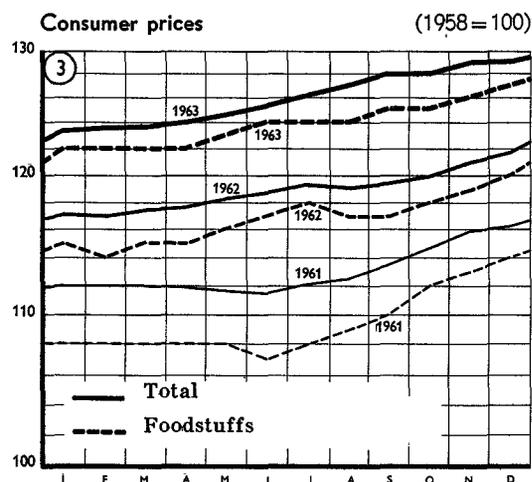
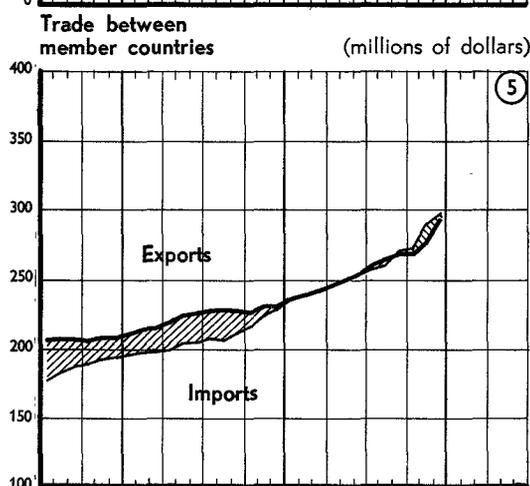
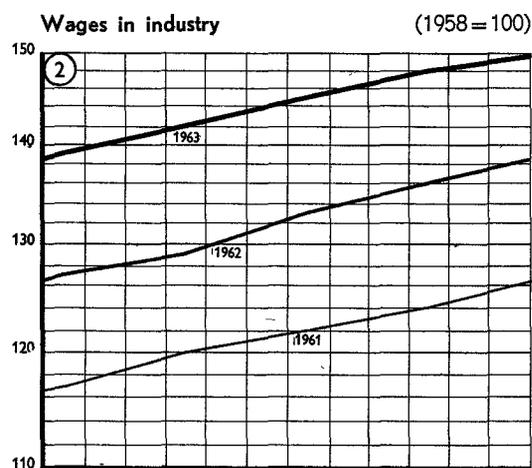
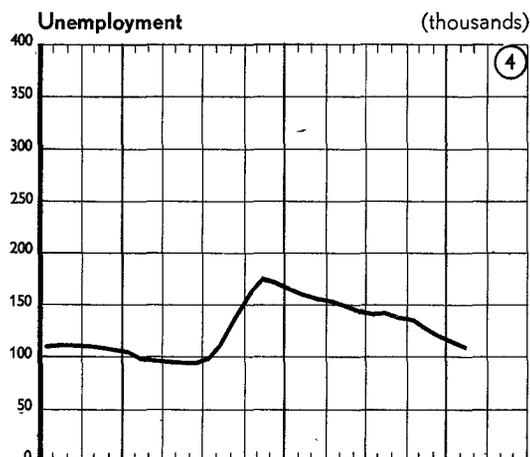
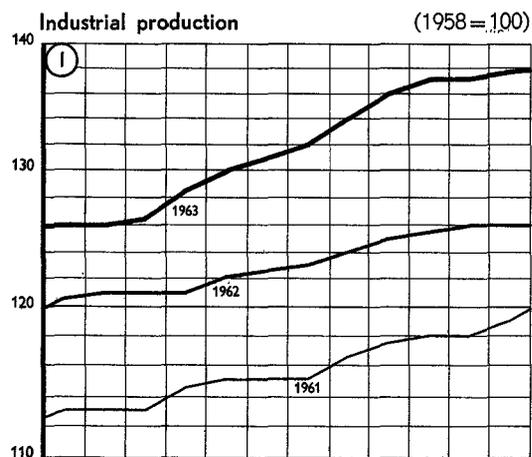
Disequilibrium in the French economy persisted in late 1963 and early 1964. It seems, however, to have tended to diminish slightly, mainly because the upward movement of internal demand has slowed somewhat.

External demand—in terms of goods and services exported—may have continued its expansion despite the undoubted weakening of French competitiveness in 1963. This certainly applies to exports of goods, which according to customs returns were almost 11 % higher than in the fourth quarter of the previous year. Exports to countries outside the franc area even showed a year-to-year growth rate of 14.5 %. This reflects the accelerated upward movement of the world business cycle, which has recently caused the increases in prices and costs in a number of non-member countries also to be sharper than before and which at least helps French exports to non-member countries. More important still, exports have expanded rapidly to other Community countries which have been suffering from or are beginning to feel inflationary pressures. It is characteristic of this situation that exports to Federal Germany have shown scarcely any significant growth.

Internal demand has also been rising further, but certainly somewhat more slowly than in past months.

Outlay on gross fixed asset formation has increased further. Investment expenditure in public undertakings, trade and agriculture may well have risen appreciably once more, and expenditure in the housing sector again advanced rapidly. On the other hand fixed investment in the private sector probably continued to stagnate; and the blocking by the Government, as part of the stabilization programme, of certain public

ECONOMIC INDICATORS



NOTES :

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

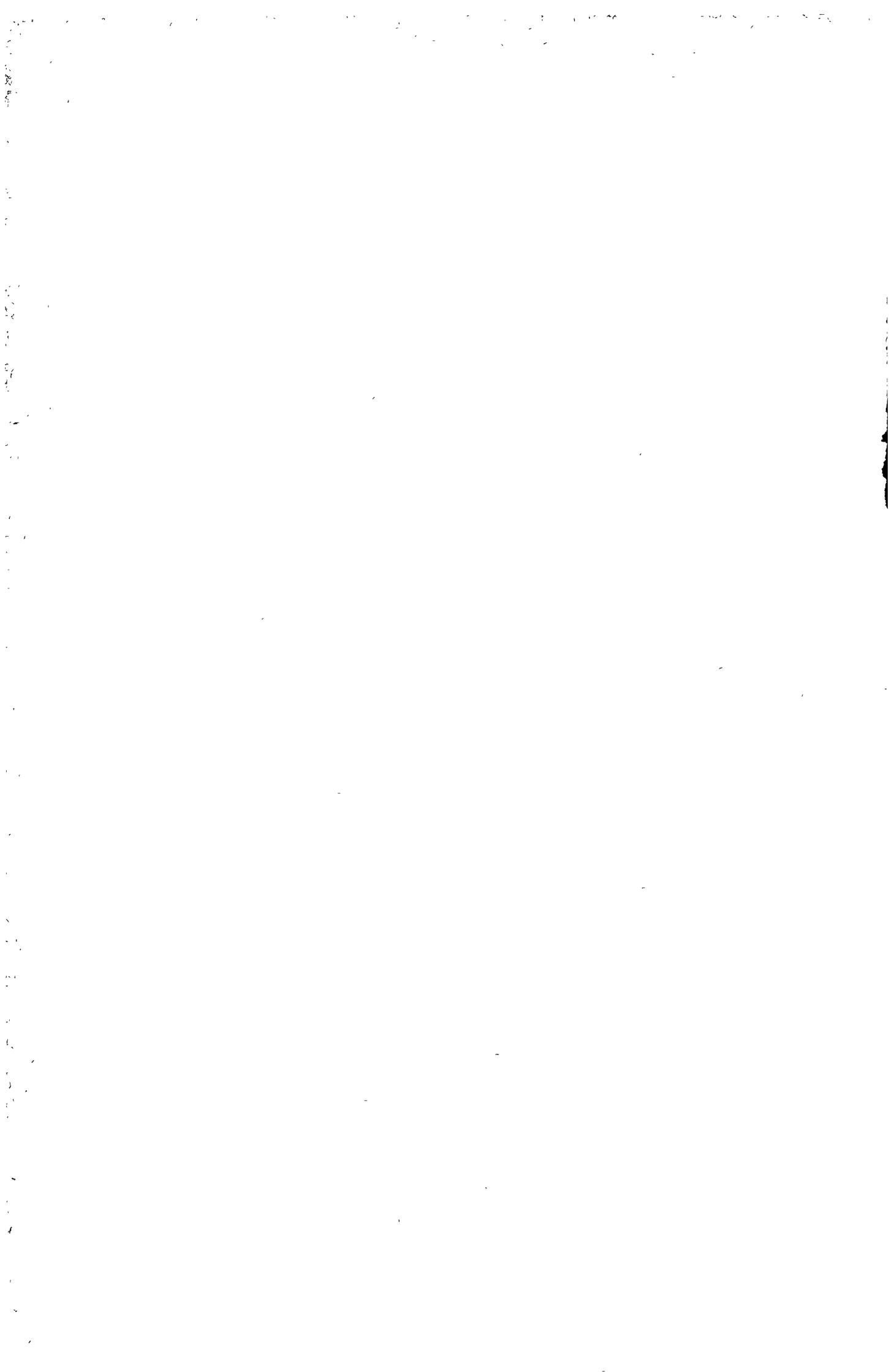
Graph 1 : Estimated trends based on SOEC seasonally adjusted data. Excluding construction, food, beverages and tobacco.

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

Graph 3 : Index of prices of 250 items in the Greater Paris area.

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

Graphs 5 & 6 : Series adjusted by SOEC for seasonal and accidental variations. Trade with non-member countries includes trade with rest of franc area. Exports fob, imports cif. Conversion at official exchange rates.



orders may have resulted, by the end of the year already, in a curbing of the fast expansion of public investment expenditure.

Investment in stocks has certainly contributed to the expansion of total demand in the last few months, although there may have been a tendency for such investment to fall off in late 1963 as enterprises encountered financing difficulties.

There was no substantial change in the trend of public current expenditure on goods and services; the growth rate of private consumers' expenditure, on the other hand, may have declined somewhat after having been exceptionally vigorous in early autumn. On a year-to-year comparison, at any rate, the increase in the turnover of Paris department stores dropped from 18.5 % in the third quarter to 9.7 % in the fourth. It is evident that the demand for cars also developed distinctly more slowly than in the preceding months.

The continuing fast growth of private consumers' expenditure was the outcome of the still vigorous increase in household incomes, especially from wages and salaries in the private sector and in public service. However, the calmer price climate induced by the measures taken under the stabilization plan and the whittling down of the amount of money available to enterprises seem to have led to some reduction in the pace of pay rises; at any rate, hourly wages in the private sector of trade and industry rose in the fourth quarter of 1963 by only 1.5 %, after rising 1.8 % in the third quarter and as much as 2.5 % in the second.

On the supply side there was a certain acceleration of growth between the third and fourth quarters, most of it however being in supply from abroad.

In the agricultural sector meat production has presented special problems, which moreover appear to be of a long-term nature. Apart from this, agricultural production would appear to have developed satisfactorily during the period under review.

The growth of industrial production has progressed at a fairly brisk rate. The seasonally adjusted INSEE index rose by 3.5 % between the third and fourth quarters; though here it should be borne in mind that results for the third quarter were somewhat influenced by the increasingly widespread granting of a fourth week's holiday with pay. Be that as it may, the figures for the fourth quarter showed an advance of 8 % over last year's figures for the same period. In construction, which in contrast to last year benefited from the weather, output rose even more sharply; the production index for the building trade and public works was 10 % higher than in the fourth quarter of 1962.

Trends in the various branches of industrial production do not appear to have undergone any substantial change; as before, progress in the consumer goods industries was rapid, and uncertain in the investment goods industries. It is interesting to note, however, that growth in the motor industry has slackened while, on the other hand, there has been an improvement in iron and steel.

A substantial contribution to the upward movement of production has been brought about by a further relatively sharp increase of the numbers in paid employment. The influx of additional manpower that usually occurs in early autumn has been fully absorbed and, what is more, the number of persons seeking jobs dropped clearly. At the end of December it reached its lowest point since the beginning of 1959, if the repatriates from Algeria not yet placed are excluded. At the same time the number of vacancies has risen further. Consequently it cannot yet be said that there has been any appreciable easing of the labour market.

The seasonally adjusted figure for imports of goods and services probably advanced even more quickly, though the rate of progress had already been very fast. According to customs returns, imports of goods were certainly some 23 % up, both in value and by volume, on the fourth quarter of 1962. In January 1964 the year-to-year growth rate even attained 31 % (value). Of course exceptional factors, for instance the absence of the bad weather that marked January 1963, may have played a role. The general impression, however, is of a clearly accelerated expansion of imports, in which the cut in customs duties made for reasons of price policy and other measures taken to promote imports certainly played a part.

The vigorous increase in imports no doubt contributed to the tendency for the level of prices to move up more slowly. The slightly more moderate expansion of demand must also have worked in the same direction. How far market factors lay—and still lie—behind this tendency for prices to rise more slowly is something which cannot be deduced from the price indices, as the prices of numerous goods and services are influenced by the Government's direct controls on prices and margins. The cost-of-living index (250 items), at any rate, rose by 1 % between September and December as against 2 % in the same period of the year before. Nevertheless the cost of living in December was 6 % higher than in December 1962 (in September 1963, 7 % higher than in September 1962).

The slackening in the upward movement of prices certainly affected foodstuffs and, to a lesser extent, manufactures. It must be remembered, however, that the latter reflected the increases that had occurred in the prices of some imported raw materials. By and large the prices of services maintained a rapid rate of growth.

The distinctly faster increase in imports in relation to exports resulted in a further increase in the deficit on trade; according to customs returns, the deficit in dealings with countries outside the franc area rose to \$77 million in the fourth quarter of 1962, as against \$10 million a year before. The consequent deterioration of the balance of current transactions was, however, offset by the continued inflow of private capital from these countries, especially as in the fourth quarter of 1963 there was no repetition of the advance repayment of foreign debts made a year earlier; at any rate the gold and foreign exchange reserves rose in the fourth quarter of 1963 by a further \$135 million.

The seasonally adjusted figures showed a slight slackening in the expansion of liquidity in late 1963. The Treasury's cash transactions were influenced by a stricter budgetary policy; its short- and medium-term commitments fell by 6.6 % between September and December, a somewhat sharper drop than is usual at this period; this marked an abrupt change of direction after the steep upward movement of the preceding months. On the other hand the restrictive credit policy had only a minor effect on the trend of short- and medium-term credits made available to business; these rose by a further 6.8 % in the fourth quarter, against 7.8 % in the same period of 1962.

Supply and utilization of goods and services

	1962 ⁽²⁾	1962 ⁽²⁾	1963 ⁽³⁾	1964 ⁽⁴⁾
	At current prices (in FF '000 million)	% change by volume on preceding year		
Gross national product	353.56	5.8	4.5	5
Imports ⁽¹⁾	49.20	10.6	11.5	9
Private consumption	229.80	6.9	6	5
Public current expenditure	46.97	2.3	1.5	2
Gross fixed asset formation	69.36	7.5	5.5	5
Exports ⁽¹⁾	51.16	2.5	8	8

⁽¹⁾ Goods, services and factor income.

⁽²⁾ Rapport sur les Comptes de la Nation de l'année 1962; SEEF., Paris.

⁽³⁾ Commission estimates.

⁽⁴⁾ Commission forecasts.

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

2. Outlook

There seems to have been a shift of emphasis in the outlook for the coming months in relation to that described in Quarterly Survey No. 4/1963, inasmuch as the authorities responsible for economic policy have meanwhile taken further steps to maintain and stiffen their stabilization measures.

The new decisions aim at a more restrictive policy on government expenditure; its growth is, in the longer run, to conform with that of the gross national product. Further, it is intended to cover the Treasury's deficits out of long-term savings, and certain alterations are accordingly to be made in the working of the money market. There will be a new approach to the financing of housing construction. Funds for this purpose will in future gradually be drawn not from medium-term (and rediscountable) credits but from long-term savings.

This policy will, it is true, be implemented in stages and will therefore not become fully effective at once. However an immediate start will be made with action to bring about the change of direction. In addition measures have been taken which will produce more rapid effects, as for instance in the sphere of budgetary policy, where it has been decided to regularize expenditure in such a way that it will be equally distributed over the four quarters; a renewed assurance that no supplementary budgets will be presented (in 1963 there were three such supplementary budgets with considerable increases in expenditure); a somewhat stricter curb on the expansion of bank credit (which would be limited to 4.5 % between the end of February and the end of September) and a further lowering of the banks' obligation to buy Treasury Bills.

In these circumstances the chances of a further reduction in the pace at which domestic demand is expanding may well have improved.

In addition, the expansion of demand from abroad may also diminish somewhat. To judge from the less optimistic forecasts made by managements, exports of goods may not develop so vigorously as in 1963. But the possible falling-off must not be exaggerated; it will probably be most marked in the motor vehicle sector, but elsewhere export prospects are by no means unfavourable.

As for gross fixed asset formation, the revival of investment activity in private industry which might otherwise have occurred is unlikely to materialize with economic activity as it stands at present; on the contrary, continuing stagnation must be expected or even, in terms of volume, a slight decline. Investment in the rest of the private sector, on the other hand, and in public undertakings will probably continue to advance appreciably. And, despite restrictive measures, a further considerable expansion of public investment expenditure is still to be expected. Finally, the increased number of building permits granted in recent months points to a continued vigorous growth of expenditure on housing.

Expansion of public current expenditure will continue to be very considerable, especially as the public services are to receive further increases in wages and salaries from 1 April. At the same time there will probably be a continuation of the tendency for the increase in private consumers' expenditure to slacken.

The growth rate of industrial production may be curbed somewhat by the slight fall in the pace at which total demand is expected to expand in the next few months. According to the EEC Business Survey, at least, weaker tendencies are likely to appear in certain capital goods industries and in the motor industry. In the iron and steel industry, on the other hand, the improvement may well continue. Building activity will advance as far as the particularly serious shortage of manpower in this sector allows, although it is not impossible that changes in the methods of financing state-aided housing may put a temporary brake on the launching of new projects.

Since excess demand may decline slightly, imports will probably expand rather more slowly than in the past year, especially in late 1963 and early 1964.

The development of prices may become more moderate; but it is not possible yet to speak of real stability, even in relative terms. For the time being at any rate, the rise in the price indices will be very modest, as the measures to peg prices will probably remain in force for some while and, in addition, no increases in the rates charged by public services are to be expected in the near future.

There is however a certain tendency for the consumer price level to be forced up by the effects of the higher cost of raw materials and of the increased prices for meat that seem inevitable if the output of meat is not to decline. To this must be added the all-important fact that, although the overall imbalance of the French economy may well tend to decrease, it will not cease to exist. Only a lifting of direct measures affecting the price mechanism would reveal how strong the underlying forces still are which would be causing prices to rise if they were not held in check by these controls.

Despite the expected slower expansion of imports, it will probably continue higher than the growth rate of exports, and the trade balance may therefore deteriorate further, though not so fast as before. The current account may show a deficit; even when allowance is made for possible further net inflows of capital, the overall balance of payments may deteriorate appreciably.

On the whole it seems clear that the policy adopted for dealing with current developments is on the right lines, especially since the additional measures taken or announced in late 1963 and early 1964, but that there is still very little likelihood nevertheless of the general imbalance being eliminated in the early future. Stabilization measures must therefore be continued and intensified even further.

Care must, however, be taken that the stabilization policy does not weigh too one-sidedly on investments of private industry, since this would greatly reduce the longer-term possibilities of expanding production and productivity and thus maintain the discrepancy between the wish of Government, business and individuals to increase their spending, on the one hand, and the limited possibility of doing so on the other, which in

turn would keep alive the danger of inflationary tendencies. The stricter anti-inflation measures still necessary should therefore be applied more directly where inflationary pressures are strongest: to the growing total of household incomes.

This would be all the more necessary should it really be considered necessary to take measures to counter the sales difficulties being experienced by some investment goods industries.

Moreover, it must be clearly understood that stabilization cannot be had without certain sacrifices: on the one hand, the reduction of over-employment, which is no doubt to the advantage of many, and its replacement by reasonable full employment and, on the other hand, difficulties for some sectors and undertakings. In a balanced economic situation it is not possible for all sectors and undertaking to keep on expanding simultaneously—and, moreover, all at the same rate.

C. Italy

The economy continued to expand considerably in late 1963, the main stimulus still coming from private consumers' expenditure. At the same time there was continued lack of equilibrium both internally and externally.

Demand from abroad, at any rate as reflected in exports of goods, increased once again in terms of value and volume; the year-to-year growth rate in the fourth quarter was 8.5 % in value.

Gross fixed asset formation made further progress, though to different degrees in the various branches. Owing in no small measure to intensified rationalization efforts and a corresponding credit policy, investment in plant and equipment was more active than investment in building. While Government spending on goods and services does not appear to have increased to any extent, private consumers' expenditure probably continued to expand appreciably, if somewhat more slowly, mainly because of the increase in mass incomes.

From the supply angle, and in view of the lively state of demand, special mention must be made of the improved fruit, vegetable and olive crops after a long spell of poor harvests. Similarly industrial production has expanded markedly and was 8.6 % higher in the fourth quarter than a year before. At the same time, however, imports of goods and services grew less rapidly than in the preceding months; by value, goods imported were some 20 % up on the last quarter of 1962.

The price trend continued to climb sharply, despite the temporary moderating influence of the better harvest already referred to. Wholesale prices in December were about 5.4 % above the December 1962 level, and retail prices were about 6.9 % up. The rise in the cost-of-living index, which is particularly important because it is the basis for cost-of-living bonuses, was as much as 8.4 %; bonuses were raised in November 1963, and this was followed by a further very appreciable rise in February 1964.

Although the relationship between exports and imports has recently improved somewhat, the deficit on merchandise trade has increased further. Official gold and foreign exchange reserves dropped by \$376 million in the fourth quarter and by \$139 million in January 1964. This did not lead, however, to reduced internal liquidity in the fourth quarter, mainly because of the sharply expansionary effect of Treasury cash operations.

A further growth in business activity is still to be expected in 1964. Exports are likely to go up more rapidly than last year. Once again the most vigorous contribution to expansion is likely to come from private consumers' expenditure. Gross fixed asset formation, on the other hand, may expand less than in 1963 and, more important, the growth rate of public expenditure on goods and services can be expected to slacken.

Given these circumstances, production will very probably continue to rise sharply. Industrial production may well attain a year-to-year growth rate of 8 %, and the real gross national product 5 %.

These prospects for the development of demand and domestic supply mean, however, that there will be further distinct, if slower, price increases and a further serious deterioration in the balance of payments situation, and this might lead to great difficulties not only for Italy but also for other Community countries. There is still just as much need for a policy aimed at putting a sharp brake on the expansion of domestic demand in money terms, even if this should mean a rather slower growth rate of production. One can therefore only welcome the Government's recent decisions—chiefly in the field of taxation—on measures to combat the excessive expansion of consumer spending and to stimulate the capital market. The Government's stabilization efforts, however, still need to be considerably extended and intensified.

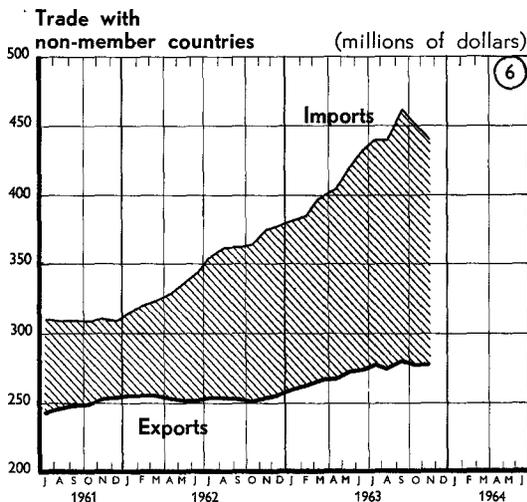
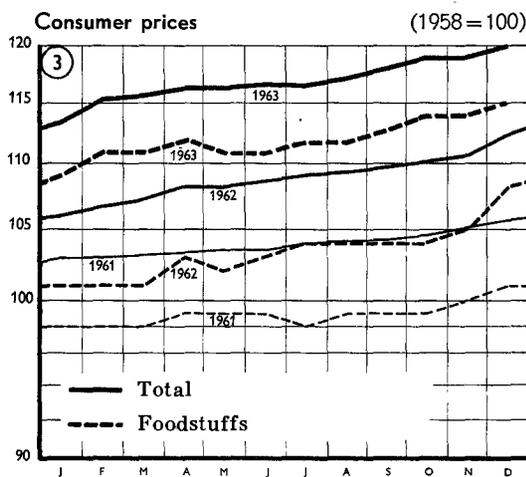
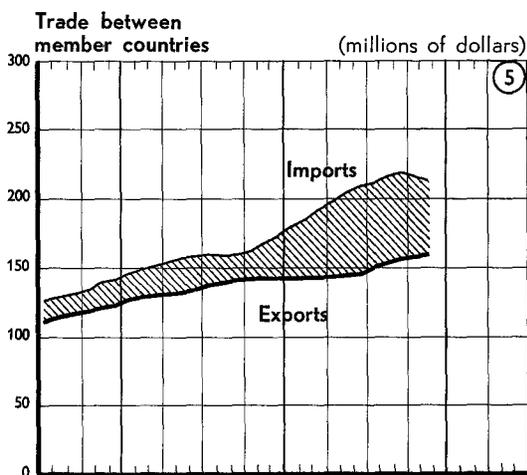
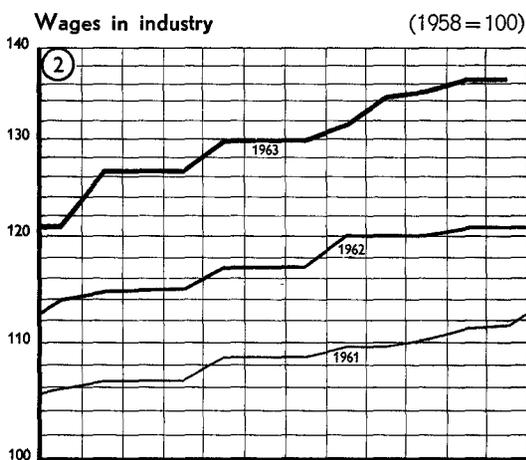
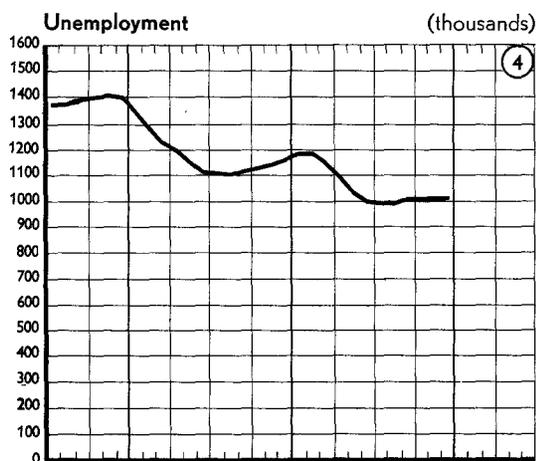
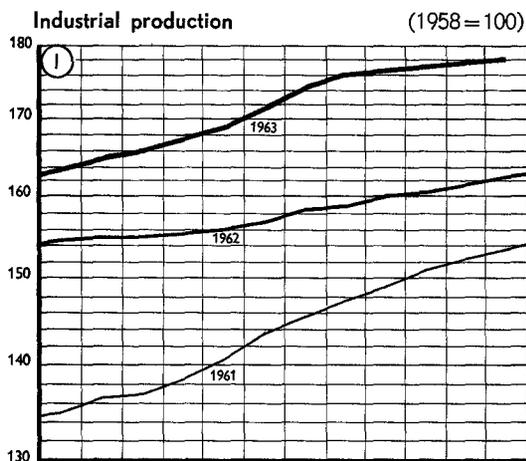
1. Recent developments

The final months of 1963 were, like those which preceded them, marked by considerable imbalance and by the effects which this had on prices and external economic relations.

Exports of goods and services rose once again in the fourth quarter, both in value and by volume. The value of goods exported, as shown by customs returns, was 8.5 % higher than a year previously (third quarter 11.2 %), exports to France and the developing countries having expanded particularly fast. Exports of services probably progressed at more or less the same rather moderate rate as in the third quarter.

At the same time domestic demand evidently expanded briskly again. This briskness was apparent in gross fixed asset formation where, however, it seems that there had been little progress in the third quarter. Investment in plant and equipment registered a marked expansion during the last quarter of 1963, and here rationalization

ECONOMIC INDICATORS



NOTES :

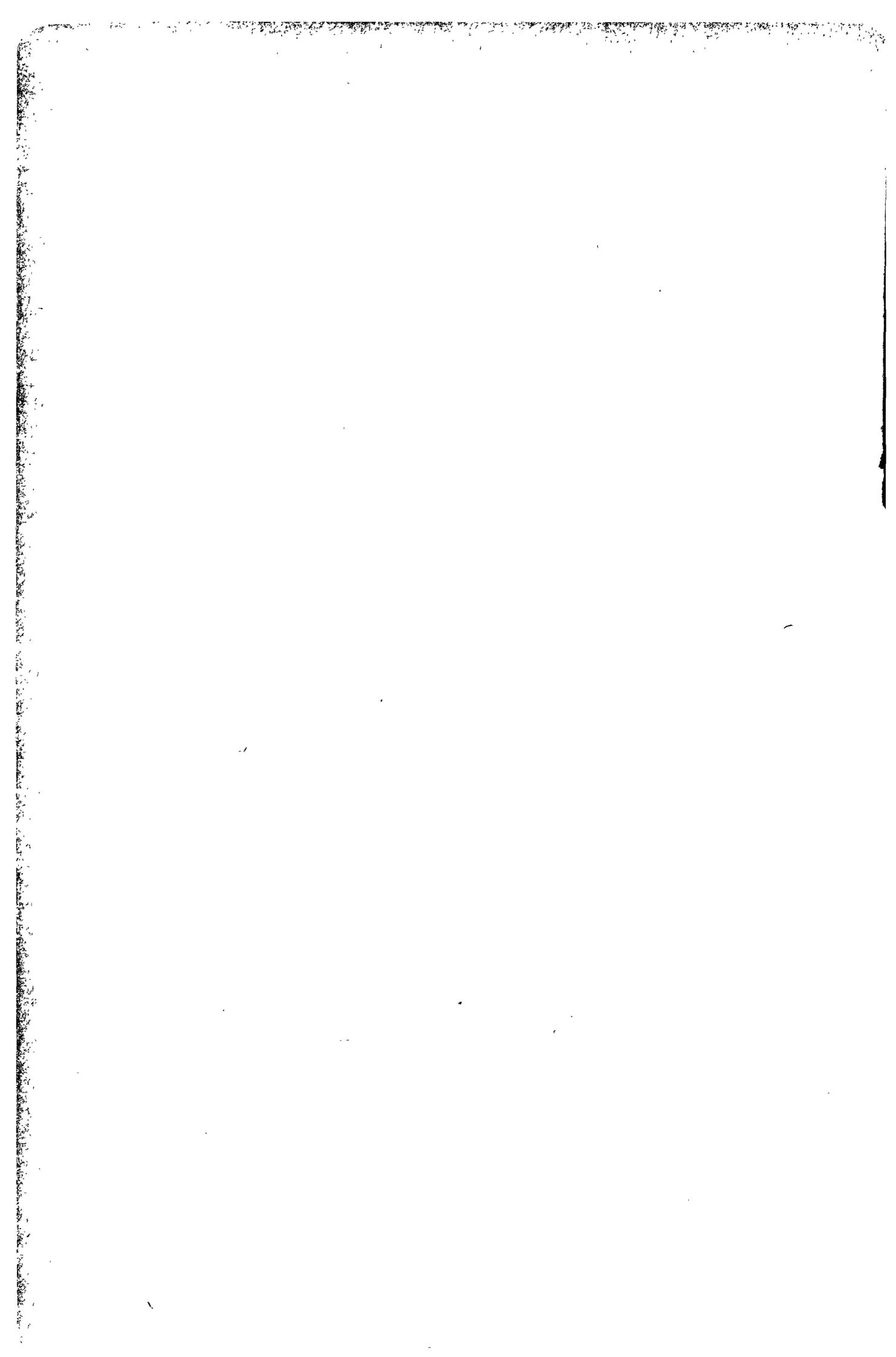
Source : Statistical Office of the European Communities (except as otherwise indicated).

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

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

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

Graphs 5 & 6 : Series adjusted by SOEC for seasonal and accidental variations. Exports fob, imports cif. Conversion at official exchange rates.



measures will have made by far the most important contribution. Investment in construction as a whole also expanded, although it was becoming increasingly difficult to obtain finance. In the fourth quarter the number of rooms completed in living accommodation in larger towns was 3.9 % up on the year before (third quarter 4.6 %); in the smaller localities the year-to-year growth rate may well have been even higher. Expenditure on public works also appears to have risen further, although in terms of volume the rate of expansion may have decreased. Expenditure on building for trade and industry probably tended to ease further.

Total expenditure on consumption seems once again to have expanded very vigorously, though perhaps a little less rapidly than in the first three quarters of 1963. Public spending on goods and services in October-November, however, no longer seems to have been increasing significantly. Government expenditure on staff (including pensions), at any rate, remained roughly at the previous year's level during this period, while as recently as in the third quarter it had been about 30 % higher than a year before.

Private consumption continues to be the main driving force behind the expansion of demand, and it rose considerably in the final quarter. The way production and foreign trade have developed in the consumer goods sector points, however, to a somewhat slower growth. In fact the rate of wage increases in the last quarter seems to have been rather slower than in the preceding months.

On the supply side, agricultural crop products, in particular fruit, olives and vegetables, were abundant in the autumn after a long spell of poor harvests. This fact was especially important because of the extremely lively state of demand.

Industrial production also expanded markedly; in the fourth quarter it was some 8.6 % higher than a year earlier (third quarter 9.9 %). Although this means that the year-to-year growth rate was smaller, there can hardly have been any substantial fall in the rate at which the seasonally adjusted figures were rising. Output of consumer goods continued to expand with particular vigour.

The shortage of skilled labour which has been experienced for some years, coupled with the shortage of unskilled labour now developing in some areas, may have become a pretty general shortage of immediately available manpower. There may already be some connection between this situation and the fact that between July and October 1963, as opposed to the same period in 1961 and 1962, only a small rise in numbers employed is recorded in ISTAT returns.

Imports of goods and services seem to have expanded more slowly than in previous months. Customs returns show imports of goods in the fourth quarter to have been 19.9 % higher in value (the figures by volume are not yet available) than last year, against a 29.4 % growth rate in the third quarter.

The expansion in imports of agricultural products and foodstuffs appears to have slackened appreciably. According to foreign exchange figures, imports of services may not have risen so quickly as in earlier months.

The underlying price trend continued to rise steeply in late 1963, though perhaps somewhat less steeply thanks to the more plentiful supply of foodstuffs and the slackening which occurred at the same time in the growth of consumer demand. Between September and December the wholesale price index advanced by 2.1 % (by 2.2 % the year before), and the retail price index went up 2.2 % (2.6 %); in December these indices were 5.4 % and 6.9 % higher than in December 1962. December also showed a year-to-year rise of 8.4 % in the cost-of-living index—used for calculating cost-of-living bonuses, this index led to a rise in the bonuses in November 1963 and to a further considerable rise in February 1964. In January and February food prices diminished somewhat. The prices of industrial products maintained their rapid upward movement, which has now lasted for two years, at any rate until December.

Although the relationship between exports and imports improved somewhat, the balance of payments continued to give cause for concern. According to customs returns, the merchandise trade gap widened considerably more than is usual at this season, reaching \$650 million against \$424 million in the fourth quarter of 1962 and \$180 million in the same period of 1961. Since, according to the Exchange Control Office, net revenue from services only just maintained its upward movement and transfers grew but little, the deficit that has been apparent for about a year in the current account is sure to have grown, though no longer so rapidly as in the foregoing months. On top of this, the deficit on capital account (exports of Italian bank notes included) was again considerable. The overall balance of payments finished the fourth quarter with an even higher deficit: \$452 million against the \$174 million deficit of a year before and the \$123 million surplus in the fourth quarter of 1961. In contrast to developments as far as September, the unfavourable course followed by the balance of payments in the fourth quarter was reflected in a corresponding drop of \$376 million of official gold and foreign exchange reserves, the banks having, at the request of the monetary authorities, ceased to expand their short-term foreign indebtedness—indeed, they even reduced it slightly. Reserves decreased further in January 1964 by \$139 million and may have dropped appreciably in the following month too.

Consequently for the first time in about a year the balance of payments had a sharply restrictive effect on bank liquidity. This was coupled with a lively seasonal increase in the circulation of notes and coin among the non-banking public, and this also had a restrictive effect. In absolute terms, however, overall bank liquidity grew somewhat between September and December (by some Lit. 25 000 million), since not only did Treasury cash operations close with an extremely large deficit financed through the Central Bank (Lit. 478 000 million), but also Central Bank credit with the banks rose considerably (Lit. 279 000 million, against an increase of Lit. 168 000 million in the fourth quarter of 1962). In relation to deposits, however, bank liquidity fell further (end

December 1963 4.7 %; 5.5 % December 1962), although the growth of deposits, and of other means of payment too, fell off appreciably.

Till early 1964 the capital market continued to be decidedly unproductive; long-term securities could be placed only at considerably increased interest rates. The net yield on state securities has risen again, from 5.4 % in September to 5.6 % in December (4.9 % in December 1962).

Supply and utilization of goods and services

	1962 ⁽²⁾	1962 ⁽²⁾	1963 ⁽³⁾	1964 ⁽⁴⁾
	At current prices (in Lit. '000 million)	% change by volume on preceding year		
Gross national product	24 693	6.0	5	5
Imports ⁽¹⁾	4 389	15.4	22	14
Private consumption	14 929	6.7	8.5	6.5
Public current expenditure	3 651	4.5	5	4
Gross fixed asset formation	5 846	8.9	7.5	6
Exports ⁽¹⁾	4 386	11.8	5	9

⁽¹⁾ Goods, services and factor income.

⁽²⁾ Italian Central Institute of Statistics (ISTAT), Rome.

⁽³⁾ Commission estimates.

⁽⁴⁾ Commission forecasts.

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

2. Outlook

Although the authorities responsible for economic policy have in many respects stepped up their action against imbalances, a further considerable expansion of overall demand in money terms can be expected.

Exports of goods and services may well expand faster than last year, mainly as a result of the steeply rising trend of business activity in many importing countries. The results of the Business Survey carried out among heads of enterprises in the Community

in the fourth quarter of 1963 and the "Forum" survey by Mondo Economico in January 1964 point to a certain tendency for demand from abroad to improve in the first half of 1964.

The outlook for domestic demand is still one of decided growth. The more restrictive credit policy being followed by the monetary authorities and the tightness prevailing on the capital market may however have a progressively moderating influence on gross fixed asset formation in general and on building in particular. The volume of building projects certainly tended to decline both in housing and in building for trade and industry during the second half of 1963. At the same time no significant further stimulus is to be expected from public works, if only because of the Government's policy of restraint. On the other hand the positive factors mentioned in the last Quarterly Survey could lead to a further growth of expenditure by enterprises on investment in equipment, especially since official credit and budget policies aim more and more at a switch in gross fixed asset formation towards investment showing quick returns. On the whole, however, growth is likely to be smaller than in the preceding years; the results of the EEC Business Survey and the Mondo Economico "Forum" survey also point to this conclusion.

Public expenditure on goods and services can be expected to grow at a distinctly more moderate rate than in 1963.

To a lesser extent this applies also to private consumers' expenditure, which may none the less again increase very considerably. In early 1964 wage disputes in numerous important sectors once again showed that there is no hope of an early end to the upward surge of wages. These will also rise further because of the automatic action of the sliding scale, but it is hardly likely that they will soar as they did in 1962/63. The Government, moreover, is now determined to counter excessive expansion of private consumers' expenditure by taxation and other means.

Production will also go up in 1964. Of the forecasts published in the last Quarterly Survey for the annual growth of production by volume, only the figure for industrial output need be amended; it should now be 8 %. The revised estimate takes into account the rapid expansion of production in the last quarter of 1963. There is no change to be made in the forecast on the pattern of industrial expansion during the year, which is expected to be rather less dynamic than in 1963.

Although imports of goods and services may also continue to expand considerably, though doubtless at a far slower rate, the forecasts on total demand and total supply imply that there will be a further sharp rise in the price level.

No new points have arisen since the last Quarterly Survey to influence the probable development of the balance of payments up to the end of 1964. A considerable widening of the trade gap is therefore still to be expected, as well as a larger deficit on current account. As a vigorous improvement of the balance on capital transactions with other

countries can be ruled out as improbable, despite any measures that may be taken to halt the flight of capital, an extremely heavy deficit must be expected in the overall balance.

In the meantime, the problems and needs arising from the economic situation, which were dealt with at length in Quarterly Survey No. 4/1963, remain as urgent as ever. So too are the recommendations in which Italy is urged to apply a rapid and effective stabilization policy, which should be mainly concentrated on budget policy. It is true that the Government has already taken or announced further steps in this direction, but it is not certain that they go far enough to let budget policy play the role it should.

As for the measures which have already been taken, it must be pointed out first of all that the growth rate of payments by the Treasury has slowed down distinctly since autumn 1963. Between December 1963 and January 1964 the Treasury's deficit at the Banca d'Italia, which had been mounting rapidly, actually shrank by Lit. 60 000 million to Lit. 445 000 million, and in February it diminished further. It is, however, possible that this development will prove to be short-lived. The decisions taken in January in view of the economic situation are at any rate evidence that the Government intends to pursue the line of policy on which it has started. The budget deficit in the coming financial year, which begins on 1 July 1964, is to be reduced by Lit. 110 000 million to Lit. 695 000 million, and local authorities have also been urged to cut down their deficits.

The planned reduction in the budget, however, seems to be slight in view of economic developments and, in particular, of the balance-of-payments situation. What is more serious, the recent proposals still allow for a considerable rise in Government expenditure, amounting to some Lit. 728 000 million, or an increase of 12 %. Spending at this rate will only aggravate the problem of excess demand, and will of course seriously weaken the anti-inflationary impact of the reduction in the deficit. Last but not least, the effects of the new budget will not begin to be felt to any extent until the second half of 1964, while Italy's balance of payments and its general economic situation call for immediate steps in the sphere of public revenue and expenditure.

In the first place no time must be lost in curbing the growth of cash expenditure more sharply and increasing cash revenue; secondly, appropriate measures must be taken as soon as possible to finance the outstanding cash deficit out of internal long-term savings. This means that fresh vigour must be instilled into the now largely atrophied capital market. The Government's recent action in this direction must therefore be approved, for it has reduced the rates of stock exchange turnover tax and, even more important, has amended the rules governing tax on dividends in a way which may encourage saving through securities.

If adequate measures are not taken in the budgetary sphere to restore stability, the brunt of the burden will continue to be borne by credit policy. Although the effects on liquidity of balance-of-payments deficits can do much to reinforce a restrictive credit policy, it is not certain whether they will suffice not only to offset the expansionary effects

produced by the budgets of the public authorities, but also to cause an actual reduction in liquidity. In the interest of long-term economic growth, moreover, it should never be forgotten that stabilization imposed in these circumstances through the medium of credit would weigh largely on direct productive investments by enterprises, and it is exactly this element of demand which for quite a long time past cannot be said to have contributed to inflation.

What would appear to be much more necessary in Italy is a curbing of the excessive growth of consumer expenditure. Certain taxation and other decisions taken in late February—some of them are still to be ratified by the Parliament—suggest that the Government's future efforts to achieve stabilization will tend to be in this direction. The tax on petrol was increased, with immediate effect, by Lit. 14 (about 20 %); this corresponds to a 13.5 %-14.5 % increase in the price of petrol. Furthermore it has been decided to impose on purchases of new cars and motor-boats during the next two years a tax equal to 7 %-15 % of the buying price. It is to be regretted, however, that the additional tax revenue will not be used primarily to reduce the budget deficit but evidently to finance investments and so to step up demand. The decision to raise initial payments to 30 % and to reduce the maximum credit period for hire purchase to twelve months may well have a dampening effect on the demand for consumer durables, as consumer credit is very widespread in Italy and has been growing rapidly.

With the aim of stabilizing prices the Government decided, also at the end of February, to continue importing butter and meat on a large scale, to lay down official prices for these goods and to exert direct pressure on the price formation of some other essential consumer goods such as olive oil, potatoes, eggs, poultry and pharmaceuticals.

These latest measures undoubtedly constitute a considerable extension of the Government's stabilization efforts. Such efforts should, however, be carried even further and aim still more at putting a general brake on the growth of demand, preferably by means of budget and incomes policy, even if this entails a temporary slackening in the present rapid growth of production. For some time past the possibility of expanding demand without causing prices to rise seems, in Italy as elsewhere, to have been severely limited by the labour market situation. A policy which aims only at longer-term stabilization and tries to avoid any slackening in the growth of the economy is by no means to be recommended, especially in view of the situation of the gold and foreign exchange reserves. Considerable though these may still be, they have diminished appreciably since September last year.

D. The Netherlands

In the final months of 1963 and early in 1964 economic growth continued at a lively pace. While there was some slowdown in the expansion of exports, internal demand advanced vigorously. Investment again rose appreciably: spending on plant and equipment continued to grow, and in the building sector very considerable progress was made as a result of the higher numbers employed, the relatively favourable weather, and improved productivity. The expansion of private consumers' expenditure speeded up appreciably following considerable rises in income and probably also thanks to a fall in the savings ratio of households.

Labour shortages continued to be very severe, and this was a contributing factor to the exceptionally sharp jump in wages which found expression in the collective bargaining agreements for 1964, concluded between the two sides of industry at the end of October.

Industrial production continued to increase. According to the new CBS index, its year-to-year growth rate was about 7 %—the same as in the preceding quarter. The growth of merchandise imports speeded up greatly.

Retail prices again tightened after having remained relatively stable in the third quarter. In mid-December the index was up 3.8 % on the level of the corresponding period of the previous year. This development mainly reflected rises in the price of certain foodstuffs, increased wage costs and higher prices for some imported raw materials.

The trade balance deteriorated considerably in the fourth quarter. On the other hand the overall balance of payments probably showed a slight surplus, mainly as a result of higher factor incomes from abroad.

In the coming months exports may well rise less rapidly because of the vigorous expansion of internal demand and the deterioration of the Netherlands' competitive position. Private consumers' expenditure in the spring will certainly expand considerably in view of the massive wage rises. Equipment investment by enterprises will at first still tend to increase but might then level off or even tend to decline around mid-year, as possibilities of financing have been considerably narrowed by the sharp rises in wage costs per unit produced and the restrictive measures taken in the credit field. Investment in building and construction will probably impart a very vigorous stimulus to the economy.

The pressure of demand and the considerable increase in productivity will cause industrial production to expand more vigorously than in 1963. Imports will continue to advance at the more rapid pace recently observed. The balance of current payments will most likely deteriorate considerably. Price trends will reflect the increasingly serious imbalance of the Netherlands economy.

Taken as a whole the outlook has become "more unbalanced" than could be foreseen when the forecasts for the full year 1964 were established towards the end of 1963. Wage and salary income—and thus wage costs and private consumers' expenditure—and also production and imports will all rise faster than initially forecast. The expansion of the gross national product could reach 5.5 %.

Because of the sharp deterioration of the trade balance the Netherlands are also contributing to the expansionary pressure on the economies of the other Community countries. The task of economic policy is not only to prevent next autumn the emergence of a wage-price spiral in 1965, and to restore a proper balance, but also to attain this balance as quickly as possible and to reduce the harmful pressure on outside countries.

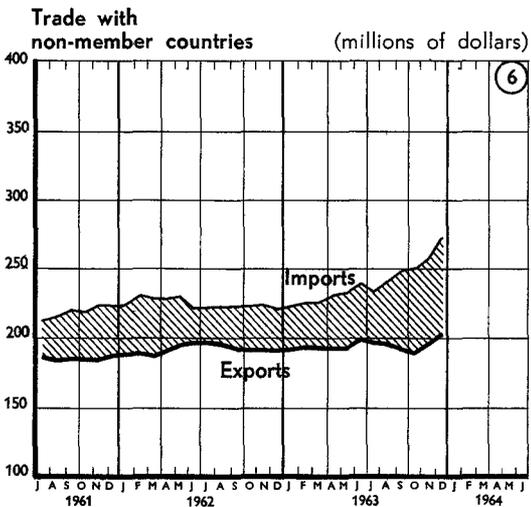
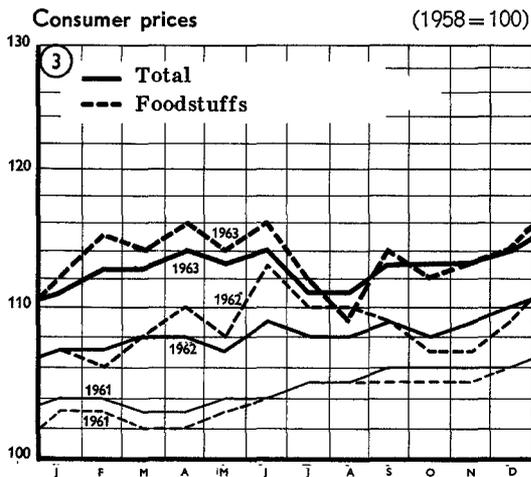
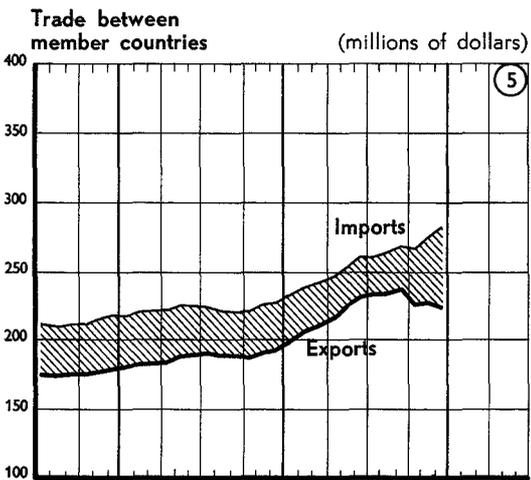
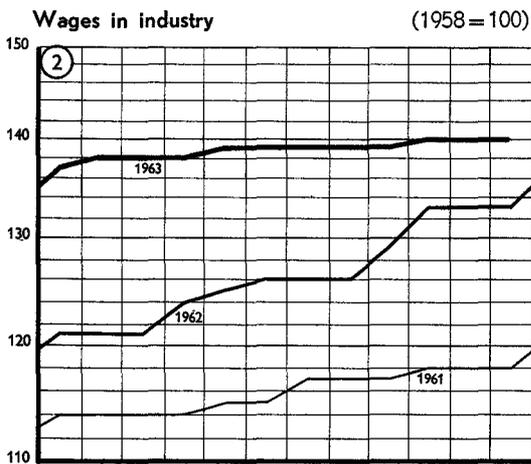
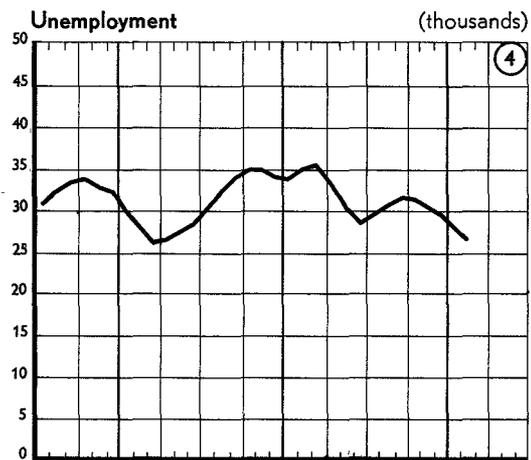
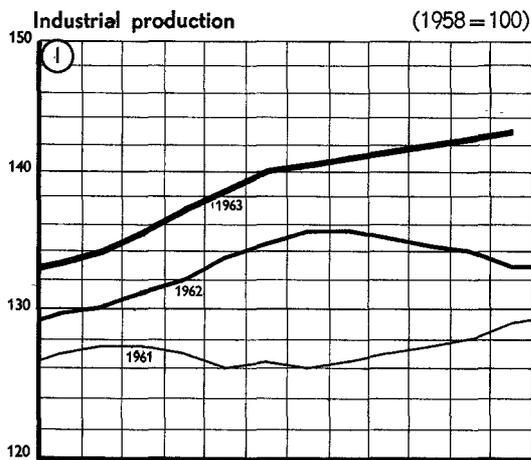
1. Recent developments

External demand—in the sense of actual exports of goods and services—probably continued to advance, but at a rather slower rate. Customs statistics show that in the fourth quarter the year-to-year growth rate of exports of goods was only 6 %, both in value and by volume, whereas it had still been nearly 13 % in the previous quarter. Seasonally adjusted and in terms of national accounting, however, exports probably maintained their expansive trend. A growth rate of about 29 % was achieved in January, mainly because of the decline registered in the corresponding month of the previous year. This improvement reflected a decidedly stronger rise in exports of industrial goods, while the increase in exports of farm products (with the exception of meat) slowed down appreciably.

The advances registered in the fourth quarter are almost exclusively attributable to the expansion of sales to member countries. Deliveries to non-member countries were a little below the level reached in the corresponding quarter of 1962.

Internal demand expanded more vigorously than hitherto. Expenditure on gross fixed capital formation rose strongly. This refers especially to expenditure on construction, since an increase in the labour force and better weather improved supply

ECONOMIC INDICATORS



NOTES :

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

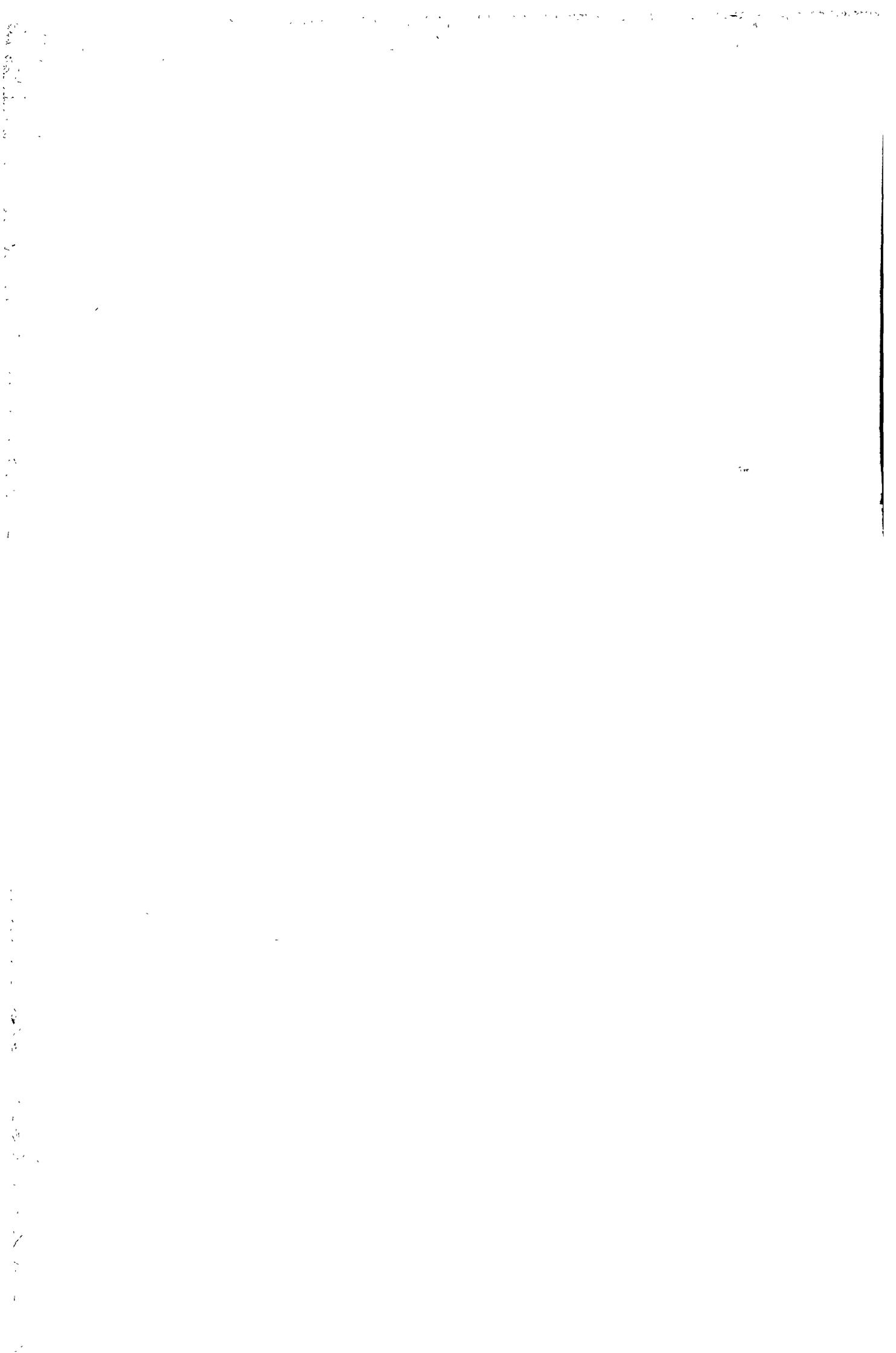
Graph 1 : Estimated trends based on SOEC seasonally adjusted data. Calculation of the trend in the Netherlands encountered certain difficulties which it will not be possible to eliminate till the new Dutch index is available; this amended index is expected shortly. Excluding construction, food, beverages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

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

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

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

Graphs 5 & 6 : Series adjusted by SOEC for seasonal and accidental variations. Exports fob, imports cif. Conversion at official exchange rates.



elasticity in all branches of construction, particularly housing. Thus in the fourth quarter the record total of nearly 28 000 dwellings was completed (24 400 in the corresponding period of 1962). Since prices rose sharply, the outlay on private building was probably about 30 % higher than in the corresponding quarter of 1962.

As the trend in imports of investment goods seems to show, the recovery of investment in plant and equipment has probably also gathered momentum. The year-to-year growth rate of purchases in this sector was about 15 % by volume, against 4 % in the previous quarter.

In all, gross fixed asset formation by enterprises (including housing) in the fourth quarter was probably up about 20 % in value and 15 % by volume on October-December 1962.

Gross fixed capital formation by the public authorities also increased at quite a fast pace. The decision of the Government to limit public investment spending does not seem to have had any appreciable effects on the trend of this expenditure in the fourth quarter.

Investment in stocks, particularly the replenishment of raw materials reserves was—if one can judge from the imports of these goods—decidedly dynamic.

In the fourth quarter the expansion of public expenditure on goods and services did not make any perceptible further contribution to economic activity. As against this, the already lively growth of private consumers' expenditure continued and probably even accelerated. Retail sales in the fourth quarter were nearly 12 % higher than a year earlier. Consumption expenditure as a whole showed a year-to-year growth rate of more than 10 % in value and 7.5 % by volume, compared with 9 % and 7 % respectively in the previous quarter.

Although the expectation that the wage increases scheduled for the beginning of 1964 might lead to price rises may well have been one reason why households were more ready to spend, the upward trend of private consumers' expenditure nevertheless stemmed mainly from the increase in disposable incomes.

In fact, total actual earnings of persons in paid employment probably expanded more rapidly than before, even though the rise in agreed wages in the fourth quarter remained roughly the same as in the third, despite a faster improvement in women's wages. This was due mainly to increased wage-drift, certain special one-time payments in several enterprises, and the particularly low level of seasonal unemployment. In the first months of 1964 the upward thrust of wages again gathered considerable strength. In terms of volume it has been definitely greater in some sectors than was provided for in the wage agreement of October 1963.

The situation on the labour market continued to be extremely strained. First, the monthly average of unemployed in the fourth quarter was 5 000 lower than in the corresponding months of 1962. It is true that in December 1962 certain effects of the particularly severe winter had already been registered; the downward trend of unemployment is, however, also confirmed by the seasonally adjusted statistics. Secondly, the monthly average of vacancies in the fourth quarter was 7 200, or 6.5 % above the already high level of the corresponding period of 1962. This is a particularly impressive figure for the season of the year.

The number of wage-earners in industry hardly changed in the course of the year, but productivity rose very appreciably, making possible a further expansion of seasonally adjusted industrial production. In the fourth as in the previous quarter, the new index of industrial production (CBS) showed a year-to-year growth rate of about 7 %.

As the vigorous expansion of demand affected imports of goods and services even more strongly than internal supply, so imports in this sector speeded up considerably. According to customs returns, merchandise imports were up 20.5 % in value and 17 % by volume on the corresponding period of the previous year, as against 13 % and 11 % in the third quarter. The increase was spread over all categories of goods, affecting in particular consumer goods (+ 20.5 % by volume) and raw materials (+ 16.5 % by volume). January imports were 25 % higher in value than in January 1963.

The price trend in the fourth quarter was clearly upward. Consumer prices again rose, after having been relatively stable in the previous quarter. In December the retail price index was 3.8 % higher than a year before, against a rise of only 2.8 % in September. In the quarterly average also the rise above the level of the corresponding period in 1962 was 3.8 %, against 2.2 % in the third quarter. This is partly attributable to seasonal or special factors (meat), higher import prices and increased wage costs, but it also reflects the fact that a situation of excessive demand has unquestionably emerged. Between December 1963 and January 1964 the index continued to rise—by nearly 1.8 %. In February it remained unchanged. Wholesale prices were stable until mid-1963 but then began to rise, and in the fourth quarter the pace quickened, particularly for raw materials and farm products.

According to customs statistics the October-December trade balance showed the highest quarterly deficit since 1957 (Fl. 1 142 million, as against Fl. 414 million in the corresponding quarter of 1962 and Fl. 773 million in the third quarter of 1963). The gold and foreign exchange reserves of the monetary authorities rose, however, by Fl. 256 million between the end of September and the end of December. This was partly the result of a very favourable trend of the other current payments items, in particular factor incomes from abroad.

As a result of the way in which the balance of payments developed and of the policy followed in connection with the maturity dates of short-term public securities,

money markets continued to be relatively liquid. The expansion of bank credits was, however, appreciably curbed by the decision in October to reapply quantitative limits. Nevertheless, the ceiling has probably been exceeded since November, and penalty deposits amounted by the end of February to about Fl. 106 million. Moreover, as part of the restrictive monetary and credit policy, Bank rate was raised from 3.5% to 4% on 6 January. From September onwards interest rates on the capital market have been showing a distinct tendency to rise. Savings have risen less strongly than during the corresponding period of the previous year.

Supply and utilization of goods and services

	1962 ⁽²⁾	1962 ⁽²⁾	1963 ⁽³⁾	1964 ⁽⁴⁾
	At current prices (in '000 million florins)	% change by volume on preceding year		
Gross national product	47.55	2.7	4.5	5.5
Imports ⁽¹⁾	23.86	6.6	9	11
Private consumption	27.48	4.2	6	7
Public current expenditure	7.04	6.3	3	0.5
Gross fixed asset formation	11.60	4.2	6	11
Exports ⁽¹⁾	24.69	6.6	7	5

⁽¹⁾ Goods, services and factor incomes.

⁽²⁾ Nationale Rekeningen 1963, CBS.

⁽³⁾ Commission estimates.

⁽⁴⁾ Commission forecasts.

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

2. Outlook

The expansion of total demand will probably continue in the coming months at an even higher pace.

On an annual basis exports will probably go up again in 1964, although their growth is likely to slow down appreciably in the course of the year; they may even flatten out at the level reached in the spring, though this development is scarcely likely to become

apparent in the months immediately ahead. It is at any rate quite conceivable that the pick-up in world business will prove insufficient to offset the pull of more rapidly rising domestic demand and the poorer competitive position of Netherlands industries which will result from the sharp rise in production costs, especially wages and salaries.

The outlook for internal demand is in fact one of clearly accelerated expansion.

Gross fixed asset formation by enterprises should again rise appreciably. Everything points to the new upward trend of investment on equipment continuing at least until mid-1964, particularly with the stimulus provided by rationalization projects. The advances in growth which can probably be attained in industrial building are a further dynamic factor in the development of fixed investment. Investment in housing will also increase rapidly, in the main because of greater supply elasticity.

There are some signs, however, that the expansion of investment by enterprises will fall off in the second half of the year and might even give way towards autumn to a decline which would probably continue in 1965. It is improbable that the reduction in costs which will ensue as production is expanded to meet the coming real increase in demand will be anything like sufficient to offset the considerable rise of certain cost factors (in particular, wages and salaries). Since the direct price policy of the authorities allows only a part of the increased costs to be passed on in the forms of higher prices, the profit situation of enterprises and consequently their ability to finance their own investments will undoubtedly deteriorate. Tax measures decided on at the end of January (suspension of advance depreciation, abolition of preferential taxation arrangements for building) operate in the same direction. To this must be added that the margin for procuring external resources has been narrowed (particularly by limiting the volume of credits from the commercial banks). It will therefore not in future be possible to implement even longer-term investment schemes without further ado.

Now that the postponements initially decided on for the October 1963-March 1964 period are to be extended for another half year, the growth rate of public investment should hardly exceed about 4 % to 5 % by volume.

Private consumption on the other hand will continue to increase appreciably. A sharp rise in consumers' expenditure by households can be expected in the spring. Despite the progressive incidence of income tax, the rapid growth of consumers' purchasing power since the beginning of the year should considerably stimulate consumption, even if the simultaneous upward thrust of prices does something to inhibit its growth. Since however the great majority of the collective agreements have already been renewed, it is possible that the growth of the total volume of wages and salaries will slow down from the spring onwards—provided rising prices do not in the autumn unleash a new wave of wage rises for 1965.

With manpower reserves almost exhausted and with continued difficulties in the recruiting of foreign workers, employment will rise at a slightly slower average pace

than in 1963 (by about 1.5 % instead of 2 %). Improvement is the more difficult because endeavours to increase labour supply (by employing married women and pensioners) and to limit the emigration of frontier populations to foreign countries are in most sectors being partly neutralized by the effect of longer holidays.

No easing of the labour market situation can therefore be expected in the coming months—at least until towards the end of the year. In these circumstances the expansion of internal supply will depend even more than in 1963 on stepping up productivity. In industry technical capacity for production has been increased to meet the growth of demand and as a step towards rationalization, and this could in fact lead to the sharpest rise in productivity since 1960. As a result, the upward trend of industrial production, which has been more rapid than throughout the greater part of 1963, could well continue in 1964. A considerable increase in building output is also to be expected.

On the whole, however, the growth of supply from domestic sources will be completely unable to keep up with overall demand, so that the rapid growth of imports will no doubt continue. In fact purchases of consumer goods—especially durables—and of semi-products and raw materials will probably rise appreciably. The expansion of investment goods imports on the other hand could well slow down after mid-year. Imports of services—with spending on tourism up as a result of the inevitable increase in the flood of those taking holidays abroad— could rise vigorously this year.

The latest available data on economic developments suggest that the 1964 forecasts established in the last Quarterly Survey (4/1963) need some amendment. Domestic demand should in fact expand rather more strongly than was forecast, and this will further aggravate the imbalances in the overall economic situation. It must be expected that total wages and salaries will be about 18 % higher than in 1963, and this will have its effects not only on consumers' spending but also—because of greater efforts to rationalize production—on outlay for capital goods. Probably imports of goods will also exceed the forecasts, and the deficit on trade could grow nearly Fl. 1 500 million between 1963 and 1964. Despite this, and although the increase in the real gross national product can also be put somewhat higher—at about 5.5 %—the new forecasts imply a very considerable tendency for prices to rise further.

The outlook for economic balance, which has become still more unfavourable since the end of 1963, has caused those responsible for economic policy in the Netherlands to step up their stabilization efforts considerably. After the steps already taken in November, further measures were introduced in January to combat the inflationary consequences of excessive domestic expenditure. As already mentioned, tax measures are to act as a brake on the expansion of investment by enterprises. The limitations on public investment outlay are also to be maintained until October 1964. In the monetary field efforts are being made to reinforce the effect of raising Bank rate at the beginning of the year and of the further quantitative limits on bank credit by holding down consumer credit through restraints on the grant of personal loans and raising the initial cost of

hire purchase (by 5 % of the total amount involved). Finally, price policy is shortly to be tightened up and the means of action in this field extended: there is to be a ban on collective and, in particular branches, also on individual vertical bindings of retail prices, and Government organs are to have greater powers to fix maximum prices even for individual enterprises. Orders pegging the prices of various goods and services have been issued by the authorities since last December.

As these new measures have been taken in agreement with the Stichting van de Arbeid (Foundation of Labour), it must be supposed that both sides of industry have recognized the need to hold as strictly as possible to the wage agreements concluded in October. From this angle the effects of the stabilization measures should be followed with special attention.

It is, however, not certain whether all this will be sufficient to keep the expansion of wages within the proposed limits—which in any case are very wide—and to prevent the occurrence in the autumn of a strong new wave of wage demands for 1965, with its inevitable effects on prices, the balance of current payments and investment. For this reason alone it would be advisable to continue and possibly to tighten up the measures in the financial and credit field designed to curb the growth of internal demand in monetary terms. The need for a co-ordinated economic policy in the Community in any case calls for a tightening up in this direction, since the expansionary pressure which the deterioration of the trade balance has on other countries in the Community plays an indirect but not inconsiderable part in making it more difficult for them to achieve or maintain stability. The Netherlands, incidentally, have themselves had experience of this pressure from without.

As in the other member countries, it is important that the burden of stabilization policy in the Netherlands should not fall principally on investment—as seems to be in large measure the case at present. Otherwise there would really be danger of a recession, or at least of a protracted weakening of growth after the present spurt of inflation, which is essentially a spurt in consumers' expenditure. In order to attack the latter more vigorously, the weapons available, apart from useful limitations on consumer credits, are in the main those offered by fiscal policy, including tax measures.

E. B.L.E.U

Belgium

In the closing months of 1963 and early in 1964 economic expansion probably speeded up a little, but the same period brought further evidence of a certain lack of internal balance.

First, the very high growth rate of exports continued, even if there was some slackening in the pace. In the fourth quarter the value of goods exported was almost 18 % higher than in the corresponding period of the previous year.

Secondly, the expansion of domestic demand probably accelerated somewhat further. Expenditure on gross fixed asset formation continued to move quite definitely upwards, and there may well have been a further quickening of the pace at which private consumers' expenditure was expanding. In any case incomes—and not least aggregate wage and salary incomes—rose faster than in the preceding months.

Although the general manpower shortage was growing more acute, supply from domestic sources again went up. According to the IRESP index industrial production in the fourth quarter of 1963 was about 9 % higher than in the corresponding period of 1962, in which however special factors had at times adversely affected the growth of production. There was on the other hand some slackening—doubtless only temporarily—in the pace at which imports were growing.

The strains caused by the pressure of total demand, increasing labour shortages, rising production costs and the limited supply of certain foodstuffs resulted in an accelerated rise in prices. In January-February 1964 the retail price index was 3.7 % higher than in January-February 1963.

In the fourth quarter the trade account closed with a considerable deficit. True, this was smaller than a year earlier but at that time special factors had adversely affected exports. The entire current account may even have been in deficit. If official gold and foreign exchange reserves nevertheless rose by \$ 43 million, this was due to imports of short-term capital to finance the Treasury deficit.

The outlook for the rest of 1964 is that expansion of total demand in terms of money will continue to exceed the possibilities of supply from domestic sources. The improvement in the world economic situation is itself likely to increase the

demand for Belgian exports; there will be a tendency for investments to continue expanding appreciably and, even more important, there is every reason to suppose that the growth of total income from wages and salaries—and thus of consumers' expenditure—will continue at least at the speedier pace which marked the closing months of 1963.

As against this, a further substantial acceleration of growth can hardly be expected on the supply side. Industrial production might advance at an annual rate of about 5 % and the total gross national product could well rise 4 % in 1964. Prices will continue their relatively vigorous climb.

The competent authorities have recently taken, or are planning to take, some further stabilization measures. It is clear that a still more efficient stabilization policy could improve many aspects of the outlook sketched above.

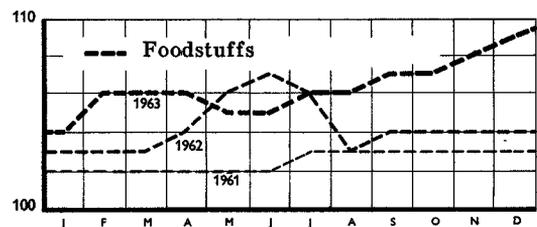
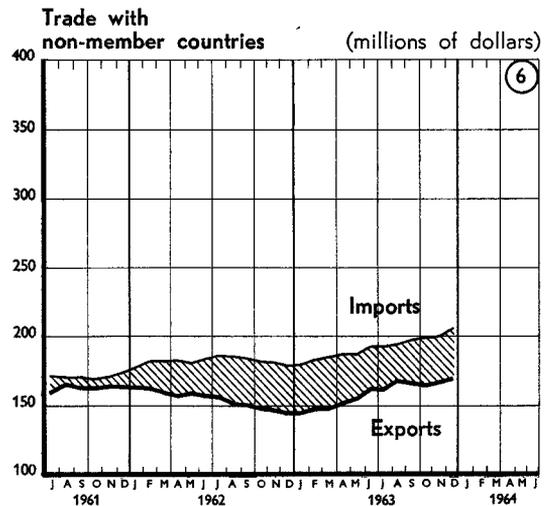
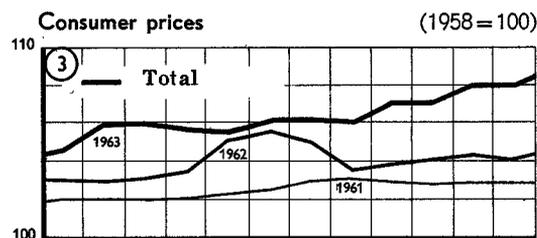
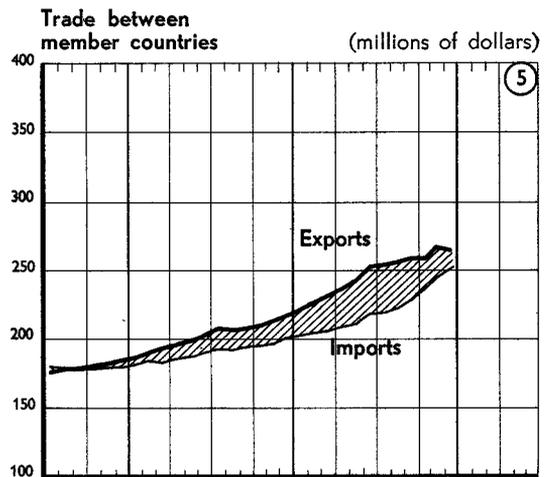
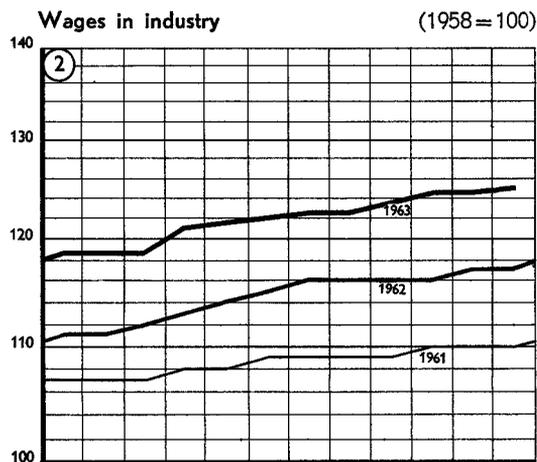
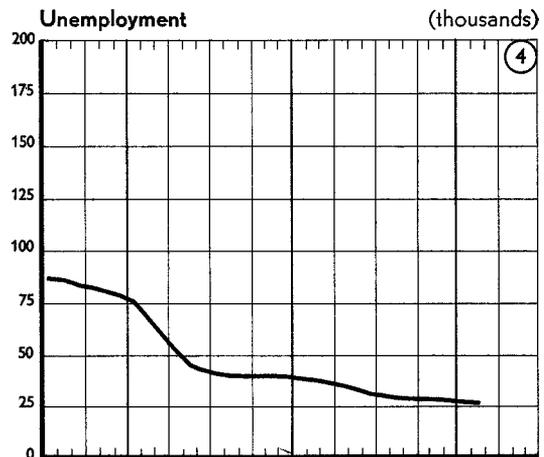
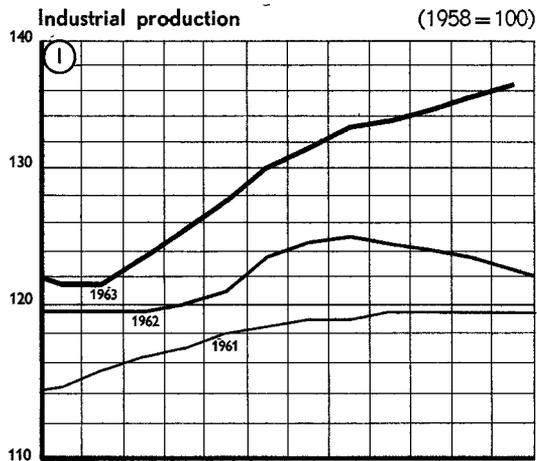
1. Recent developments

The expansion of total demand seems to have accelerated a little further in the final months of 1963 and at the beginning of 1964.

This does not however apply to demand from abroad. It is true that in the fourth quarter of 1963 exports of goods, according to customs statistics, were up almost 18 % in value on the corresponding period of the previous year (growth rate in the third quarter : 17 %). However, it must be remembered that special factors adversely affected exports in December 1962. It is remarkable that the expansion of sales to the other EEC countries has recently slowed down, at least to judge by the year-to-year growth rate, which fell from 25.4 % in the third quarter to 18.8 % in the fourth. On the other hand sales to non-member countries have speeded up appreciably. In the last three months of 1963 they were 15.3 % higher than in the same period of 1962, after a year-to-year growth rate of only 5.5 % in the third quarter. In January a growth rate of 29 % was registered, mainly because of the considerable decline that occurred in January 1963.

The reasons why the seasonally corrected export figures were no longer rising more strongly in the fourth quarter may be, first, that for certain foodstuffs restrictions were placed on sales to other Member States or, for others, that sales simply slowed down, and, secondly, that limits on the capacity of certain industrial branches seem to have prevented a more rapid increase in sales abroad. This in turn is not unconnected with the rather speedier growth of demand at home. Here again it was less investment than consumers' expenditure which carried expansion forward at a higher pace.

ECONOMIC INDICATORS



NOTES :

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

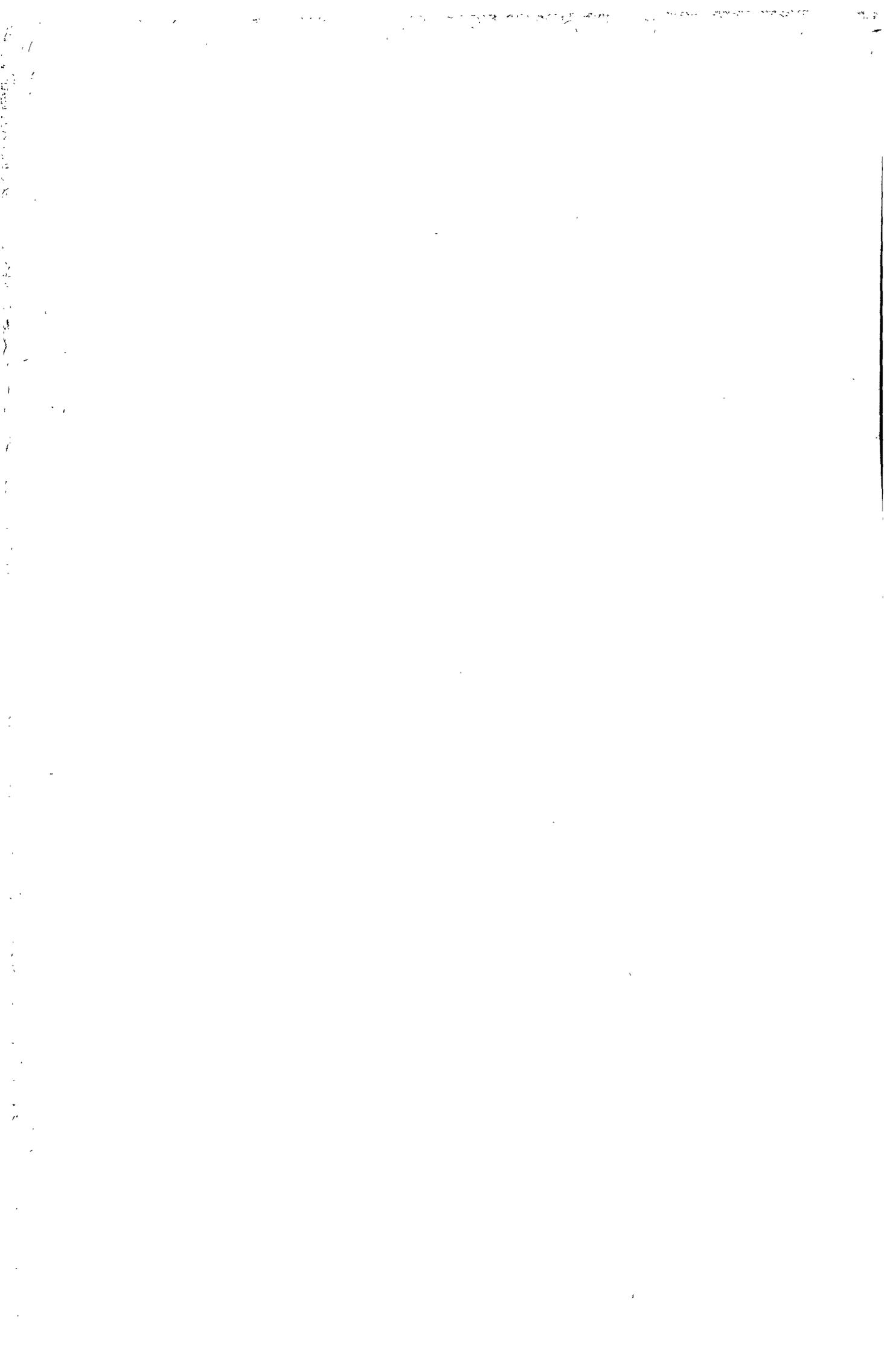
Graph 1 : Estimated trends based on SOEC seasonally adjusted data. Excluding construction, food, beverages and tobacco.

Graph 2 : Index of wage rates.

Graph 3 : Index of consumer prices, excluding rents.

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

Graphs 5 & 6 : Foreign trade of Belgo-Luxembourg Economic Union. Series adjusted by SOEC for seasonal and accidental variations. Exports fob, imports cif. Conversion at official exchange rates.



Nevertheless, gross fixed asset formation was again marked by an appreciable expansion of spending by enterprises on capital goods and industrial building. Public investment again increased relatively fast. In housing also investment probably rose further, even if in terms of volume the rise was slight. These developments and the considerable price rises that accompanied them indicate that supply is failing to keep up with demand (manpower shortages). Another pointer here is that the period of work ensured by orders already booked in the building sector has further lengthened.

Private consumers' expenditure probably increased at a speedier pace. The rise in disposable income of households was particularly vigorous, not only because the number of persons in paid employment and probably also actual hours worked per wage-earner rose further, but even more because of a further and sharper increase in hourly wages and salaries. Here the application of the sliding wage scale no doubt considerably accelerated the pace of increase of agreed wage rates. In addition transfer incomes again rose, and it is likely that the other categories of household incomes also advanced quite appreciably.

On the supply side there was undoubtedly a considerable increase in industrial production: the seasonally adjusted IRESP index again rose considerably, after remaining stable between the second and third quarter. According to the gross index, the level of production in the fourth quarter was about 9 % above the corresponding figure in the previous year, but it should be remembered that this high growth rate is in part due to the influence of special factors. The increase in the activity of the basic materials industries (iron and steel, non-ferrous metals) is particularly noteworthy, for here the elasticity of supply was ample. On the other hand physical obstacles occasionally impeded the growth of output in consumer goods and in some branches of the investment goods industry.

The limited elasticity of supply seems to be less a matter of inadequate technical capacity than of the manpower shortages which were becoming more and more a feature of the labour market. The seasonally adjusted number of vacancies reached a new peak towards the end of 1963, while the number of fully unemployed, also seasonally adjusted, tended to decline further. In absolute figures the fully unemployed numbered 33 200 in December, or 11 500—25.7 %—less than a year earlier, and of these the greater part were doubtless more or less unemployable.

The sharp rise in total demand also led to a further—although, for the time being, slower—increase in imports. According to customs statistics, imports of goods in the fourth quarter were up about 13.7 % in value on the corresponding period of the previous year, against a year-to-year growth rate of 19.5 % in the third quarter (figures by volume are not yet available).

The rise in prices speeded up appreciably in the fourth quarter, in part because of certain increased costs (world market prices for raw materials, wage costs), in part as a result of the price movements which occurred in the meat sector. The retail price in-

dex—which, however, because it is not entirely representative and is not weighted, probably does not always fully reflect price changes—shows that consumer prices went up by about 2 % between September 1963 and February 1964. This is substantially more than usual for the season; the January-February 1963 level was consequently exceeded by 3.7 % in January-February 1964. The price rise is general: not only food was affected, but the cost of services rose particularly strongly and the price of many industrial products also moved up quite considerably.

Customs returns show a deficit on trade account of Bfrs. 4 800 million in the fourth quarter. In the same period of 1962 the deficit was Bfrs. 6 300 million, but in December 1962 exports were adversely affected by special influences.

The overall balance of payments may have been slightly in deficit, although surpluses were achieved on services and also on capital account, as the State took up further short-term external credits. Between the end of September and the end of December official gold and foreign exchange reserves rose by about \$43 million. At the same time there was again some weakening in the net foreign exchange position of the commercial banks.

Supply and utilization of goods and services

	1962 ⁽²⁾	1962 ⁽²⁾	1963 ⁽³⁾	1964 ⁽⁴⁾
	At current prices (in Bfrs. '000 million)	% change by volume on preceding year		
Gross national product	637.2	3.9	4	4
Imports ⁽¹⁾	229.8	8.5	10.5	8
Private consumption	432.8	4.0	4	4
Public consumption	79.5	6.2	5.5	3.5
Gross fixed asset formation	121.7	1.5	4.5	5
Exports ⁽¹⁾	231.4	9.2	9	8

⁽¹⁾ Goods, services and factor incomes.

⁽²⁾ Comptes nationaux 1953-1962, Institut National de Statistique.

⁽³⁾ Commission estimates.

⁽⁴⁾ Commission forecasts.

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

Although the balance of payments made no contribution to internal liquidity, Treasury operations probably led to some increase. Though the State took up new loans amounting in all to Bfrs. 7 500 million on the capital market, short and medium-term indebtedness in Belgian francs declined (net repayment). Despite the further increase in foreign indebtedness, the liquidity situation at home became tighter, since demand for financing from the private sector was again very high, and since some savings are still being hoarded rather than invested, and thus not brought on to the market. These developments, coupled with the fiscal factors already referred to on several occasions in previous surveys, led to a considerable rise in interest rates. They were also reflected in a further increase in Bank rate, which was raised in October from 4 % to 4.25 %. In addition, the National Bank also used moral suasion on the banks to induce them to slow down the expansion of bank advances.

2. Outlook

The outlook for demand—particularly consumer demand—seems to be one of rather greater expansion than was foreseen in the last Quarterly Survey.

The rapid growth of demand from abroad, in terms of actual exports of goods and services, may none the less slow down a little, especially if disinflationary policy in some customer countries, particularly France, proves more successful. Against this, however, must be set the continued inflation being experienced in certain other member countries and, in particular, the strength with which business is now expanding in a number of non-member countries also, with a continuation or renewal of cost and price rises; Belgian exports will therefore receive substantial support from these quarters.

The results of the latest EEC Business Survey clearly show the upward trend of new orders from abroad. However, the manpower shortages in a number of export branches will have an increasingly restrictive effect, the more so as domestic demand is tending to grow further—and faster. All in all, it must therefore be expected that, even when allowance is made for the exceptionally sharp rise in wage costs per unit of production, exports will continue to expand, but probably somewhat less rapidly than last year.

Expenditure on gross fixed asset formation will also continue to increase. True, the now more restrictive credit policy, the cut-back in certain public investments and the stricter line on granting credits for which the State provides guarantees and interest subsidies, will be so many curbs on the pace of expansion. The sharp increase in building costs could work in the same direction. On the other hand, however, increasing demand, rising production costs in industry and manpower shortages represent strong stimulating factors. In fact to judge by the results of the Business Survey domestic demand for investment goods had probably been rising constantly since mid-1963. In particular

the relative ease with which increased costs can be passed on in the form of higher prices may in fact mean that in several sectors it is still quite possible to finance growing investments.

The pace of growth of private consumers' expenditure should remain high under the influence of a continuing and quite rapid rise in total income from wages and salaries : the number of wage and salary earners will increase further, although certainly more slowly than in 1963, and income per person employed will rise at least as fast as in the final months of 1963, for in some sectors quite appreciable increases in agreed wages rates have recently been granted or planned. It is also possible that the application of the sliding wage scale will once more bring further improvements. In addition, transfer incomes will again increase vigorously.

The rapid expansion of demand points to continuing growth of domestic supply. The increase in production is likely, however, to be limited even more than in recent months by physical obstacles—in particular manpower shortages. As a result, industrial production will probably grow only a little more speedily. Nevertheless, the year-to-year growth rate will probably be more than 5 %.

Imports will continue to expand vigorously, with manufactures, particularly consumer goods, taking the lead. In view of the outlook for imports and exports it is hardly to be expected that the trade balance will improve.

Price trends may well continue to be clearly upward, reflecting the strong pull of overall demand in money terms and the rise in costs. Import prices have gone up and wage costs per unit produced, which have gone up even more, will grow further and perhaps even faster, since wage increases are again likely to be substantially higher than the rise in productivity. The probable continuation of the upward movement of food prices could further aggravate the imbalance.

In view of this outlook it seems clear that the Belgian authorities concerned must step up their efforts to stabilize the level of prices. Obviously, any action to this end must be centred on a budget policy intended to put a brake on the economy. For it is by no means true that rising price trends in Belgium are entirely imported. This factor certainly played a considerable part, but budget policy has done nothing to counter it; on the contrary, its effects have been considerably aggravated by the budget policy which has been followed.

In fact the rise in the deficit on Treasury operations in 1963 was very considerable. The increase in State indebtedness (exclusive of certain special transactions, particularly those with the International Monetary Fund) grew from Bfrs. 12 100 million in 1962 to Bfrs. 23 000 million in 1963. Direct indebtedness in foreign currencies rose in 1963 by 10 000 million francs. The increase in the short-term debt in Belgian francs has also certainly been financed in part from foreign sources via the banks, which borrowed abroad.

Not only the sharp rise in State expenditure and the growth of the deficit, but also the manner of financing it—in an economy at full stretch this could not but give rise to dangers of inflation—were anything but anti-cyclical in their effects.

Although the sharp rise in the deficit is largely attributable to increased investment expenditure, decisions to limit the growth of expenditure should not concentrate too strongly on this but also deal with current spending—public outlay on goods and services, and transfers—which has been rising considerably. In any case the deficit must be materially reduced and appropriate measures taken to finance it in future entirely from long-term internal savings.

In Belgium as elsewhere, however, stabilization will not be successful unless the credit brake is effectively applied. This is true not only of consumer credit but also of credits to enterprises.

The ability of enterprises to accept excessive cost rises and pass them on in higher prices can also be limited by stricter use of the direct price policy machinery available in Belgium. However, this seems to be justified only as a temporary expedient to be used on condition that sufficiently rapid steps are meanwhile taken to concentrate all the resources of economic policy on the task of eliminating excess demand.

In addition efforts should be stepped up, also by agreements on incomes policy, to abate the excessive rise of incomes and costs and to limit the effects which the reduction in the agreed working week may have on the growth of supply. Even these efforts, however, can only produce results if general economic policy simultaneously manages to reduce the excessive pressure on labour markets. For this it is not only essential to limit the expansion of demand but also advisable to step up efforts to improve labour supply (greater immigration of foreign workers, removal of existing impediments to wider employment of women, more rapid vocational training and retraining, etc.).

Without any doubt the Belgian authorities are already making considerable efforts along these lines. As part of their fiscal policy decisions have been taken to postpone a part of existing public investment plans, and finance for housing has been cut back. An agreement has been concluded by which the banks undertake to limit the expansion of credit in 1964 to 10 %, a percentage substantially below the expansion observed in 1963. Special emphasis will be laid on restricting consumer credit and credit for stock-building. Statutory measures to limit all forms of consumer credit are also being considered. Finally, efforts to increase immigration have been intensified. However, further stabilization measures will certainly be necessary, and these will have to include a more strongly anti-cyclical approach to the ordinary State budget and an overhaul of the means by which the total deficit is financed.

Grand Duchy of Luxembourg

In the fourth quarter of 1963 overall demand expanded but little. Despite initial signs of an improvement in the world market for iron and steel, the trend of exports continued to be hesitant. The growth of domestic demand was mainly due to a further increase in private consumption, while investment rose only moderately.

The tendency for industrial production to improve faded out. The total number of persons in paid employment hardly rose. Thanks to a slight fall in food prices there was probably a distinct easing of the pace at which the cost of living was increasing.

The outlook for the whole of the current year described in Quarterly Survey No. 4/1963 is still valid in the main for the development of Luxembourg's economy in the coming months, though the pick-up in exports may prove to be rather more vigorous than was forecast. Private consumers' expenditure should continue to expand vigorously, while fixed investment will certainly flatten out a little. There is likely to be a recovery in the growth of industrial production, and prices are likely to edge further upward.

1. Recent developments

Although there were signs in the fourth quarter of 1963 that demand from abroad was picking up, exports of iron and steel products were still substantially unchanged both in value and by volume. In view of the way sales of other products shaped, it is possible that Luxembourg's total exports during the period under review nevertheless rose slightly.

Gross fixed asset formation does not appear to have provided any substantial stimulus to growth. Construction, especially public works, undoubtedly benefited from the fact that the weather was better than in the corresponding period of the previous year, but expansion will most likely have been considerably hampered by the constant shortage of manpower. Industrial investment, with the possible exception of that undertaken by new enterprises, is unlikely to show any great advance once the seasonally adjusted figures are available.

Private consumption, particularly of consumer durables and services, again rose rapidly in the fourth quarter as a result of appreciable income increases. In fact wage and salary incomes seem to have risen considerably, with the number of wage-earners in

industry and construction declining, but with the total numbers in paid employment practically unchanged compared with the same period of 1962. Salaries of officials and employees in the public service were increased on the average by 20 %. However, as payment of the increase was staggered, consumer demand was affected only towards the end of 1963.

The new upsurge of industrial production from its quite low level at the beginning of 1963 clearly seems to have tailed off in the fourth quarter. The growth rate of about 1 % compared with the corresponding period of 1962 (3.2 % in the third quarter) was almost exclusively accounted for by higher output in iron and steel and in ore mining.

The situation on the labour market continued to be marked by severe strains. The total numbers in paid employment in industry and construction was 0.5 % below the level of the corresponding period of the previous year and the number of foreign workers even went down by 3 %. Numbers employed in the services sector, however, seem to have grown slightly.

The cost of living continued to rise in the fourth quarter but at a definitely slower pace. Whereas the rise between June and September was about 1 %, it was negligible between September and December. This trend is mainly attributable to a slight fall in foodstuff prices. In January 1964 the cost-of-living index remained at the level reached in December, but in February and March the tendency to rise reasserted itself. In March the index was about 3.7 % above March 1963. The main increases on a year-to-year basis were in milk, bread and clothing. In addition, the Luxembourg Government was obliged to fix maximum prices for sugar and veal and to control the prices of electrical household equipment. It also intends to lay down maximum prices for imported branded articles.

2. Outlook

As a result of a new increase in orders from abroad, particularly from non-member countries, the backlog of these orders in the Luxembourg iron and steel industry at the end of 1963 was considerably higher than at the end of 1962. Exports prospects in 1964 must therefore be considered more favourable, especially as the improvement in business on world steel markets of which there are signs should continue in the coming months. In addition Luxembourg's exports of processed products incorporating raw materials of foreign origin could be boosted by the impending introduction of refunds of the taxes paid when such basic materials are imported. This measure must be added to the factors, already referred to in Quarterly Survey No. 4/1963, which can be expected to stimulate Luxembourg's total exports (completion of the Moselle canal, and diversification of exports thanks to the opening of new plant).

As the obstacles hampering investment in expansion in the iron and steel industry and private housing may well continue, gross fixed asset formation may be expected to weaken, although public investment—despite the reduction of extraordinary expenditure provided for in the State budget—may again increase both in value and by volume.

Private consumers' expenditure will most likely again grow considerably. Not only may total employment increase somewhat more strongly than in 1963, despite the still considerable difficulties in recruiting foreign labour, but the increase in wages could be at least as large as in the previous year. In addition, transfer incomes will rise faster than in 1963 thanks to a reform of the pensions system. Private consumption will expand appreciably more vigorously in value than by volume, since the general upward trend of prices is likely to continue. The upward thrust of prices could certainly be further stimulated by the entry into force if a bill now under consideration is adopted, increasing turnover tax by 2 % to 3 % and putting up certain indirect taxes (to finance the higher pensions).

In view of these trends in the various elements of demand, the expansion of industrial production should again be lively. Its probable extent is, however, difficult to forecast at present, since it depends too much on further developments in the international iron and steel market.

The Luxembourg Government's measures to damp down inflationary trends were already referred to in the last Quarterly Survey for 1963. Further steps have since been taken to mitigate the existing labour shortages. A committee in which management and labour and also the Government are represented is to travel around the frontier areas to mobilize any manpower reserves with the help of the local authorities. Efforts to recruit workers for the construction industry from Italy and Spain will also be stepped up. It is certainly also advisable that the State should for the time being abstain from encouraging the setting up of new industries and so help to avoid the otherwise inevitable further aggravation of the situation on the labour market. Care must also be taken that the limitation of investment credits from the Government, intended to quieten the situation on the building market, really does put a brake on demand in this sector. It also appears to be advisable to ensure that any benefit which might be derived from these measures is not whittled away by the action of the local authorities or by increased private expenditure on housing.

EUROPEAN ECONOMIC
COMMUNITY

**Opinion of the Economic Policy Committee on
the economic budgets and on short-term economic policy
to deal with current developments for 1964**

1. At a meeting held on 27-28 January 1964 under the chairmanship of M. Pérouse, the Economic Policy Committee examined in detail the immediate policy problems raised by the analysis of economic developments in the Community in 1963 and the forecasts for 1964. The Committee's work was based on the economic budgets of the Member States and on analyses, a synthesis and forecasts worked out by the staff of the Commission.
2. The Committee believes that the value of the recommendations which it put forward on 12 November 1963 has been enhanced by events: demand from non-member countries seems certain to gather momentum while in internal demand there may well be a further substantial increase in consumption, which will be accompanied in certain member countries by more rapid progress in investment.
3. Although the threats to internal stability and the balance of the economy which France and Italy experienced in 1963 as a result of the over-rapid expansion of overall demand seem to have been partially dispelled in France, they remain serious in Italy. Meanwhile, similar threats have emerged in the Netherlands and in Belgium. It is true that in the Federal Republic of Germany the chances of maintaining relative price stability are more favourable, but the risk of a renewed period of disequilibrium is discernible there too, if only because of the heavy pressure exerted by demand from other Community countries.
4. The Community's current account with non-member countries probably closed with a slight deficit in 1963, contrasting with a surplus of nearly \$3 000 million as late as 1961. This decline has been reflected, to a varying extent, in the relations of all the member countries with the outside world.
5. The Committee considers that a situation of disequilibrium has developed in the Community. This situation can no longer be redressed solely by the use of selective measures: in most member countries energetic measures to curb overall demand are also needed. These measures must be varied enough to allow for distinct differences in strain

from one country to another. However, the Committee has reached the conclusion that, if the problems caused by the present disequilibrium are to be solved, all member countries must, in view of their close economic interdependence, share in the effort to re-establish as quickly as possible a situation of balanced economic development within the Community. It also notes that current conditions in certain member countries now make the implementation of such a policy easier than in the past.

6. The Committee considers that a rigorous policy to stabilize domestic prices would not be feasible without a strict budgetary policy. In the cases in point, Italy, France and Belgium will need to maintain, or even carry further, the measures already taken to cut their budget deficits. Italy and Belgium will need to take special care to see that inflationary procedures are avoided when they decide on the methods of financing their deficits. Cutting the deficit is not, however, enough: what really needs sharp curtailment in most of the member countries is the growth of government expenditure. The main need is to stem—directly or indirectly—the expansion of demand for building and construction, since in several member countries trends in this industry are all too apt to spread to other industries.

7. The Committee notes with satisfaction that most of the member countries are already implementing a more restrictive credit policy: the economies cannot be stabilized unless action in other fields is backed up by the support of monetary measures. Only in the Federal Republic of Germany, where the monetary situation is well in hand, has it not been necessary to depart from a neutral policy. The Committee believes that in certain member countries recent balance-of-payments trends have improved the possibility of taking successful action in the fields of credit and interest rates. This does not mean that the problem of the influx of capital, with its undesirable effects, has disappeared. The influx has in fact continued and sometimes increased in certain member countries and credit policy must continue to take this threat into account.

8. Because of the deterioration of the economic situation in Italy the Committee, conscious of the responsibilities resting upon it, feels compelled to emphasize that although the concrete measures taken so far are steps in the right direction, they fall short of what is needed to re-establish equilibrium quickly enough. The Committee believes that the deterioration in the Italian balance of payments has reached such proportions that it might well create serious difficulties for the internal equilibrium of the Community. To remedy this state of affairs, action undertaken to slash the deficits of the Treasury and of the local and regional authorities and to curb the expansion of current government expenditure and public investment must be continued and taken even further. At the same time, monetary policy should aim at keeping the expansion of the volume of credit within the limits necessary to ensure a return to stability. The Committee hopes that the specific measures called for will be taken without delay and that they will be stringent enough to fit the immediate need. In view of the very lively increase in money incomes which, since it has been largely responsible for the rise in costs and the advance of private

consumption in the last two years, is the key to current disequilibrium, the Committee considers it essential that the Government should increase the effectiveness of its incomes policy.

9. The Committee notes with satisfaction that in France the first phase of the stabilization policy launched in September 1963 has led to some improvement in the price situation. As direct controls on prices and profit margins—which have been of great psychological importance—must be considered as temporary measures, what is now needed is a direct attack on overall demand so as to bring it down to normal proportions as quickly as possible. The first thing that should be done is to restrict public expenditure even more severely and, if need be, to make a further reduction in the “impasse”. Moreover, the French monetary authorities should continue to ensure that the expansion of credit is kept within bounds.

10. In the Netherlands, wage increases granted in the early months of the year are bound to link up with a sharp increase in prices and a heavy deficit on current account. The Committee considers that the first necessity is to use general policy measures affecting demand to prevent these developments impairing overall equilibrium. Should it prove impossible in the course of the year to cushion very appreciably—by an appropriate policy—the impact of increases in costs and prices, a very dangerous price-wage spiral might be the result. Aware of this danger, the Dutch authorities have already decided to scale down investment by the State, to curb the investments of regional and local authorities and to reintroduce quantitative controls on the expansion of credit; they have also raised Bank rate slightly. The situation calls for vigilance, for if in the near future it does not appear that equilibrium has been re-established, other restrictive measures will have to be taken.

11. For some time the maintenance of internal stability seems to have been in danger in Belgium as well. Although the problem is admittedly not yet comparable to that with which other member countries have to cope, any more rapid expansion of demand would be certain to bring it to the fore. This being so, the expansion of public expenditure ought to be restricted still further, and in particular arrangements should be made to ensure that the deficit is financed out of long-term savings. In addition, the granting of credit must be kept within limits compatible with the policy of reducing current strains.

12. In the Grand Duchy of Luxembourg, where measures have already been taken to curtail excess demand, it may, in the Committee's view, prove necessary to slow down the implementation of measures of structural conversion if the recruiting of labour continues to raise serious problems.

13. The Committee has noted with satisfaction that in the Federal Republic of Germany the prospects for the maintenance of domestic stability are better than in the other Member States. By deciding to limit the growth of expenditure in the 1964 budget to 6 %, the Federal Government is making a major contribution, notably in the example

it is thus giving to regional and local authorities, to improving the price situation. None the less, price stability is being endangered by the emergence of heavier balance-of-payments surpluses as a result of an improvement in the balance on current transactions and of a heavier influx of capital. The Federal German authorities are therefore once again faced with the dilemma of being unable to curb home demand without further increasing surpluses on the balance of payments. This does not mean that internal economic policy measures should be relaxed; however, the Committee realizes that if inflationary strains in the other member countries did not ease rapidly, the Federal Republic of Germany could not go on contributing alone to the maintenance of stability in the Community.