OECD

ORGANISATION FOR ECONOMIC CO-OPERATION AND DEVELOPMENT

ECONOMIC OUTLOOK

ORGANISATION DE COOPÉRATION ET DE DÉVELOPPEMENT ÉCONOMIQUES

6

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CONVENTIONAL SIGNS

$	US dollar	—	Irrelevant	( )	Figures based on incomplete data
c	US cent	.	Decimal point		
£	Pound sterling	I, II	Calendar half-years		
..	Data not available	Q1, Q4	Calendar quarters	*In charts:*	
0	Nil or negligible	Billion	Thousand million	S	Strike
				B	Break in series

THE ECONOMIC OUTLOOK FOR 1970

Since the July issue, there have been important changes in the economic situation. The slowdown of economic growth in the United States has become clear to see. The United Kingdom's balance of payments has strengthened markedly. And the French and the German parity changes will help establish a better pattern of balances of payments on both current and capital account.

In the OECD area as a whole, the growth of output in 1969 seems to have slowed down a little to about 5 per cent—reflecting restrictive policies in the United States and also the United Kingdom. In many other countries, expansion has accelerated, creating high demand pressures. Both in the United States and other countries, the pace of price inflation has increased.

For 1970, with policies in almost all countries directed to disinflation, a year of below-average growth seems likely. International trade also seems likely to slow down. It seems to have been rising at the unusually fast rate of over 15 per cent. In 1970 the increase might be about 10 per cent—an average rise.

The policies responsible for this slowdown will be judged by the extent to which the price rise decelerates—there is normally some time-lag before price movements respond to falling demand pressures—by the speed with which payments imbalances are reduced, by the course of interest rates and, above all, by the ability of national authorities to avoid recession.

Summary of underlying trends[a]

Percentage changes
annual rates seasonally adjusted
July forecasts in brackets

	1958 to 1967 Average	1968	1969 I	1969 II	1970 I	1970 II
REAL OUTPUT (GDP or GNP)						
United States	4.6	5	2½ (3)	1¾ (1½)	½ (2¼)	3¼
Other OECD	5.8	6½	7½ (7)	7 (5¾)	5¼ (5)	5½
TOTAL	5.2	5¾	5 (5)	4 (3½)	2¾ (3½)	4¼
PRICES (GNP deflator)						
United States	1.8	4	4¾ (4¼)	5[b] (4½)	3¾ (3¼)	3¾
Germany	2.9	2	2¾ (3)	4 (3½)	5 (3½)	3
Other OECD	3.6	3¾	5 (4½)	5 (4)	4¼ (3¾)	4¼
TOTAL	2.5	3¾	4½ (4)	5 (4)	4 (3½)	3¾
OECD TRADE (values)						
Imports	9.4	12¾	15¾ (13½)	15¾ (9½)	7 (8½)	7¾
Exports	8.9	12¼	15¾ (13½)	16½ (9½)	8 (8½)	7¾

a) For various adjustments, see footnotes to Tables 3 and 8.
b) Includes the federal pay rise in mid-1969.

DEMAND MANAGEMENT

It would be generally agreed that the United States, France and the United Kingdom all need to maintain restrictive policies for the sake of restoring internal and external equilibrium. This implies a diminution of the external demand supporting other countries; and normally these countries could be expected to respond by stimulatory measures. But since most of them also need to damp down their internal demand and cost pressures, some general reduction of growth rates in 1970 seems to be appropriate. At the time of writing, the risk of a cumulative downturn seems less than the risk of continuing inflationary tendencies.

Developments such as are indicated by the forecasts in the table above cannot be characterized as a recession. But how much risk is there of recession developing unexpectedly? One danger might be that countries were failing to allow for the repercussions on them of developments in other countries: in fact, however, countries' forecasts appear reasonably self-consistent. But they are based on the expectation that the middle of the year will see a revival of growth in the United States; and there could—unexpectedly—be an abrupt downward shift in U.S. business sentiment. Moreover, when policy is formulated, full attention needs to be paid to the fact that prices are likely to respond to falling demand pressures only with some time-lag: restrictive action additional to that now generally envisaged, while bringing little immediate improvement in price performance, would increase the risk of recession. Trends in several of the major countries are likely to be crucial.

United States

In the United States cost and price trends may be on the verge of weakening following the easing of demand pressures. The rather disappointing experience to date mainly reflects cost pressures generated in earlier boom conditions. But widespread doubt as to the success of the stabilisation programme may also have played a part. Demand has so far been resilient and recent investment surveys show that intentions remain strong. The possibility of a significant absolute fall in demand and output in the next six months or so cannot be excluded; the situation depends heavily on business confidence, as reflected in fixed investment decisions, retention of labour and especially stockbuilding, factors which could change quickly. But demand, notably in housebuilding, should respond quickly, if necessary, to an easing of monetary policies.

In the middle of October, unemployment has not risen above 4 per cent, still inside the acceptable limits. At this stage, it seems more important to guard against premature relaxation of policies—which could sacrifice the chance to improve price performance—than against the danger that reflationary action might be delayed too long. Evidence that price increases are slowing down is still limited. And even if real demand follows the rather smooth path of deceleration and renewed acceleration at present envisaged, the extent to which price trends will improve will, for some time yet, remain uncertain, especially as numerous wage agreements are due to be negotiated in the coming year. In the long run, adequate price performance may depend as much on the development of new attitudes towards the appropriate size of increases in money wages as on demand management alone.

Other OECD countries

Most other OECD countries are likely to see some fall in the pace of expansion between 1969 and 1970. In practically all countries, policies are now directed to keeping the growth of demand in line with—or below—the expected growth of productive potential, and this may continue for some time to come. This is clearly true of France and the United Kingdom. The situation is less clear, however, in some countries which have, up to now, enjoyed particularly strong current balance positions—especially Germany and Italy.

Germany

Conditions in Germany will have an important influence on business attitudes in surrounding countries. During 1969, demand has risen faster than anticipated. The economy was clearly beginning to strain at capacity limits by the summer, though neither the trade balance nor consumers' prices were by then very substantially affected. For the next few months, large outstanding orders and new large wage increases will probably keep demand pressures very high; and as cost increases work through, prices could rise fast by past standards. But there could be a change in sentiment affecting, in particular, business investment. The capital outflows resulting from the revaluation have already provided some tightening of monetary conditions, though the authorities have partially offset the effects by easing banks' reserve requirements. The probable fall in the real external surplus, and any further tightening of monetary conditions, should lead to easier demand pressures in the course of 1970—though it is difficult to predict how rapidly conditions might change.

Italy

Italy is the main country in the OECD area where a noticeable margin of slack persists (though in some industries, particularly construction, demand pressures have been high). On the assumption that more normal conditions are quickly re-established, domestic demand seems likely to grow strongly, with a rise of perhaps close to 15 per cent in the wage bill between 1969 and 1970. Apart from making up shipments delayed by strikes, exports are likely to rise less fast than they did in most of 1969 because of the general deceleration of world trade. The risks of excessive real demand pressures do not seem very great. And though there could be an immediate problem in absorbing rather large and sudden wage increases, Italy's present cost position relative to those of other countries seems sufficiently favourable to enable the wage increases to be borne without serious loss of competitiveness.

Japan

In Japan, the recent tightening of monetary policies was a reaction to symptoms of faster-rising costs and prices rather than to the persistence of high interest rates overseas. The spring wage-round yielded the biggest wage increases for about twenty years and wholesale prices rose faster in the summer, partly because of higher import prices. The pace of expansion seems likely to slow down somewhat, with less impulse from exports, leading to some easing of demand pressures. This might, in turn, permit an easing of policies, with the aim of maintaining about a normal rate of growth of output.

Smaller countries

In most smaller OECD countries, demand pressures are currently quite high. Policies, especially monetary policies, have become more restrictive both for domestic reasons and, defensively, to keep pace with the general rise of interest rates. Faced with a prospect of more widespread disinflationary policies in major countries, there may be a tendency for smaller countries to play for safety in policy formation. But neither balance of payments constraints nor internal cost pressures seem, in general, to call for substantially new policies. Countries particularly dependent on trade with Germany seem, however, likely to experience some net addition to demand or cost pressures and this may call for offsetting action. The unilateral tariff reductions and other steps effected by Austria constitute a useful example of how to combat additional price pressures.

PRICE INFLATION

The price rise in 1968 was already well above that for the previous decade. In 1969 there has been a further acceleration in which all major countries have shared. Some slowing down of the rate seems in prospect for most countries. But the general price rise in 1970 is likely to remain well above average: among the major countries, only the United Kingdom and possibly Japan are likely to see increases close to past average rates. Elsewhere the rate of increase may remain rather large by past standards. Both Germany and Italy may see the general price level rising faster as a result of larger wage settlements.

In the United States, the behaviour of prices is largely explained by cost increases following from recent excess demand pressures, though a continuation of inflationary expectations may also be playing a part. The acceleration has affected world trade prices, and has also contributed to price and wage increases in Canada, which have not yet responded satisfactorily to disinflationary policies. In many other countries, unit labour costs benefited until recently from the upswing in activity; but, with the scope for cyclical gains in productivity largely exhausted, stronger pressures on costs and prices have now developed. In the coming months, rather rapidly increasing prices may have to be accepted while underlying demand pressures are in the course of being corrected by the present disinflationary policies.

Despite the obvious difficulties, most (though not all) governments believe incomes and prices policies have a role to play. It is clear, however, that a period when prices are rising unusually fast provides the least favourable conditions for their success. Such policies cannot usefully be regarded as an emergency expedient, to be introduced when the need for quick results is particularly strong, but rather as a useful adjunct to policy in a longer perspective.

Over the longer period, significant differences are likely to re-emerge between the rates of price rise that individual countries will in practice accept as tolerable. Such differences in attitude have an important bearing on the problem of securing a balanced growth of world trade. The problem can be further complicated by the important structural contrasts between countries which lead to differential price developments in domestic and export markets.

PAYMENTS PROSPECTS

Changes in relative demand and cost pressures, and the changes in the French and German exchange rates are likely to lead to an improved pattern of international payments which may nevertheless not yet reach, in some instances, the full balance of payments adjustment desired. On present policies, the United States current account should swing from deficit (effectively caused by strikes early in 1969) to some surplus; the trend of the United Kingdom's current account should remain favourable; and that of France should strengthen. Counterparts would include a major reduction of Germany's current surplus; some fall in that of Italy; and a reversion of the smaller OECD countries generally to more normal, less favourable, positions. The French and German parity changes should have a major settling effect on speculation in foreign currency markets.

Forecasts for current balances of individual countries are subject to large margins of error, especially in view of the recent parity changes. The combined effects of these on other countries' current balances may, by and large, be offsetting—though some countries particularly dependent on trade with Germany, such as Austria, stand to be affected.

Much of the substantial improvement suggested for the United Kingdom is likely to have been obtained by the end of 1969. Some further improvement can be expected so long as no undue relaxation of domestic demand management policies takes place, though there seems likely to be comparatively little additional effect from the 1967 devaluation, either on exports or imports. For France, improvement in the immediate future may depend mainly on the reduction of domestic demand pressures; but the benefits of the devaluation (and of the Deutschemark revaluation) should progressively be felt. The changes forecast in both the United States and the German balances reflect the very different domestic conditions they expect in 1970. In Germany, the effects of revaluation should be supplemented by the persistence, into 1970, of

Current balances
$ billion, estimates and forecasts

	1968	1969	1970
United Kingdom	–0.72	0.70	1.2
United States	–0.28	–0.60	1.5
France[a]	–0.86	–1.30	0.2
Germany	2.84	1.50	0.4
Italy	2.64	2.45	1.8
Canada	–0.09	–0.65	–0.8
Japan	1.05	2.20	2.0
Total seven countries	4.58	4.30	6.3
OECD CURRENT BALANCE WITH REST OF WORLD[b]	3.7	3.9	5.4

a) Transactions with non-franc countries. Secretariat estimates for the first half of 1969.
b) Roughly estimated by the Secretariat.

above-average demand pressures. In the United States, on the other hand, improvement of the current balance would take place at a time when demand pressures were tending to become lower than would be considered desirable in the medium term. The position of Canada seems likely to be somewhat less satisfactory than in the recent past. Italy is likely to remain in large current account surplus, though at a lower level than in the recent past. Japan's strong surplus position seems unlikely, on present trends, to be much reduced in 1970.

MONETARY PROSPECTS

In the first three quarters of 1969 increasing monetary tightness in the United States led to an unprecedented pull of funds through the Euro-dollar market. Waves of speculation led to recurrent large inflows—and subsequent outflows—of funds to Germany. Monetary conditions were tightened generally in other OECD countries. A feature of the year was the enlarged capital outflow from Italy. The revaluation of the Deutschemark had already led by mid-November to a substantial reflux of capital from Germany. The tightening of German monetary conditions caused by this outflow was only partially eased by relaxing banks' reserve requirements. Interest rates on the Euro-dollar market, after an initial fall, rose again in November.

In the period ahead, the pattern—and scale—of capital flows may depend largely on developments in domestic monetary policies. So long as stringent monetary conditions are maintained in the United States, this should continue to exert some pull on external funds. The fact that outstanding Euro-dollar liabilities of U.S. banks have not on balance risen markedly since mid-July (they have fluctuated around $ 14 billion) might, however, suggest that further large net inflows such as occurred earlier in 1969, are now less likely. At some point, the United States' authorities will wish to ease monetary conditions, if only moderately. If other countries were then anxious to maintain relatively stringent conditions—whether for balance of payments or domestic reasons—the pattern of monetary forces and international capital flows would change again. Despite improvement of the United States' current account, the official settlements position might well be less favourable than in 1969. The overall payments positions of other OECD countries would then be further strengthened.

Such developments might generally be regarded as acceptable in the context of other trends in the coming period. But the speed with which very large amounts of capital move from one area to another underlines the limitations that need sometimes to be imposed on the use of monetary policies for domestic demand management. To the extent that external considerations effectively limit the use of monetary instruments, the need to have alternative fiscal instruments readily available is all the greater. A further consideration is that interest rates as high as at present have disadvantages not only for OECD countries but for developing countries as well.

24th November 1969.

GENERAL TRENDS

OUTPUT, DEMAND PRESSURES, COSTS AND PRICES

The growth of output seems bound to slow down in 1970. But the slowing down by no means betokens a recession—output may still show a rise of 3 or 4 per cent. Moreover, it has to be viewed as the correction of a past rate of growth which was unduly high: demand pressures have become strong, and will only gradually be reduced. The cost and price pressures generated by past high demand are likely to take even longer to be reduced.

There have already been signs of a slowing down of output; but it has so far been mainly concentrated in a few large countries. The fact that total output is likely to rise by approximately 5 per cent this year, compared with nearly 6 per cent in 1968, is almost entirely accounted for by the effects of disinflationary policies in the United States and the United Kingdom, some temporary pause at the beginning of the year in Japan and the emergence of capacity constraints in some countries during the year.

In almost all the smaller countries, 1969 is likely to have proved a year of more growth than 1968—and, in a substantial number, faster than the average

TABLE 1

Growth of real GDP of Member countries

1958-1968, 1969 estimates and 1970 forecasts

	Weights in total[a]	Annual percentage changes			
		1958-1967 Average	1968	1969	1970
TOTAL OECD	100.0	5.2	5.7	5	3½
MAJOR 7 COUNTRIES	89.0	5.2	5.8	4¾	3¼
United States (GNP)	51.2	4.6	4.9	2¾	1½
Canada (GNP)	3.7	4.7	4.7	5	4
Japan (GNP)	8.4	10.7	14.2	12½	11¼
France	7.5	5.1	4.2	8¼	4
Germany (GNP)	7.8	4.8	7.0	7¾	4½
Italy	4.4	5.6	5.4	6	7¾
United Kingdom	6.0	3.3	3.6	2	3
OTHER OECD NORTH[b]	8.1	4.7	4.1	5¼	4
Austria	0.7	4.3	4.1	5½	4
Belgium	1.2	4.4	4.0	6	4¾
Denmark	0.8	5.0	3.6	7	3¾
Finland	0.5	5.3	2.0	8	6
Ireland	0.2	3.7	4.9	4	4½
Netherlands	1.5	5.0	6.2	5	3½
Norway	0.6	4.8	3.8	4½	4¾
Sweden	1.6	4.5	3.3	4½	3¾
Switzerland	1.0	4.9	4.0	4½	4
OTHER OECD SOUTH[c]	2.9	5.8	5.1	7½	6½
OECD Europe	36.7	4.8	5.0	6	4½

a) GDP for 1968 in dollars at current rates of exchange.
b) Including Luxembourg and Iceland.
c) Spain, Portugal, Greece and Turkey.

for the past decade. Austria, Belgium, Denmark, Finland, Sweden and Spain all are in this category. Ireland and the Netherlands are among the few smaller countries to experience a deceleration in 1969, in both following exceptionally rapid expansion last year (see Table 1).

The coming year is likely to see deceleration of real growth in the area as a whole. Recent indicators for industrial production show a definitely weaker trend already setting in during the third quarter. But apart from clear evidence of flattening in the United States, as fiscal and monetary policies bite progressively harder, in most countries demand seems still to be strong. The apparent recent slowing-down in Europe mainly reflects capacity constraints in Germany as well as France and strikes in Italy (see Table 2).

In the course of 1970 slower expansion in the large countries is likely to be passed on to many of the smaller ones. In 1970, the growth of imports of the six major OECD countries[1] is forecast to fall to 10 per cent, compared with 15 per cent in 1969. This is a prime cause behind the expectation that the rate of growth of smaller OECD countries' exports will be nearly halved, falling from about 18 per cent in 1969 to some 9 per cent in 1970. Although the current external balances of these smaller countries are expected to deteriorate relatively little—their imports are likely to slow down almost as much as their exports—the weakening of their foreign markets will have a contractionary impact on their economies. And with disinflationary policies, albeit of a fairly mild nature, now quite widespread, virtually all these countries may see their growth rates falling—though in few cases substantially below the longer-term average.

The deceleration of growth among the major countries—and, therefore the downward bias imparted to the smaller OECD countries—may be fairly short-lived. In the United States, on the basis of present forecasts, output would pick up substantially in the second half of 1970. Canada may follow suit. There could also be some acceleration in France, assuming stabilisation policies are producing their intended effects by mid-year. These would be more important than further deceleration in Germany (see Table 3).

1. Canada is excluded since three-quarters of her imports come from the United States.

TABLE 2
OECD industrial production
Indexes 1967 = 100

	1968 I	1968 II	1969 Q1	1969 Q2	1969 Q3
United States	103.2	105.2	107.6	109.2	110.2[a]
Canada	103.4	107.3	111.0	110.3	109.1
OECD Europe	103.7	111.3	114.8	117.3	118.2
Japan	112.3	122.5	126.6	134.4	140.2
Total OECD	104.4	108.7	111.8	114.1	115.0

a) October = 109.6.

DEMAND PRESSURES

Over the last two years almost all OECD countries have experienced faster than average rates of expansion. As a result, demand pressures have been rising since about mid-1967, and by 1968 they were very high. Evidence of the inflationary tendencies which have led most countries to adopt more restrictive demand management policies can be seen from Chart A. The past year has seen conflicting movements. Pressures have begun to ease in the United States and Canada and eased to a small extent in the United Kingdom—at any rate in the first half of the year. Elsewhere increasing demand pressure has been almost universal.

In the United States the excess of actual over " potential " GNP was just about eliminated by the second quarter and some unused margin began to emerge in the third quarter. In Canada, with a dip in output in the second quarter, unused resources increased and unemployment was over 5 per cent (seasonally adjusted) by the autumn. In the United Kingdom, total output was probably no higher in the first half of 1969 than in the second half of 1968 and demand pressures must have eased somewhat; evidence as to the extent of slack is, however, rather conflicting. In the three months to mid-November, unemployment averaged 2.4 per cent but the number of job vacancies and the extent of overtime in manufacturing industry indicated less margin. Better unemployment benefits and redundancy pay may have changed the meaning of a given level of unemployment as an indicator of slack. The temporary check in Japan early in the year was followed by fast growth and appears to have been hardly significant in terms of resource utilisation.

In continental Europe, demand pressures have increased rapidly. The degree of capacity utilisation in Germany has been at an all-time peak since May, with a ratio, seasonally adjusted, of nearly 5:1 between job vacancies and the number unemployed and a record number of foreign workers. In France, the degree of capacity utilisation in the second quarter was probably the highest for ten years, and industrial production levelled out between April and September despite buoyant demand. In June, 41 per cent of industrial enterprises declared that they could not increase their output because of capacity shortages—the highest proportion since the quarterly enquiries were started in 1960. Registered unemployment was no lower than at the end of 1967, but the tensions on the labour market showed up in the exceptionally high level of unfilled vacancies and in wage drift. For the smaller industrial countries, judging from growing tensions on labour markets (as reflected, in particular, by unfilled vacancies), the degree of capacity utilisation increased during the first half of 1969 in Austria, Belgium, Denmark, the Netherlands and Sweden. In Norway and Switzerland, capacity utilisation has probably remained about unchanged at a high level. The Italian situation (before the strikes) differed from that of most other industrialised countries. Slack has been appreciable; and although it has been reduced somewhat, capacity utilisation is still well below that in 1963-1964. In July unemployment was still above the 1967 level and more than 60 per cent higher than the all-time low point of 1963.

Looking ahead, demand pressures are likely to decrease in several countries, though the timing and the pace of the changes are bound to differ. In the immediate future, a marked easing of pressure is expected only in the United States, where unemployment could well go up to 4½ per cent. The margin of slack will also be increasing in Canada. By contrast, pressure of demand is not expected to change in the United Kingdom; rapidly growing domestic demand should ensure continued full capacity utilisation in Japan.

In continental Europe, pressure seems likely to rise in Italy. The outcome of the labour disputes is not yet clear, but it seems certain that new wage agreements, together with the implementation of increased pensions and multiplier effects of past reflationary measures, will add substantially to purchasing power in the short run. The need to make good output lost in the strikes will further add to demands on productive capacity. On domestic grounds, there is no reason to expect any weakening of demand pressures in Germany, at least until about mid-1970. How quickly revaluation may affect resource utilisation is highly uncertain; a falling external surplus, combined with domestic monetary tightness, could gradually ease demand pressures in the course of 1970, particularly as there seems to have been some acceleration of the rate of growth of capacity as a result of exceptionally large productive investment since the end of 1967. In France, demand pressures have probably begun to relax since the devaluation and accompanying measures; a gradual easing is expected from now on, but the pace depends very much on reactions to the new restrictive policies. For other European countries, some, but probably rather little, general easing of demand pressures is implied in the forecasts.

TABLE 3

Growth in real GDP in the seven major OECD countries

Seasonally adjusted percentage changes at annual rates

	1967 II to 1968 I	1968 I to 1968 II	1968 II to 1969 I	1969 I to 1969 II	1969 II to 1970 I	1970 I to 1970 II
United States (GNP)	5.6	4.7	2.6	1¾	½	3¼
Canada (GNP)	5.9	6.6	4.7	3¼	4	4¾
United Kingdom	4.5	3.5	0.0	4½	2¾	2½
France[a]	–3.7 (2.1)	21.3 (8.5)	5.1 (11.0)	3¼	4¼	4¼
Germany[b] (GNP)	6.0 (9.3)	10.6 (7.7)	6.4 (8.8)	7½ (6¼)	4	2½
Italy[a]	4.2	5.9	7.7	2½ (4¼)	11½ (7¾)	6 (7½)
Japan (GNP)	13.7	15.7	9.0	16	8½	12
Total	6.3	6.4	4.6	4	2½	4¼

The figures for total and in brackets are adjusted for the distortions caused by:
a) strikes ;
b) German fiscal measures.

TABLE 4
Consumer prices
Index, average 1967 = 100

	1968 I	1968 II	1969 I	1969 Q1	1969 Q2	1969 Q3
United States	102.9	105.4	108.3	107.2	109.2	110.7
Canada	103.1	105.3	107.6	106.6	108.6	109.9
United Kingdom	103.5	105.9	109.5	108.7	110.4	110.5
France	103.3	105.9	109.5	108.8	110.2	111.4
Ireland	103.9	105.6	110.7	109.8	111.7	113.5
Netherlands	102.9	104.6	110.9	110.0	111.8	111.4
Other OECD[a]	102.7	103.7	105.7	105.1	106.2	107.2

a) Weighted by consumer expenditure in 1967 at 1967 exchange rates.

Thus, outside North America, the prospect seems to be for only some easing of demand pressures from their present high levels. But this depends on disinflationary policies remaining moderate in the face of price rises which, if decelerating, are still above the normal rate.

COSTS AND PRICES

The Present Situation

The acceleration of cost and price increases has to be viewed as a result, predominantly, of past demand pressures. Though a slowing down of the cost and price rise is now likely, it will be slow for two reasons. First, demand pressures are themselves going to take some time to abate; and, second, the effect of lower demand pressures will take some time to be fully reflected in a moderating of cost and price trends. In past cycles, deceleration of the growth of output has been reflected in the price trend only in the following year or so.

The main developments in prices since early 1969 have been (see Tables 4 and 5):

a) A rapid rise in the United States: the GNP deflator in the first three quarters rose at annual rates of around 5 per cent and the monthly consumer price index has risen faster. Signs of deceleration are still rather weak. Prices have also risen fast in Canada.

b) Unusually large rises, especially of consumer prices, in the United Kingdom, Ireland, the Netherlands and France. In all these countries, consumer taxes were increased late in 1968 or early in 1969 and in the United Kingdom and Netherlands the increases were concentrated early in the year. In France and Ireland prices continued to rise fast as demand and cost pressures mounted. In Iceland, devaluation late in 1968 has led to a sharp rise.

c) Gradual acceleration of the rise of consumer prices in Italy (mainly food, rent and imported goods) and very rapid increase in wholesale prices and construction costs. Fairly normal increase in Japan until the summer—in September consumer prices were 5½ per cent up on a year earlier, little above the long-run average—but acceleration of wholesale prices, partly related to import prices. Signs of acceleration in Germany by the summer, mainly of producer's prices.

TABLE 5
Price and wage indicators in seven countries
Percentage changes over corresponding period of previous year

	Average 1964-68	1969 Q1	1969 Q2	1969 Sept.
AUSTRIA				
Consumer price	3.5	2.5	3.4	2.5
Hourly rates in industry	6.8	4.7	4.5	7.4
BELGIUM				
Consumer price	3.6	3.1	3.8	3.8
Hourly earnings in mining, manufacturing and transport *a*	8.6	8.2	7.3	..
DENMARK				
Consumer price	6.5	3.7	2.2	3.6
Hourly earnings in industry	10.7	12.8	..	..
NETHERLANDS				
Consumer price	4.7	7.5	8.1	7.2
Hourly rates in industry (males)	10.1	8.9	8.7	8.2 *b*
NORWAY				
Consumer price	4.2	2.5	3.3	3.6
Hourly earnings in mining and manufacturing (males) *c*	7.6	12.4	12.1	..
SWEDEN				
Consumer price	4.2	2.0	2.4	3.1
Hourly earnings in mining and manufacturing	8.2	6.2	6.7	6.8
SWITZERLAND				
Consumer price	3.5	2.4	2.6	2.5
Hourly rates in industry *a*	5.2	4.7	4.7	..

a) Monthly figures are not available, quarterly figures relate to the last month in quarter.
b) August.
c) Earnings rose sharply between the first and third quarters of 1968, affecting the annual comparisons in the table. During the first half of 1969 the increase was at an annual rate of 8 per cent.

TABLE 6
Unit wage or labour costs
Index, average 1967 = 100

	1968		1969			
	I	II	I	Q1	Q2	Q3
UNITED STATES						
ULC	102.9	105.2	106.1	105.7	106.5	107.9
CANADA						
Unit wages and salaries	101.0	102.0	104.4	103.5	105.3	106.1 *a*
UNITED KINGDOM						
ULC in the whole economy *b*	102.4	105.0	107.5	106.6	108.3	..
Unit wages and salaries	101.1	100.9	104.7	104.3	105.1	104.5 *a*
GERMANY						
Unit wages and salaries *c*	97.4	95.4	98.2	97.9	98.5	95.0 *a*
ITALY						
ULC	98.5	98.1	98.5	..	..	..
FRANCE						
Unit wage costs	107.5	102.1	104.1	103.9	104.2	107
JAPAN						
Unit wages and salaries	100.3	99.5	101.1	100.5	101.8	103.5 *a*

Note: ULC = Unit Labour Costs. All figures are seasonally adjusted and refer, unless otherwise stated, to manufacturing industry. For sources and methods, as well as coverage and definitions, see notes to detailed tables in "Technical notes", pp. 98-100.
a) July-August.
b) Including Selective Employment Tax.
c) Including mining.

d) Above-normal increases in food prices in several countries.

e) Not much sign of acceleration in most other countries up to the middle of the year.

f) An above-normal rise in export and import prices. For the United States, export prices generally reflect domestic price developments. The border tax measures which preceded the revaluation were a factor for Germany. But the acceleration has been widespread, and probably reflects the generally high demand pressures. The same influence has also been felt in commodity prices.

Information on short-term cost changes is much less readily available; few countries publish regular material on wage or labour costs per unit of output and both the industrial and the cost coverage differs from one to another. Table 6 summarises the main national wage cost data including some tentative estimates. [1] It brings out clearly the cyclically favourable development in Germany and Italy up to mid-1969 which, in both countries, must now be changing as a result of large wage demands. Rather considerable increases are shown in both the United States and Canada, reflecting checks to productivity rather than acceleration of money earnings; [2] the size of wage agreements has been tending to fall in both countries over the period, though it may have increased again lately in Canada. In the United Kingdom, the rather large increase in costs in 1968 in the economy as a whole, despite good productivity gains, reflected the combination of a large wage round (partly catching-up after earlier freezes) and increases in the Selective Employment Tax. In 1969, despite a relative absence of new wage agreements (hourly wage rates rose only 2 per cent in the nine months to September), average earnings in the United Kingdom have risen at an annual rate of some 6 per cent in the whole economy and more in manufacturing industry; with output and, probably, employment changing little, short-run unit labour costs have again risen rather fast. In France, rapidly rising productivity and the abolition of the payroll tax at the end of 1968 seem to have absorbed for the time being much of the potential impact of the 1968 wage increases on costs; but with earnings rising and production tending to level out, a fairly strong rise of costs must have resumed after the early part of 1969.

For other countries, indicators are even less complete, but the general impression from, for example, wage rate indexes and reports of current settlements is that the growth of average earnings has been accelerating with rising activity. In some countries, notably Ireland, wage cost increases have been very large. But in others, such as Sweden, increases may not have accelerated much.

Cost and Price Prospects

In 1970 there are some prospects that the increase of the general price level will slow down in most of the major countries, given the path of demand pressures envisaged and the timing and size of wage increases in train or expected. Only Germany and Italy seem clearly likely to have larger increases in the general price level between 1969 and 1970 than have been experienced recently. In Germany the revaluation should help to damp down the rate of domestic price increase in the course of the year,

1. For more detailed figures, sources and methods of estimations see "Technical Notes", pp. 98-100.
2. The increases in unit labour costs in the United States show even more clearly in the series for the whole private economy—see United States note, p. 57.

CHART A

INDICATORS OF DEMAND PRESSURES IN SEVEN COUNTRIES 1965-1970

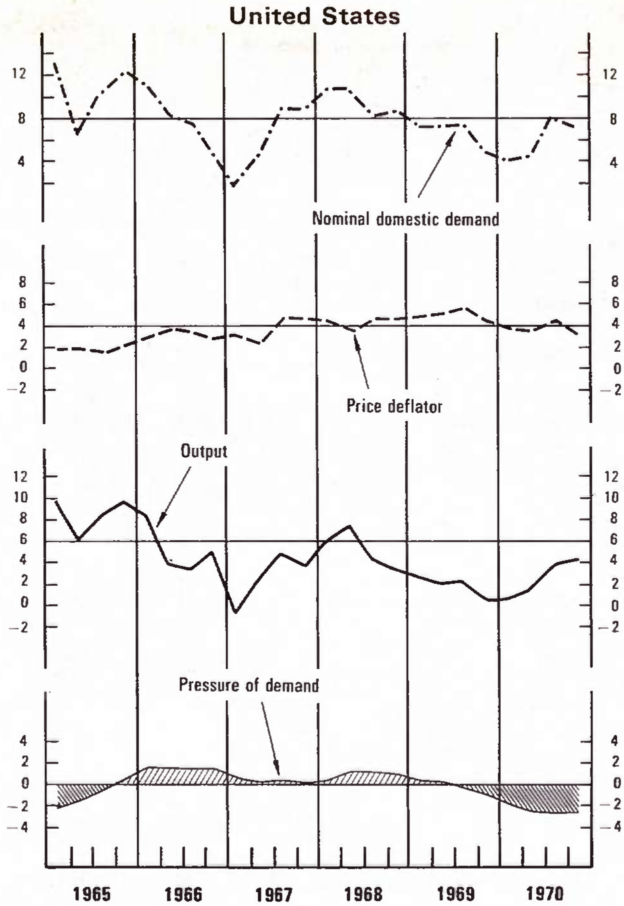
(estimates and forecasts)

Percentage changes at annual rates of:

- Nominal Domestic Demand (including stockbuilding)
- Implicit Price Deflator of Domestic Demand
- Real Output (GDP or GNP)

Pressure of Demand (derived from comparison of actual and "potential" GNP—see "Technical notes").

N. B. The figures are adjusted for various distortions and accidental variations described in table 3.



though how soon past stability can be regained is necessarily uncertain at this stage.

The estimates and forecasts of the general price level are summarised in Table 7. Chart A shows, for each country, fluctuations in domestic expenditure, real output and prices. In the major countries, except possibly the United Kingdom and possibly also Japan, the rise of prices seems likely to continue for a time to be well above the average of the decade 1958-67.

UNITED STATES: *No marked slowdown in prices before the first quarter of 1970.* Disinflationary policies are intended to lead to a further deceleration of the growth of domestic demand. Since a margin of spare capacity is only just emerging, the price movement is unlikely to be substantially affected until early 1970. How quickly and how far the price rise drops back in the course of the year is difficult to forecast. If business confidence and expectations of future full employment remain strong, the process could be rather slow. Against this, it can be argued that the margin of slack foreseen as having developed by mid-1970 would be larger than any since 1964, and likely to stay substantial. In the past, price performance has been responsive to such changes in pressure, and it seems reasonable to look for a decelerating rate of price increase once a significant margin of slack has emerged. But much will depend on new wage agreements which will be more numerous in 1970 than in 1969.

CANADA: *Persisting cost and price pressures.* The persistence of unsatisfactory cost and price developments in the face of disinflationary demand management policies remains a major problem. Collective wage agreements recently concluded, and covering one to three years, greatly exceed expected productivity gains. This points to a further rapid rise of labour costs in the period ahead. In the longer run,

CHART A (cont.)

INDICATORS OF DEMAND PRESSURES IN SEVEN COUNTRIES 1965-1970

(estimates and forecasts)

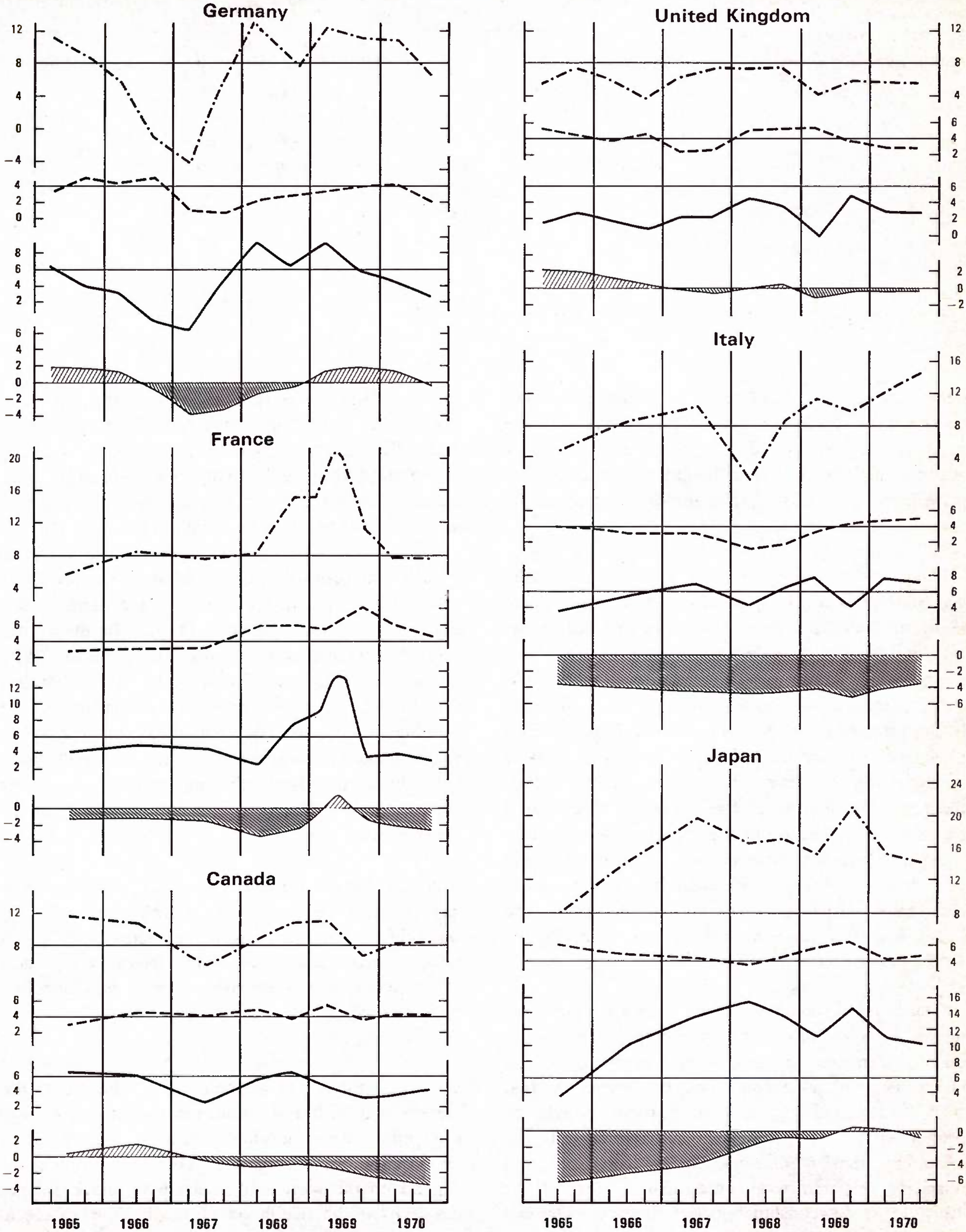


TABLE 7

Deflators of GNP at market prices

Annual percentage changes

	1958-67 Average (9 years)	1958-1968 Smallest annual rise	1958-1968 Largest annual rise	1968	1969 Forecasts	1970 Forecasts
United States	1.8	1.2	4.0	4.0	4¾	4
Canada	2.5	0.7	4.5	3.6	4½	4
Germany	2.9	0.7	4.3	2.2	3	4¼
United Kingdom	3.0	1.3	4.9	3.7	4¼	3
(at factor cost)	(2.9)	(1.7)	(4.0)	(2.5)	(3½)	..
Italy	3.8	–0.5	8.7	1.5	3¼	4¾
France	3.8	2.5	6.4	5.0	6½	5½
Japan	4.4	2.6	5.9	4.0	5	4¾
Total OECD	2.5	2.0	3.8	3.8	4¾	4¼

because of the close links between the two economies, Canada may benefit from an easier cost-price climate in the United States. But in the short run rapidly rising money incomes seem bound to lead to further price increases and, probably, some worsening of the current external balance.

UNITED KINGDOM: *Perhaps a return to past average rates of cost and price rise.* If earnings go on rising at about the present rate and output grows roughly in line with the estimated growth of productive potential—about 3 per cent a year—labour costs will continue to rise quite significantly; the increase is accentuated by higher rates of the Selective Employment Tax (which affects employment outside manufacturing industry) and of employers' social security contributions. The general price level seems likely to rise by at least the past average rate —lower than that experienced in the most recent past, but only because prices in the last two years have been pushed upwards by indirect taxes and higher import prices (the latter partly reflecting the 1967 devaluation).

GERMANY: *revaluation should help to reduce domestic price inflation.* The slightness of the acceleration of prices in the first half of 1969, despite faster rising home demand and the strong external surplus, reflected the continued rapid growth of productivity, the progressive absorption of the remaining margin of slack in the economy, and relatively few new wage agreements. Most of the acceleration in consumer prices between October 1968 and June 1969 resulted from changes in food prices. Producer prices have risen faster since mid-year. Current wage agreements point to an end of the stability of unit wage costs, especially since the scope for further increases in productivity is now limited. Without the revaluation, an abrupt acceleration in prices would have seemed certain. Even now, it is improbable that a period of sharply rising prices can be avoided, because of the demand and cost pressures which have built up. In the course of 1970, unit labour costs will still be rising. With the economy at capacity, rapidly rising nominal demand will spill over into both higher prices and a falling foreign surplus. But if, as seems possible, excess pressures ease rather quickly and competition from imports reduces the opportunity for raising domestic prices, the trend of prices should gradually become more normal.

ITALY: *Larger price increases in prospect.* New large wage settlements now in train may raise the wage bill by as much as 15 per cent in 1970. A rather sharp acceleration of unit costs in the short run, reflected in a faster rise in prices, may therefore be inevitable.

FRANCE: *A third year of fairly fast increases in domestic prices.* Developments in the next few months will be heavily influenced by the mechanical price effect of the devaluation and the lagged impact of domestic cost increases. Thereafter, much will depend on the wage settlements now under discussion. Given the likelihood of feedback from recent price increases and high demand pressures, increases in wage rates may be large enough to lead to a further fairly large rise in costs, in view of the small scope for increasing output. The general price level, though less affected than recently by changes in indirect taxation, could well rise fairly rapidly for the third successive year.

JAPAN: *Trends could moderate quite soon.* Although the economy has been operating near capacity in the past few years, unit labour costs and wholesale prices have remained relatively stable. This picture has not changed seriously, despite the renewed acceleration of economic activity which succeeded the short-lived pause in the first quarter of 1969. There has been some edging-up of unit labour costs in manufacturing and some increase of wholesale prices reflecting higher import prices and localised demand pressures. There could be some further acceleration in the rise of unit labour costs and the overall price level in the short run, but the previous moderate trend could be resumed soon as domestic and foreign demand becomes less buoyant.

It is evident from this survey that rather strong price pressures are likely in several of the major countries, especially in the early part of next year; and it must be uncertain at this stage quite how soon more normal performance will be restored, a question which arises most acutely perhaps for the United States and Germany. In the short run, the efficacy of demand management to deal with price increases once they have become manifest is limited.

TRADE AND CURRENT PAYMENTS

The trends in internal activity reviewed in the previous section will have important repercussions on the pattern of trade and payments. The growth of United States imports has already slowed down: it may decrease further before picking up again in the second half of 1970. The growth of United Kingdom imports should also continue to be moderate. More modest domestic demand trends should help to slow down the growth of imports in the case of France and to some extent in other members of the European Economic Community. The deceleration of imports into smaller European countries seems unlikely to be sharp.

The recent parity changes should exert an additional significant depressive effect on France's imports next year but boost Germany's significantly. (The effects on their exports—in terms of dollar values—are likely to be less.) The effects of the two exchange rate changes are likely, by and large, to cancel out for third countries. The net overall effect is, however, expected to be inflationary with German export prices particularly affecting smaller neighbouring countries.

OECD trade has continued to grow strongly in recent months, with little sign of any abatement up to the end of the third quarter. The whole year will probably see both imports and exports growing about 15 per cent, the fastest rate since the Korean war boom in 1951. Since trade grew rapidly in 1968 as well, the present boom will have seen OECD imports and exports grow much faster than in any other period of cyclical upswing since the early fifties.

In 1970 the growth of aggregate OECD imports, and hence also exports, may fall to about 10 per cent—on a year-to-year comparison. This would be well up to what could be regarded as a " normal " growth. But since trade has continued to grow so rapidly during 1969 the starting point is already high; from the second half of 1969 to the second half of 1970, total OECD imports and exports might grow only about 8 per cent—somewhat less than the long-term average (Table 8).

The check to the growth of trade is seen as developing within the next few months; but the timing depends to a large extent on the flow of imports to the United States, Germany and France. The trend in the second half of next year is also necessarily somewhat uncertain. Were, for instance, activity in the United States not then to pick up as

TABLE 8

Foreign trade of the OECD area[a]

Values, per cent changes, seasonally adjusted annual rates
Estimates and forecasts

	1968 \$ billion[b]	Average 1959-60 to 1966-67	From previous year 1968	1969	1970	From previous half-year 1969 I	1969 II	1970 I	1970 II
TOTAL[c]									
Imports	164.4	9.4	12.8	15½	9½	15.8	15¾	7	7¾
Exports	158.7	9.1	12.3	16	10	15.7	16½	8	7¾
INTRA-OECD									
Exports	111.0	10.6	13.8	17½	10¼	19.7	16½	8	9¼
EXTRA-OECD									
Imports	48.6	6.8	10.5	11	6½	8.4	13¾	4½	4
Exports	45.7	6.6	8.8	13	9	11.3	16¼	8¼	4
Memorandum item:									
Recorded figures[d]									
TOTAL[c]									
Imports	..	9.4	13.0	14¾	10	13.0	15¼	9¼	7
Exports	..	9.1	12.9	15	10½	12.4	16½	9½	7

a) Adjusted for statistical discrepancy in the recording of intra-OECD trade, and for the timing effects of the U.K. dock strike (late in 1967), of the French strikes (in 1968), of the U.S. dock strike (early in 1969), of the Italian strikes (in late 1969) and for the estimated shift between 1968 and 1969 of German imports and exports affected by speculation and the export tax.
b) Recorded figures.
c) Including trade with unspecified origins/destinations.
d) Adjusted for statistical discrepancy in the recording of intra-OECD trade.

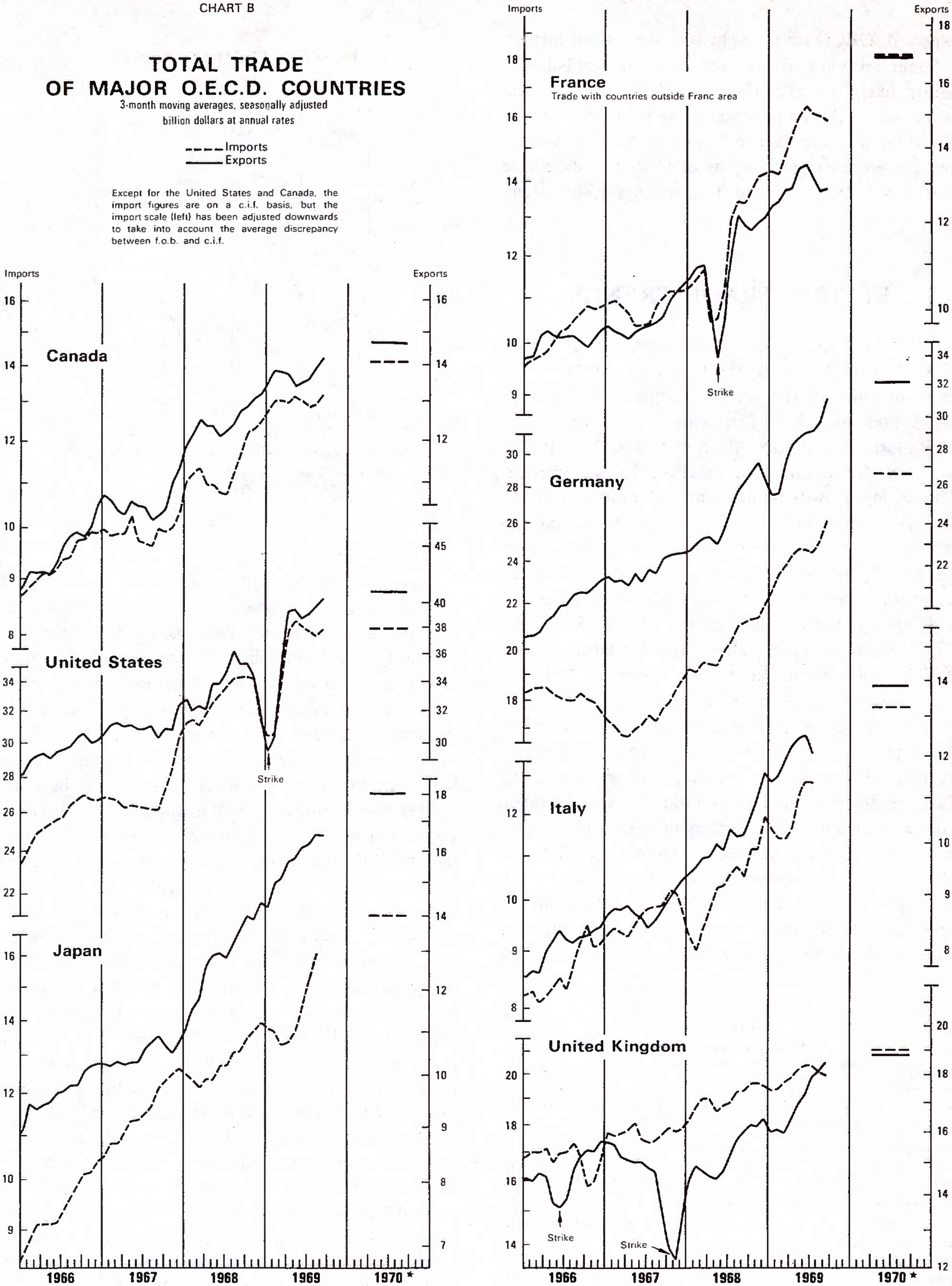
CHART B

TOTAL TRADE OF MAJOR O.E.C.D. COUNTRIES

3-month moving averages, seasonally adjusted
billion dollars at annual rates

- - - - Imports
——— Exports

Except for the United States and Canada, the import figures are on a c.i.f. basis, but the import scale (left) has been adjusted downwards to take into account the average discrepancy between f.o.b. and c.i.f.



★ Forecast annual level.

expected, OECD trade might well slow down further.

Some lessening of present payments imbalances seems likely to take place in 1970. The current accounts of the United States and of the United Kingdom, and also that of France, should strengthen; and the large current surplus of Germany should be greatly reduced, as should, to a much smaller extent, that of Italy.

RECENT TRADE TRENDS

There was hardly any deceleration of the growth of OECD trade up to third quarter of 1969. In most of Europe, the growth continued to be very rapid, and there were few signs of a slowing down of imports into North America (Chart B). It was too soon for devaluation to affect French imports. The strong growth of demand and output over the area as a whole was the main cause of the continuing rise in the volume of trade. But the lagged impact of domestic price developments on foreign trade prices was also affecting the growth of import and export values significantly (Table 9). Total OECD average export values in dollar terms—which rose by only one per cent a year between 1960 and 1967—may have increased in 1969 by 2 or 3 percentage points, after falling one per cent in 1968. Average values are a notoriously imperfect indicator of price movements in international trade and the data presented in the table should therefore be taken only as indicating broad orders of magnitude. They do, however, show an almost uniform acceleration of the rise of prices since the fourth quarter of 1968, noticeable at first on the export side but quickly reflected in imports. The relative price stability experienced during 1968 probably owed much to the British devaluation, which had led to a downward shift of prices (expressed in foreign currency) of U.K. imports and exports and, perhaps, to the after-effects of the 1967 recession in Germany. As inflationary pressures increased in North America and elsewhere, the combined influence of domestic price pressures in some countries and widespread demand pull, together with the German border tax changes, led to higher export prices for most countries of the area.

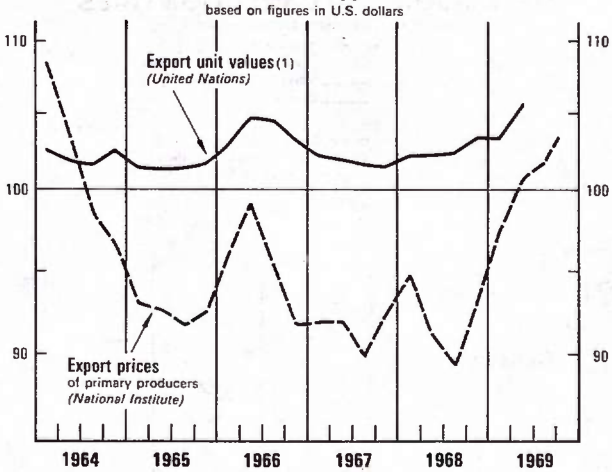
This was reinforced on the import side by rising primary product prices. In the 12 months to October the NIESR index of primary producers' export prices rose by some 13½ per cent. In part, this increase was due to the strength of non-ferrous metal prices, but prices of agricultural products rose by 10 per cent, reflecting in particular higher quotations for sugar, cocoa and rubber. Past evidence suggests only a loose connection between movements of commodity price indices, based on market quotations, and primary producing countries' export unit values. A large part of trade in primary commodities takes place at prices that are a good deal less volatile than those on free markets. Nevertheless, unit values tend to move in the same direction as prices, and the United Nations unit value index of total exports of non-OECD countries rose by 3 percentage points between the third quarter of 1968 and the second quarter of 1969—an exceptionally rapid movement in an index that is usually rather stable. (See Chart C.)

CHART C

PRIMARY PRODUCT PRICES

1963 = 100

based on figures in U.S. dollars



(1) Less developed countries *plus* Australia, New Zealand, and South Africa.

Sources: U.N., *Monthly Bulletin of Statistics*; National Institute, *Economic Review*.

TABLE 9

Export average values

Indices 1967 = 100. Estimates and forecasts

	1968 Q1	1968 Q2	1968 Q3	1968 Q4	1969 Q1	1969 Q2	II
United Kingdom	92.3	92.4	93.9	95.2	96.0	96.3	96½
United States	100.1	101.7	101.7	101.7	103.6	103.6	104¾
EEC	99.7	98.0	97.9	99.0	100.1	101.0	102
Other OECD	101.2	101.7	102.4	103.0	103.8	105.7	105½
Total OECD	99.5	99.3	99.6	100.3	101.5	102.4	103
Memorandum item:							
Total OECD import average values	101.9	101.9	101.4	101.7	103.2	103.8	104¾

The latest indicators, mainly price indices, show OECD trade prices still rising. The unit values of OECD imports from the rest of the world are probably increasing as well, and the continuing price inflation in North America and EEC countries is probably prolonging the rise in export prices. The net effects of the recent parity changes seem likely to reinforce these developments (see p. 27 below).

For 1969 as a whole, the growth of OECD trade is now put at 15-16 per cent, with a volume increase of 13-14 per cent. This implies a relatively strong growth of imports in the fourth quarter, notably in Germany and the smaller OECD countries, partly offset by a deceleration into the United States and little change in the level of imports into the United Kingdom and France.

TABLE 10
OECD real output and value of imports
Percentage change on previous year
Estimates and forecasts

	GNP	Imports
1960	4.5	12.5
1961	3.9	5.7
1966	5.6	11.2
1967	3.4	5.2
1969	5	15½
1970	3½	9½

TABLE 11
Imports of selected OECD countries or areas
Annual percentage changes ; estimates and forecasts

	1959-60 to 1966-67	1967 to 1968	1968 to 1969	1969 to 1970
United Kingdom[a]	5.3	5.8	5	7
United States	8.2	23.5	8½	5
France	11.4	12.7	24½	5
Germany	9.7	16.1	23½	16
Italy	12.4	4.3	19	23
Belgium-Luxembourg	10.1	15.9	20	9½
Netherlands	9.9	11.4	17½	10
Other OECD countries	10.6	9.0	14½	12

a) Excluding purchases of U.S. military aircraft.

OECD IMPORTS IN 1970

The growth of OECD imports is expected to slow down quite sharply. It may, however, remain faster than in previous cyclical downturns, such as those of 1961 and 1967, even though the growth of total output in the area is not expected to be very different from what it was then (Table 10). The very high starting point is one reason for the difference; import growth during 1970 is put at only 8 per cent. Another is the fact that the deceleration in United States imports may not be as pronounced as that witnessed in 1967—when there was a big downward stock adjustment. A third reason is that the rise in import unit values may be high between 1969 and 1970, with the effects of the Deutschemark revaluation more than offsetting those of the franc devaluation, and the likely decline in primary commodity prices not being reflected in import unit values until late in the year. Nonetheless, a slower rise of demand in the United States and in virtually all European countries is likely to dampen the growth of the volume of imports.

The following developments are expected for major countries:

FRANCE: *A very sharp deceleration of imports.* This is the consequence of the disinflationary monetary and fiscal measures and the devaluation. The hypotheses underlying estimates of devaluation effects are of necessity very tentative and subject to large margins of error—as shown by most of the import forecasts made for the United Kingdom following the November 1967 devaluation. It has been assumed that response elasticities would gradually increase from very low values (—0.1 in the second half of 1969) to near unity (at least for manufactures) by the second half of 1970.[1] Combining these elasticities with the assumed actual and relative increases in import prices suggests that devaluation by itself will reduce the value of imports, in terms of foreign currency, by some 1 per cent in 1969 and a further 3½ to 4 per cent in 1970. This, together with the assumed dampening of the growth of domestic demand, accounts for part of the sharp deceleration of French imports in 1970 shown in Table 11. But the forecast incorporates the further

1. See below, p. 27 for a more detailed discussion of the effects of the parity changes.

assumption that the very high level of French imports in 1969 owed something to speculative factors, and that a progressive return of confidence will lead to the disappearance of such factors in 1970. This adds to the margin of uncertainty in the forecast.

GERMANY: *Rapid, but nevertheless decelerating, import growth.* This forecast, also, is necessarily tentative. The revaluation can be thought of as having been partially in effect for most imports since the introduction of the border tax measures, so import propensities will already have been shifted somewhat upwards. In foreign exchange terms, revaluation effects, relating to the net new change, have been put at an extra 1 per cent on the annual value of imports in 1969—mainly a price effect—and a further 3-3½ per cent in 1970. But the expected easing of excess demand pressure on the domestic economy—itself partly brought about by the revaluation—has also to be taken into account. This must be expected gradually to lead to a more normal growth of demand for imports after the very fast rise during the past two years of cyclical upswing. The net effect in 1970 seems likely to be a further substantial increase in German imports but at a less exceptional rate than this year.

ITALY: *A further sharp rise of imports.* This is linked with continued strong growth of domestic output. The pace may be affected by the wave of strikes in the autumn of 1969, but the underlying trend is assumed to accelerate.

BELGIUM AND THE NETHERLANDS: *A considerable slackening of import growth.* Disinflationary policy measures have been in force for some time now and a less buoyant export picture in most of their markets may also dampen domestic growth.

UNITED STATES: *Rather slow growth of imports.* Trends have been blurred in the last year and a half by the effects of actual or threatened strikes. On an underlying basis it has been estimated that U.S. imports will have grown by some 10 per cent in 1969 and will rise by only 4 per cent next year. [1]

1. This deceleration is partly hidden in the total figures, shown in Table 11, by imports of automotive equipment from Canada, exceptional steel and copper imports in 1968, and the once-and-for-all loss of U.S. imports in 1969 caused by the dock strike. At present this loss does not appear to have been very large and has been tentatively put at some ½ per cent of a year's imports.

TABLE 12

Foreign trade of selected smaller OECD countries

Values, per cent changes ; forecasts

	Imports		Exports	
	1968 to 1969	1969 to 1970	1968 to 1969	1969 to 1970
Austria	13½	13	20	10½
Denmark	17	7	15	8
Finland	21½	15	17	9
Norway	6	12½	15	5
Spain	18	13	23	12
Sweden	15	10	15	7½
Switzerland	15	15	15½	9
Memorandum item:				
Norway (excluding ships)	14½	8	16	11

This estimate is based on a relatively smooth development of domestic demand. The forecast assumes that the buying habits which have developed during the past two years or so will be only partly reversed when domestic pressures ease. Thus import propensities are forecast to remain relatively high by earlier standards—though imports still meet only a small fraction of total demand. A significant absolute fall in domestic demand, or a more prolonged period of stagnation, might weaken this assumption.

JAPAN: *Little change in the year-to-year growth rate for imports.* Japanese imports, low at the beginning of 1969, recovered very sharply in the third quarter of the year. This probably reflected a more normal stock development. The 1970 outlook, for relatively slow import growth through the year, still implies a rather high year-on-year increase. Despite the continuing strength of domestic activity, the behaviour of Japanese imports over the last few years [2] does not, at present, warrant a more buoyant forecast.

UNITED KINGDOM: *Continued slow growth of imports.* The small rise in 1969 has been mainly due to higher prices. The lack of growth of the volume of imports corresponds with the lack of growth of aggregate demand, at least in the first half

2. See the OECD's 1969 *Annual Survey* of Japan (pp. 18-25) for an analysis of recent import trends.

of the year. Some effect may also have come from the import deposit scheme. In view of the continuing restrictive business climate foreseen, only a moderate growth of imports is forecast. Prices are expected to rise less and deliveries of U.S. military aircraft are due to be almost completed.

Most of the other OECD countries have been experiencing above-average import growth in 1969. The policy measures taken to restrain demand in several of them, together with the expected deceleration of the growth of exports (see below) should reduce pressures on domestic capacity and import demand in 1970 (Table 12). This may be particularly marked in Denmark, where the trade deficit in 1969 is likely to be a record; the growth of imports into Sweden and Norway may also slow down. (In Norway, however, imports of ships are expected to increase considerably after two low years.) Austria and Switzerland, on the other hand, may see their imports increasing, by value, as fast as in 1969, partly because they depend on Germany as a major supplier and are, therefore, likely to be faced with higher import prices.

OECD TRADE WITH NON-OECD COUNTRIES

Non-OECD countries' exports to the OECD area have been on a strong upward trend for just over two years and their own import demand (as measured by OECD exports to them) has increased even more rapidly since the beginning of 1968. The trade surplus of the OECD area has, therefore, increased sharply over the last eighteen months and is probably now at a seasonally adjusted annual rate of some $ 4½ billion, well above the average of the 1960's ($ 2½ billion). In the past, such a development would have run into increasing financial difficulties in primary producing countries and been rapidly followed by a cut-back of their import demand. The present situation, however, seems different. Table 13 shows that, despite the considerable worsening of their trade position, most primary producing countries have increased their foreign exchange reserves quite substantially since end-1967.

The scanty information available for recent months shows no sign of this situation changing (Chart D). The inference is that capital outflows from the OECD area must have stayed high despite the tightening of monetary conditions. But the explanation of the apparent upward shift in the financing capacities of non-OECD countries is uncertain and so are the chances of its continuing.

It has been tentatively assumed for the present forecasts that capital outflows may not be fully maintained, but that the effect of any reduction would be mitigated by:

i) The possibility of increased disbursements by multilateral aid organisations from existing resources;

ii) The activation of the SDR scheme which could, other things being equal, finance a steep increase in primary producers' imports;

iii) The fact that reserves are now larger than they have been and could therefore cover a larger swing in the trade balance than has been possible in the past.

For these reasons, the expected deceleration of OECD purchases from the rest of the world is expected to lead to a weaker lagged effect on purchases from OECD countries than could have been expected on the basis of past links between the export proceeds and import demands of primary producers.

The countries most likely to have to react to a deceleration of OECD import demand are those in Latin America, Africa and Asia (apart from South-East Asia) whose reserve increases have been relatively modest. These have, in the past, tended to be

TABLE 13

Changes in primary producers' trade balance with the OECD area and in reserves[a]

1967 II to 1969 I ; $ billion ; estimates

	Change in trade balance (seasonally adjusted)	Change in reserves[b]
Total	–1.27	3.58
Developed primary producers	0.12	1.34
High reserve countries	–0.31	0.58
Latin America	–0.41	0.60
South-East Asia	–0.73	–0.10
Other Afro-Asian countries	0.05	1.15

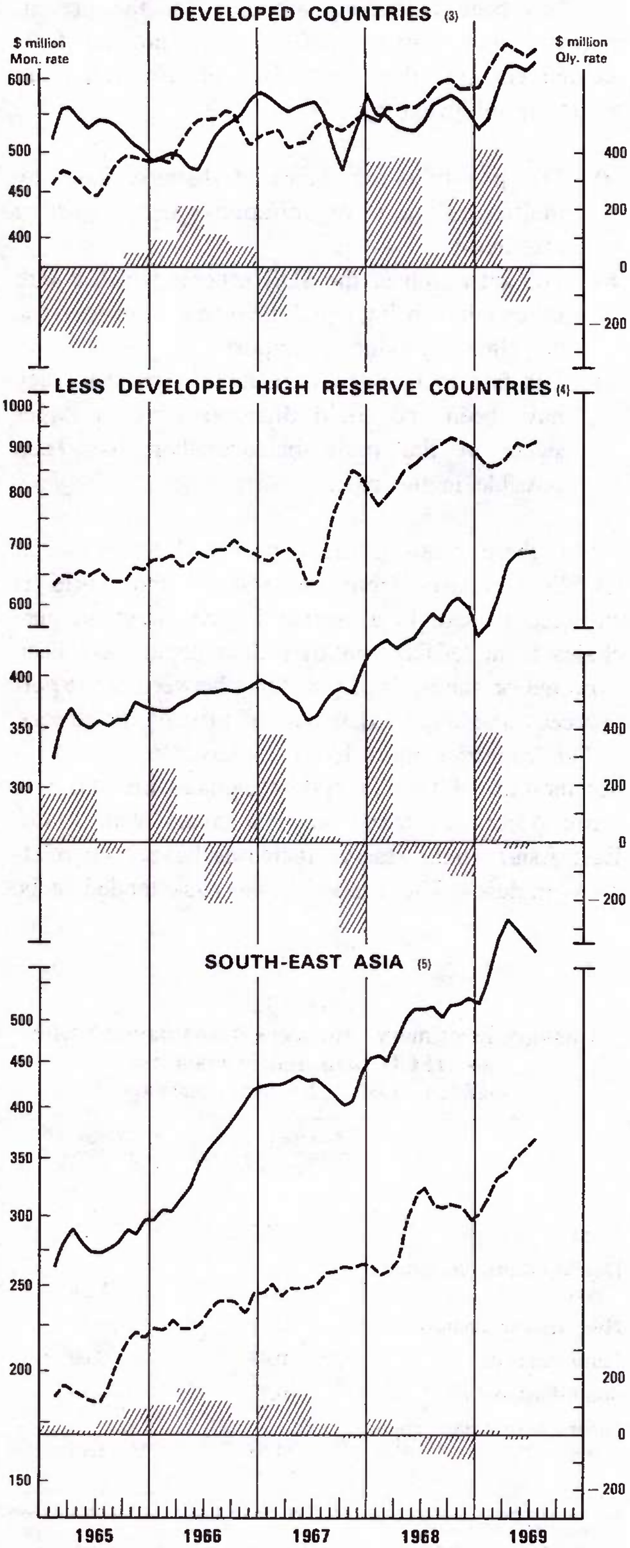
a) For composition of the areas, see footnote to Chart D. Reserves include net IMF position.

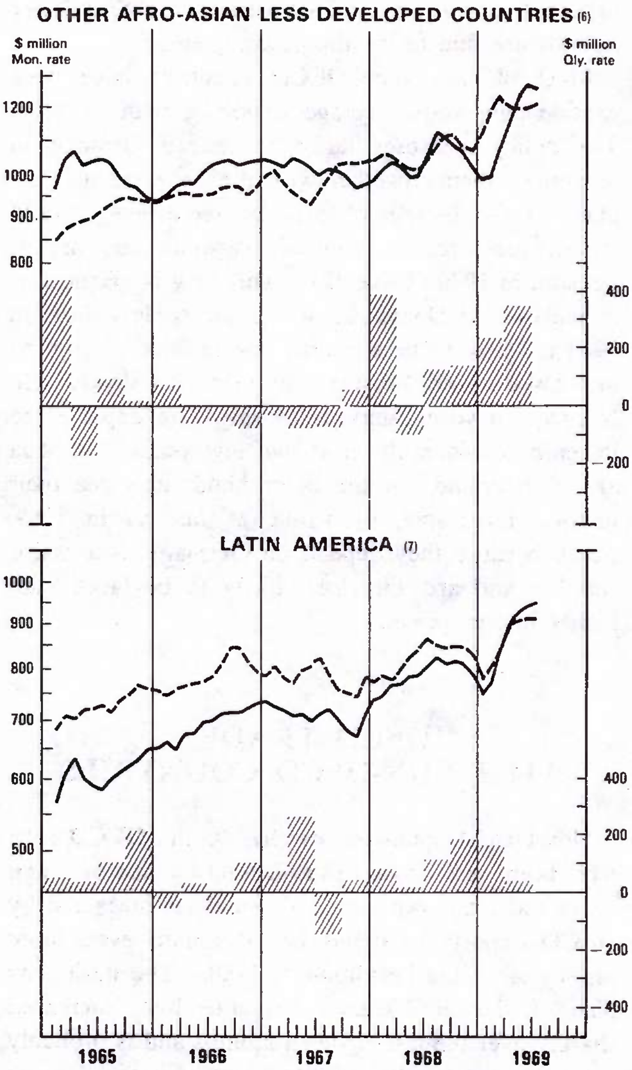
b) End-1967 to mid-1969.

CHART D

O.E.C.D. TRADE WITH PRIMARY PRODUCING COUNTRIES AND PRIMARY PRODUCERS' RESERVES

Adjusted for seasonal variations
3-month moving averages





KEY

- ——— O.E.C.D. exports to region (1) } left scale
- – – – O.E.C.D. imports from region (1) } left scale
- ////// Change in region's reserves (2) right scale

NOTES

1. O.E.C.D. exports and North American imports are f.o.b. Other O.E.C.D. imports are c.i.f.
2. Including net I.M.F. position. Fourth quarter 1967 data are not adjusted for the change in the dollar value of sterling area countries' reserves due to the devaluation of the pound.
3. Australia, New Zealand, South Africa.
4. Bahrain, Iraq, Israel, Kuwait, Lebanon, Libya, Malaysia, Saudi Arabia, Singapore, and Venezuela.
5. Cambodia, Formosa, Hong Kong, Laos, Philippines, South Korea, South Vietnam, and Thailand.
6. Including Yugoslavia.
7. Excluding Venezuela.

the most sensitive to cyclical fluctuations in industrial countries and any reduction of U.S. aid disbursements would affect them more than other countries. South-East Asian countries, on the other hand, can be expected to continue increasing their imports very rapidly, despite the probable levelling-out and possible fall of U.S. military expenditures in the area. Rapidly rising demand is also expected in Australia and South Africa.

OECD EXPORTS IN 1970

The forecast deceleration of imports by non-OECD countries, and slower United States growth, will face both Japan and Canada with a more unfavourable growth of export markets in 1970 (Table 14) than other countries are likely to experience. The Netherlands and France may benefit from better export markets than most other countries since Germany is so important a market for both (especially for The Netherlands), and France also has a high share in the booming Italian market. For most other countries market growth is expected to be relatively close to the average for the area as a whole—some 10 per cent. Apart from the United States, exports of all countries are likely to rise less in 1970 than in 1969.

FRANCE: *Not much slowing down in export growth.* French export prices were not far out of line before the devaluation. The immediate effect of the latter was a reduction of the dollar value of that part of French exports made under franc-denominated contracts. As exporters adjust their franc prices upwards, however, the fall in dollar export unit values is expected to remain small (see below). On the other hand, exporting has become rather more profitable, and by mid-1970 it is expected that significant gains in market shares (even in dollar terms) will be scored as a result of the devaluation.

TABLE 14
Relative export performance
Percentages ; estimates and forecasts

	Growth of markets and growth of exports						Total market gains or losses[d]		
	1968 to 1969			1969 to 1970			Average		
	Growth of country's export markets a b	Growth of country's exports a	Growth of country's recorded exports c	Growth of country's export markets a b	Growth of country's exports a	Growth of country's recorded exports c	1959-60 to 1966-67	1968 to 1969[a]	1969 to 1970[a]
United Kingdom	15¾	14	12½	10½	9	..	–3.1	–1¾	–1½
United States	14½	9¾	9½	9¾	9¾	10	–1.5	–4¾	0
France	16½	17¾	..	12	14	..	2.1	1¼	2
Germany	17¼	19	15¾	10½	10½	12	0.5	1¾	0
Italy	18½	19	17	10½	13	16½	4.7	½	2½
Belgium-Luxembourg	20¾	21½	..	11	9½	..	0	¾	–1½
Netherlands	19¾	19	..	12	10	..	–0.5	–¾	–2
Canada	11½	10½	..	8	6	..	–2.6	–1	–2
Japan	13¾	24	..	8	13	..	7.2	10¼	5
Other OECD North	15½	15½	..	10½	8	..	–0.3	0	–2½
Other OECD South	15¾	18¼	..	10	9	..	1.1	2½	–1
Total OECD	16	16	15	10	10	10½	..	..	..

a) Adjusted for the effects of the U.K. and U.S. dock strikes, for the acceleration in German exports at end-1968, and for the Italian strikes at end-1969.

b) The growth which would have occurred in a country's exports if it had exactly maintained its share in total OECD exports to each of 15 broad geographical areas. The figures are adjusted for certain special factors such as U.S.-Canadian trade in cars under the Ottawa Agreement.

c) Given only in cases where the figure differs from that in the previous column.

d) The difference between the growth rates of markets and (adjusted) exports, i.e. a measure of the extent to which countries gain (+) or lose (—) market shares in total OECD exports.

GERMANY: *A progressive deceleration of exports.* The short-run price elasticity for German exports is probably fairly low, judged by experience following the 1961 revaluation.[1] Since it is not expected that German exporters will absorb much of the effect of revaluation in their export prices, the value of German exports has been forecast to rise faster in the immediate future than it would otherwise have done. In the longer run, however, higher prices will reduce the export volume and some net adverse effect on German export earnings may develop during 1970. Together with high (though easing) domestic demand pressures, this could lead to no gain in market shares in 1970, instead of the more usual fairly small gain.

All in all, the combined short-term effects on export performance of the two recent parity changes may not affect third countries very significantly. The commodity composition of German and French exports is rather different, however, and the effects on individual third countries will depend not only on the geographical, but also on the commodity, composition of their exports.

UNITED KINGDOM: *Continuing above-trend export growth.* The expected loss of shares in both 1969 and 1970 is well below the longer-run average. This assumes that the 1967 devaluation, if with a lag, is giving a substantial fillip to British exports. The forecasts do not include allowance for a reduction in the under-recording of exports that is now known to have been taking place. To the extent that this is eliminated, the recorded growth of U.K. exports on a customs basis will be higher, other things being equal, than forecast in Table 14.

UNITED STATES: *Fairly moderate underlying export growth.* The dock strike early in 1969 caused a sizeable once-for-all loss of U.S. exports. The present tentative estimate of this loss is put at 2½-3 per cent, similar to the estimate for 1965 when the strike was shorter but re-routing by air less common. The apparent " performance " in 1970 will be automatically boosted as exports come back to their normal levels. A further element likely to increase the U.S. gain in market shares in 1970 is the expected large deliveries of commercial aircraft. On the other hand, the recent price performance of the economy may have some negative effect on sales abroad, and exports of agricultural commodities may continue to fall. The latter have now been on a downward trend since mid-1966, with wheat most affected. The main factors seem to be the reduction of aid programmes (e.g. PL 480), increased foreign competition and/or protection, and improved harvests in less developed countries. The relative weight of these factors and their possible future development are, however, difficult to gauge.

JAPAN: *Much slower export growth.* In the last two years Japan has enjoyed very large gains of market shares. The once-for-all loss of United States exports as a consequence of the dock strike may have benefited Japan to some extent, but a more important factor is probably the commodity composition of U.S. import demand in periods of rapid domestic growth. The demand for semi-manufactures and for consumer goods is probably then of the more dynamic elements in United States imports and the Japanese economy is well suited to take advantage of it. Conversely, in years of slower U.S. growth, Japanese export performance was less remarkable; in 1961, when U.S. imports fell slightly, Japan had only a very small gain of market shares (+ 1.7 per cent) and in 1967 almost no gain at all (+ 0.2 per cent). In view of U.S. prospects and the relatively strong demand pressures within Japan, Japanese gains in 1970 may be below the longer-run average, unless the experience of the past two years indicates a new change in the Japanese competitive position.

CANADA: *An underlying improvement in exports.* Almost the opposite pattern seems to apply here. Canada supplies across the border a large proportion of raw materials whose share in U.S. imports tends to remain nearly constant in periods of slow growth, but falls sharply when U.S. demand is buoyant. Thus Canada's export performance in the sense of this calculation was poor in 1965, 1966 and 1968, but well above average in 1967. The relatively favourable performance in 1969 is largely artificial; exports (and imports) appear to have been boosted at the beginning of the year by trade destined for the United States which was re-channelled through Canada to avoid strikebound ports. On an underlying basis, Canada's performance in 1969 has probably been much less satisfactory, and an improvement is implied for 1970.

1. See OECD, *Economic Outlook*, No. 4, December 1968, p. 54.

TABLE 15. Effect of parity changes underlying the trade forecasts

Percentage changes, actual rates

	France						Germany					
	Imports			Exports			Imports			Exports		
	1969 I to 1969 II	1969 I to 1970 I	1969 I to 1970 II	1969 I to 1969 II	1969 I to 1970 I	1969 I to 1970 II	1968 II to 1969 II	1968 II to 1970 I	1968 II to 1970 II	1968 II to 1969 II	1968 II to 1970 I	1968 II to 1970 II
1. Prices in foreign currency	–1¼	–¾	–¾	–4½	–2½	–2½	3¼	5½	5½	4¼	6¾	6¾
2. Prices in domestic currency	9	11¾	11¾	5	9¾	9¾	–1¼[b]	–3½	–3½	–¼	–2¼	–2¼
3. Relative price change[a]	7¾	10	10	–4½	–2½	–2½	–2¾	–3	–3	3¼	5	5
4. Price elasticity	–0.1	–0.3	–0.5	–0.3	–1.1	–1.8	–0.2	–0.4	–0.7	–0.5	–0.8	–1.4
5. Volume change	–¾	–2¾	–5¼	1¼	3	4¾	½	1¼	2	–1½	–4	–7¼
6. Value in foreign currency	–2	–3¼	–5¾	–3½	½	2¼	4	6¾	7½	2½	2½	–1
Less: Effect of 4 per cent border tax on foreign currency values							2	2½	3	1¾	1¼	¼
Equals: Net revaluation effect							1¾	4¼	4½	1	1¼	–1¼

a) Due to devaluation effects only.
b) At border. The price fall for the domestic purchaser is 2 per cent lower in view of the partial rebate of TVA on imports.

Table 15 shows the results of Secretariat calculations of the possible impact of parity changes on foreign trade flows of France and Germany. The figures are the product of a complex—although inevitably arbitrary—sequence of assumptions about price changes and response elasticities for various categories of commodities and various regional groupings. In particular, bilateral German-French flows have been analysed separately, in view of the much larger size of the parity change affecting them.

Line 1. It has been assumed that French exporters reduce their foreign currency prices only slightly to foreign buyers and that German exporters raise theirs by most of the extent of the revaluation. Such assumptions appear plausible in the light of the prevailing world trade climate and seem to be confirmed by scattered press information on firms' price behaviour. For Germany, there is a precedent in the responses of German exporters to the 1961 revaluation; such a response is probably facilitated by the commodity composition of exports, notably the importance of investment goods, for which demand elasticities are probably low. For France, further factors suggesting the probability of small foreign price cuts (large increases in franc terms) are that export profit margins may have been squeezed somewhat since mid-1968 and the lack of strong evidence that French export prices had become uncompetitive by the time of the devaluation. High levels of domestic demand in both countries are assumed to lead to similar effects on foreign currency import prices—only a small cut is forecast for France and a fairly large increase is assumed for Germany. (Thus for both countries little change in the terms of trade—adverse for France, favourable for Germany—is implied).

Line 2. Shows the same price assumptions expressed as changes in terms of domestic currency.

Line 3. Figures for relative price changes refer to the effects of parity changes alone, abstracting from other movements in domestic and foreign prices which are incorporated in the basic "pre-parity change" forecasts. For imports, they represent the difference between the assumed change in import prices in domestic currency and the direct effect of this change on internal prices (+ 1½ per cent in France, — ½ per cent in Germany in 1970). For exports, they represent the difference between price changes by French and German exporters and other countries' reactions to them in export markets—for France it has been assumed that third countries would cut export prices slightly, but that this reaction would be swamped by the increase in German export prices; for Germany the rise in other countries' prices (net of lower French prices) was put at 1½ per cent.

Line 4. The elasticity assumptions are very uncertain. The difficulties in estimating the relevant elasticities are well known. Most existing estimates of price elasticities are based on time series in which relative price movements are very small. They may, therefore, not have much relevance to the possible impact of the relatively large price changes that follow parity changes, or give much indication of the time pattern of responses. In view of the commodity composition of imports and exports of the two countries, lower final values are given to import than to export elasticities. Both reach their full value fairly quickly. By the end of 1970, at least for exports, the elasticities are assumed to be not far from longer-run equilibrium values. The calculations for Germany incorporate the assumed effects of the former special arrangements rebating some TVA tax on imports and allowing less than full remissions on exports. Since it is thought that response elasticities increase over time, the existence of the tax measures for some nine to ten months before the revaluation contributes to the assumption of moderately larger effects than would have been warranted in the short-run if there had been a single change. The estimated net effects of the revaluation are shown at the bottom of the table as the difference between the assumed total effects and the effects that would have been assumed for the border taxes, had they alone been operative in the forecast period.

The net effect on France in 1970 of the devaluation is put at a reduction of the foreign exchange value of imports of some 3½ per cent coupled with an increase in that of exports of 3 per cent. Adding a gain in invisibles of $ 150 million, this gives a total gain on current account of just over $ 1 billion, of which some $ 950 million reflects transactions with non-franc countries. The net effect of the revaluation on German exports in 1970 is very small (— ½ per cent in foreign exchange value) since the effects of higher foreign currency prices and lower volumes are very nearly offsetting. The foreign exchange value of imports is assumed to be increased by some 3½ per cent. Together with a $ 200 million increase in the invisible deficit, this results in a reduction of the current surplus of just over $ 1 billion.

The geographical distribution of French and German current transactions suggests that the effects of the parity changes on current balances of most other countries are unlikely to be very large The net effect on world trade prices is an increase. Price increases assumed to be caused by the German revaluation are larger than the price falls assumed to flow from the French devaluation and they relate to a much larger body of trade. Countries with strong trade links with Germany stand to be particularly affected by German price increases and by the greater pull of German import demand.

ITALY AND THE BENELUX AREA: *Slower export growth than in 1969.* Export performance is forecast to be below longer-run averages, reflecting the expected domestic conditions. The growth of Italian exports may, however, be boosted by the cessation of losses caused by the 1969 strikes. Any benefit in third markets from the German revaluation will probably be small since German exports, composed mainly of investment goods, compete more directly with American and British products than with those of other EEC members. The French devaluation, on the other hand, may lead to some substitution of French exports at the expense of Italian and Benelux sales.

Export results in 1969 have been rather favourable for the smaller countries of the OECD area. Several of them have recorded gains in market shares, contrary to longer-run trends. Rising demand in North America and in the EEC coincided with a period of relatively low pressure on capacity in the smaller countries consequent upon the restrictive policy measures they took in 1967. A phase of export-led growth therefore developed. In recent months, however, the growth of imports has outstripped that of exports. In these conditions it can be expected that in 1970 export performance of most of these countries may worsen; domestic demand and price pressures will react only with a lag to the tightening of domestic policies which has been taking place and to the deceleration in export sales themselves. Some deceleration is also expected in export growth of the southern countries of the area, as the benefits to Spanish exports of the peseta devaluation in 1967 begin to wear off.

CURRENT INVISIBLES

The main factors affecting the development of invisible transactions in 1969 were:

i) A renewed growth of tourism, following the relative stagnation in 1967 and 1968;

ii) Buoyant investment income flows, as a result of high interest rates and large capital flows;

iii) A rapidly rising volume of transactions on transportation account, in line with the growth of world trade, partly offset by a falling back of freight rates from the exceptional levels attained after the Suez Canal closure.

TABLE 16
Current invisibles, 1968 to 1970 and longer-run trends
$ billion, estimates and forecasts

	Average 1960-63	Average 1964-67	1968	1969	1970
United Kingdom *a*	0.49	0.48	0.90	1.25	1.35
United States *a*	–2.37	–1.14	–0.91	–1.25	–0.90
RESERVE CURRENCY COUNTRIES	–1.89	–0.66	–0.01	0	0.45
France *b*	0.41	0.10	–0.84	–0.55	–0.35
Germany	–1.66	–2.72	–2.84	–3.40	–4.00
Italy	1.08	1.56	1.59	1.95	1.90
Belgium-Luxembourg	0.06	0.02	0.06	0	–0.05
Netherlands	0.49	0.51	0.39	0.40	0.40
TOTAL EEC	0.39	–0.53	–1.64	–1.60	–2.10
Canada *a*	–1.31	–1.47	–1.79	–1.90	–1.95
Japan	–0.40	–1.05	–1.48	–1.60	–1.80
Other OECD North	1.15	1.51	1.82	2.00	2.25
Other OECD South	0.98	1.91	2.12	2.40	2.70
TOTAL OECD	–1.08	–0.28	–0.98	–0.70	–0.45

a) Data include waived debt obligations payable by the United Kingdom to the United States and Canada (1964, 1965 and 1968).

b) Transactions with non-franc countries. See note to French Balance of Payments Table on page 80.

For most countries, the effects of these factors have been at least partially offsetting, and few substantial changes seem likely in invisible balances between 1968 and 1969 (Table 16). The main feature may be a worsening of perhaps $ ½ billion in Germany's balance (travel expenditure and foreign workers' remittances having increased even more than investment income receipts),[1] and an improvement of rather more than $ ½ billion in the balance of the Mediterranean countries, including Italy, which are the main beneficiaries of the recovery of tourism and emigrants' transfers. Italy, which up to 1967 had a net deficit on investment income, has also been reaping some income benefits from its increasing capital outflows. The rise of net receipts may have been less than usual for the smaller Northern European countries as a result, in particular, of lower freight rates. The United Kingdom seems likely to show an improvement of $ 0.3-0.4 billion, with strongly increasing investment income receipts only partially offset by growing debt-service charges. The United States balance may

1. The latter may hide some element of speculation, with foreign-owned companies repatriating fewer profits and German-owned firms abroad accelerating remittances to parent companies.

worsen by about the same amount, as rapidly rising interest payments on Euro-dollar borrowing outweigh another strong rise in income receipts. For France, published figures are likely to show a sizeable improvement, but largely because the 1968 figure—which is on a settlements basis—may have included a substantial element of disguised capital outflow and accelerated transfer payments and was also adversely affected by loss of tourist income.

For 1970, some improvement is forecast in the United States balance. Overseas military expenditure may begin to fall. Investment income receipts should continue to grow steadily and payments have been forecast to level off, influenced, among other things, by the assumption of less borrowing in the Euro-dollar market and lower average interest rates. For the United Kingdom, the considerable boost to the invisible account given by devaluation is assumed to have worked itself through, and only a small further improvement is expected. The German account will probably continue to worsen substantially, for much the same reasons as in 1969; revaluation will tend to reinforce this development. Little change is expected for Italy; receipts should continue to grow, but debit items, in particular transportation payments and Italian travel abroad, also seem likely to increase considerably. The French devaluation is likely to mitigate the relatively strong trend towards deterioration of most service items while growing receipts from the EEC agricultural fund should boost the transfer account. The smaller northern countries of the area should resume, and the smaller southern countries continue, their positive trends, while Canada and Japan are expected to continue to show worsening balances. In the latter case some benefit may, however, come from visitors to the Osaka Expo-1970.

CURRENT BALANCES

Thanks partly to the parity changes of the past two years, and partly to relative cyclical positions, 1970 is likely to see substantial progress in the direction of current account aims of individual countries (Chart E and Table 17).[1] This will be facilitated by the fact that non-OECD countries as a group seem likely to run a record current deficit. The fact that so large a deficit may not be sustainable, over the longer-run, without a large upward shift in

1. These were discussed in *Economic Outlook*, No. 5.

TABLE 17

Current balances, 1968 to 1970 and longer-run trends

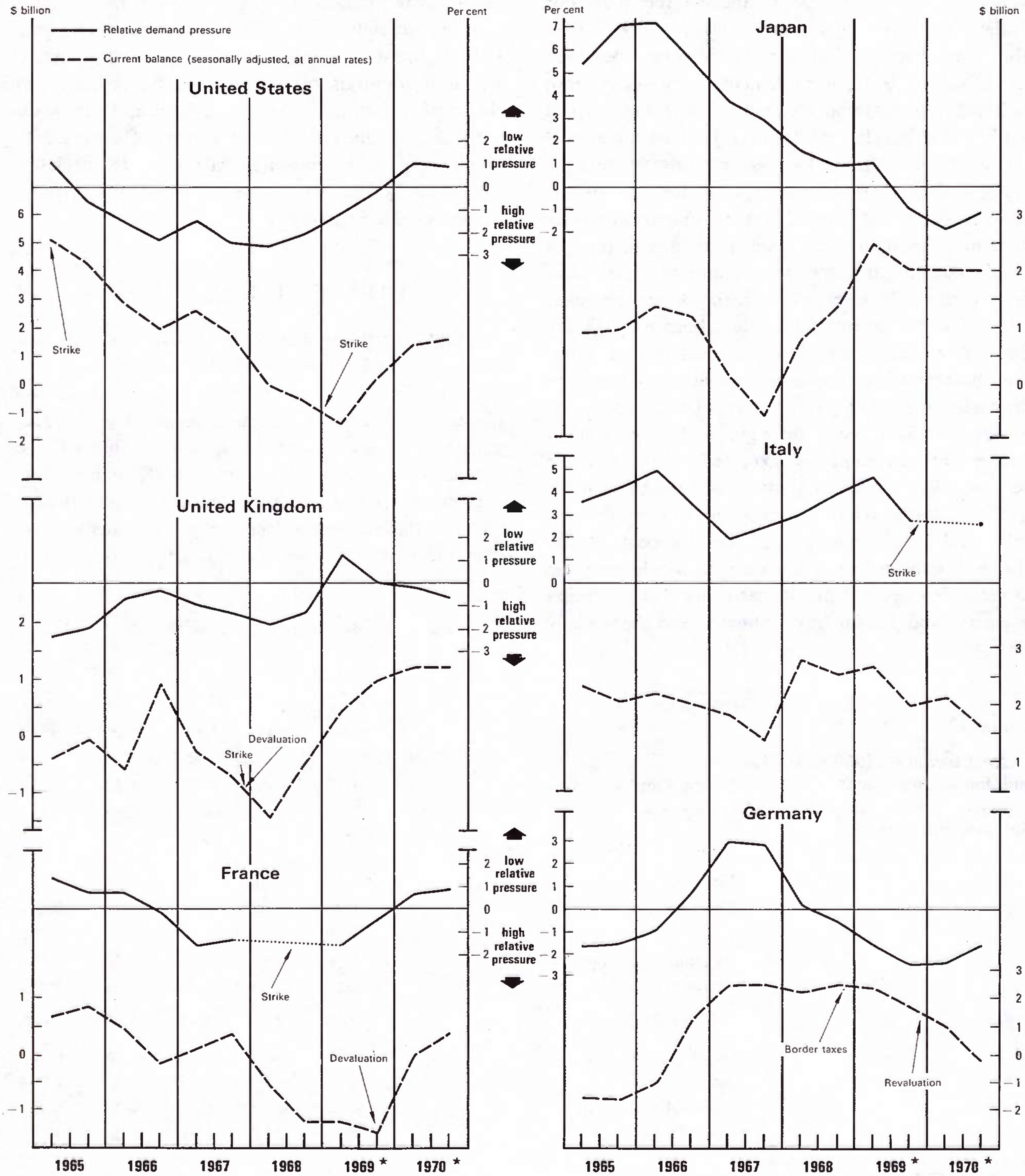
$ billion
Estimates and forecasts

	Average 1960-63	Average 1964-67	1968	1969	1970
United Kingdom	–0.03	–0.48	–0.72	0.70	1.20
United States	2.70	3.75	–0.28	–0.60	1.50
RESERVE CURRENCY COUNTRIES	2.67	3.27	–1.01	0.10	2.70
France[a]	0.80	0.27	–0.86	–1.30	0.20
Germany	0.43	0.25	2.84	1.50	0.40
Italy	0.10	1.64	2.64	2.45	1.80
Belgium-Luxembourg[b]	0.06	0.15	0.29	0.35	0.35
Netherlands	0.20	–0.10	0.06	0.15	0.05
TOTAL EEC	1.59	2.21	4.97	3.15	2.80
Canada	–0.86	–0.75	–0.09	–0.65	–0.75
Japan	–0.42	0.38	1.05	2.20	2.00
Other OECD North	–0.59	–0.90	0.10	0.25	–0.40
Other OECD South	–0.12	–0.58	–0.48	–0.50	–0.65
TOTAL OECD	2.27	3.63	4.55	4.55	5.70
Adjustments[c]	–0.5	–0.5	–0.8	–0.6	–0.3
OECD CURRENT BALANCE WITH REST OF WORLD	1.8	3.2	3.7	3.9	5.4

a) Transactions with non-franc countries. See also note to French Balance of Payments Table on page 80.
b) Secretariat estimates on a transactions basis.
c) For inconsistencies in recording of intra-OECD transactions.

CHART E

RELATIVE DEMAND PRESSURES AND CURRENT BALANCES



* 1969 2nd half and 1970: forecasts.

Note: Relative demand pressure for a given country is defined as the difference between the measure of demand pressure shown in Chart A above for the country itself and the average of such measures in partner countries reweighted by their shares in the trade of the given country. Current balance figures have been adjusted for the United States dock strike in early 1965 and for the other shifts in trade flows enumerated in footnote *a* of Table 8 above.

the OECD area's capital flows to the rest of the world (see page 23), needs to be borne in mind when assessing the sustainability of the balance of payments positions at present forecast for next year.

In the United States, the continuance of disinflationary policies developed over the past one and a half years should result in a year of significantly reduced demand pressures. In these conditions, some return to surplus on current account seems likely. However, the United States current balance has deteriorated considerably over the past three years (Chart E) and it does not seem likely to return in 1970 to the levels reached in previous periods when the cyclical position of the United States relative to the rest of the world was similar to that now forecast.

The United Kingdom's current account has improved a great deal as a result of devaluation and of the restrictive domestic policies that followed it. If the long-term capital account is near to balance the aim of a basic surplus of £ 500 million may be achieved in 1970. The Secretariat's forecast, however, assumes only a moderate recovery of domestic demand in the second half of 1969 and moderate growth in 1970. More rapid growth of domestic demand would jeopardise attainment of the target.

The French current balance deteriorated sharply in 1968, following the May-June events, and has deteriorated further in 1969, to a deficit perhaps of some $ 1¼ billion. The forecast for 1970 implies return to a current account surplus by the second half of the year. Although this forecast is subject to a considerable margin of error, a reduction of relative demand pressures from the recent high level should lead to a substantial improvement of the current balance. An increasing benefit (on tentative Secretariat estimates perhaps about $ 1 billion in the year as a whole) could result from the combined effects of the French and German parity changes.

The German surplus had remained roughly constant (after adjustment for temporary disturbances) for nearly three years at the high level reached during the 1967 recession, while demand pressures increased steadily in Germany relative to those in other countries. The recent parity changes are expected to lead to a large reduction in the German current surplus next year; the fact that relative demand pressures, though falling in the second half of the year, are likely to be on average higher in 1970 than in 1969, should work in the same direction.

Both Italy and Japan are expected to see more rapid domestic growth in 1970 than most other OECD countries. This may well be reflected in a falling current surplus for Italy, but a fall seems less likely for Japan. In Italy, import elasticities have been, on average, relatively low over the past few years because actual levels of economic activity have, until now, been consistently below potential levels. The more rapid economic growth experienced in 1969 and expected for next year may be coupled with a return of import elasticities to more normal, higher levels.[1] In Japan, very rapid domestic growth rates seem to have been accompanied in the past two years by a downward movement in import elasticities. This, together with favourable market growth and outstanding export performance, has led to a sharp increase in the current surplus despite a continuous rise in relative demand pressures. The growth of traditional Japanese markets may be rather less favourable in 1970, but, unless growth of output substantially exceeds growth of capacity, import elasticities may remain low, as in the recent past, and the current balance may show little change.

The current balances of most of the smaller OECD countries are expected to deteriorate next year from their unusually favourable positions in 1969. A return to their previous large aggregate deficit position does not, however, seem likely.

1. As noted earlier, however, the recent wave of strikes in Italy is probably causing temporary disturbances to trade and invisibles flows which are extremely difficult to assess at the time of writing.

CAPITAL MOVEMENTS AND MONETARY DEVELOPMENTS

Three major factors dominated the first three quarters of 1969:

i) Increasing monetary tightness in the United States. This, coupled with certain institutional factors, led to an unprecedented pull of funds through the Euro-dollar market—and a large official settlements surplus in the first half-year, despite the poor current account position.

ii) Waves of speculation leading to recurrent large flows of funds to Germany. As a result, in the first three quarters Germany was a net importer of capital, with recorded and unrecorded short-term inflows more than offsetting very large long-term capital outflows.

iii) Tightening monetary conditions in all other OECD countries, arrived at partly as a result of defensive action against the pull from these two countries but partly on domestic grounds, to combat the increase of inflationary pressures in most of the OECD area.

In the United States, open market policy was the most important means used by the monetary authorities to enhance stringency in money and credit markets. In addition, the discount rate was raised in December and April, minimum reserve requirements were increased, and Regulation Q ceilings on rates payable on time deposits have been kept at the level of April 1968. As a result of these measures, and despite booming credit demand boosted by expectations of continued inflation, total loans and investments of commercial banks remained substantially level from April to September. Short-term interest rates climbed steadily until mid-year, with the prime rate raised to a record 8.5 per cent in June. Since Regulation Q ceilings made it impossible for commercial banks to bid competitively for an important traditional source of funds, the amount of large outstanding certificates of deposit declined by $ 11.7 billion in the first nine months of this year. In these circumstances, the banks resorted to heavy borrowing from their foreign branches and their liabilities under this head rose from $ 6.0 billion at the end of 1968 to over $ 14 billion at the end of the third quarter. In the process, interest rates in the Euro-dollar market rose to over 11 per cent by mid-year, well above United States rates. Indeed, for short periods of acute pressure in the market, Euro-dollar rates even exceeded 12 per cent.

Apart from the inflow to the United States and speculation on the Deutschemark, the main features of the first three quarters were the reduced outflow from France, the significant improvement in the United Kingdom position, the enlarged capital outflow from Italy, and a shift towards greater outflows from other countries, in particular the Scandinavian countries.

By mid-year, short-term interest rates in most OECD countries had risen by between 1 and 3 percentage points above their late-1968 levels: long-term interest rates in most countries had also climbed quite steeply. Since then, however, the pattern has been more mixed (see pages 39-41).

Immediate effects of the informal and of the formal revaluation of the Deutschemark were a sharp reversal of speculative capital inflows, with a resulting decline in Germany's official reserves. The effect on bank liquidity has been tempered by reducing reserve requirements. A good deal of the capital withdrawn from Germany appears to have strengthened the official reserve positions of some other European countries, either because of inflows in anticipation of further revaluations or because confidence has improved. Some of the funds leaving Germany have returned to the Euro-dollar market, where interest rates fell back substantially in October, but they hardened again in November.

CAPITAL FLOWS IN 1969

The Position in the First Three Quarters

Table 18 summarises for major countries capital flows up to the third quarter of 1969, defined in the broadest sense as the difference between the identified current balance and the balance on official settlements.

Within the total, movements of non-monetary capital (including unrecorded transactions) changed markedly. In large part this reflected confidence factors; but for the United States it also reflected the outward drag of high Euro-dollar interest rates relative to earnings on deposits and other short-term investments within the United States and changing expectations of stock market developments.

Some components of capital flows to and from the *United States* in the first half of the year are shown in Table 19. One difficulty in analysing recent developments, not only in the United States but also in other countries, is the exceptionally large or unusual figures for errors and omissions.

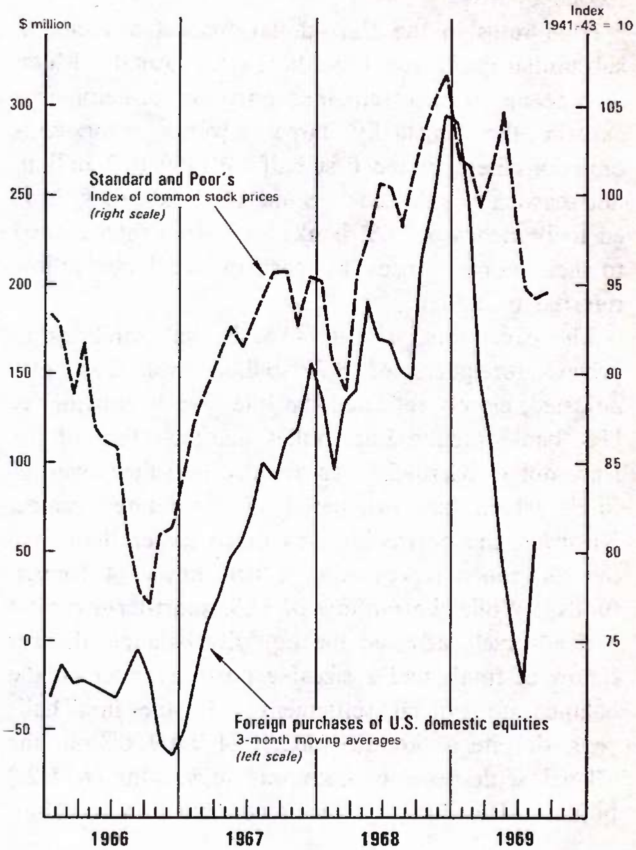
An important feature of the first half year was the sizeable increase in the net outflow of funds both through transactions in U.S. private non-monetary

TABLE 18
Total capital movements[a] in OECD countries in 1968-69
$ million, not seasonally adjusted

	1968 I	1968 II	1969 I	Changes from 1968 I to 1969 I	1969 Q3[b]
United States	1 040	577	3 125	2 085	-250
Germany	-533	-550	-679	-146	1 519[d]
United Kingdom	-1 724	-751	-73	1 651	-500
France[c]	-1 819	-1 072	(-400)[b]	(1 420)[b]	300
Italy	-1 114	-1 591	-1 524	-410	-1 100
Canada	-38	336	496	534	-100
Japan	72	-257	-496	-568	-520[d]
Other OECD countries	533	401	(-930)[b]	(-1 460)[b]	-100
Total OECD	-3 583	-2 907	(-490)	(3 100)	-350

a) Including banking funds and unrecorded transactions.
b) OECD Secretariat estimates.
c) Transactions with non-franc countries. See also Note *d)* to Table 21.
d) Actual provisional figure.

CHART F
U.S. STOCK PRICES AND FOREIGN PURCHASES OF U.S. EQUITIES



assets and through bank lending. In total these two flows increased from $ 2.4 billion in the first half of 1968 to $ 3.3 billion in the first half of 1969, largely as a result of increasing direct investment and a revival of short-term bank lending to foreigners. The former may have been partly connected with the reversal of window-dressing operations made by corporations late in 1968 to comply with the balance of payments programme.

There was a large decrease in the inflow related to the foreign purchase of U.S. securities other than Treasury issues. Probably as a result of the progressive weakening of stock prices and the uncertain outlook on Wall Street (Chart F), net purchases of U.S. corporate stocks declined considerably in the second quarter from their previous record levels and gave way to net foreign sales in June (and July). At the same time, the widening interest differential in favour of yields on the Euro-dollar market compared with yields on U.S. Euro-dollar bonds, and the reduced attraction of convertibility clauses, contributed to a decline in new issues of such bonds in the second quarter.

High rates in the Euro-dollar market attracted a substantial outflow of U.S. short-term capital. Much of it seems to have remained unrecorded, helping to explain the unusually large adverse errors-and-omissions item in the first half of 1969 ($ 2 billion, not seasonally adjusted). Some of these funds flowed to branches of U.S. banks, and were then loaned to their home offices as part of the large inflow referred to earlier.

The exceptional rise in U.S. banks' liabilities to private foreigners of $ 7½ billion, not seasonally adjusted, closely reflected the intensive borrowing by U.S. banks on the Euro-dollar market. Part of the Euro-dollar borrowing, as already indicated, was of funds which had originated in the United States. However, the borrowing was much larger than this, the difference representing a net inflow of foreign funds. While the outflow of U.S. short-term capital had adversely affected the liquidity balance, the net inflow of funds had a sizeable positive effect on the balance on official settlements. In the first half-year, despite a liquidity deficit of $ 4.9 billion, the official settlements balance was in surplus by $ 2.9 billion. The liquidity deficit continued in the third quarter but there was little further change in outstanding Euro-dollar liabilities, so that the balance on official settlements was in deficit to the extent of about $ 1 billion.

Developments in the *Euro-dollar market* were very largely conditioned by this strong pull from the United States in the first six months. On the basis of incomplete data (see Table 20), the total net size of the market is estimated to have increased by some $ 8 to $ 9 billion to a total of around $ 33-34 billion. Of this increase, some $ 7 billion were accounted for by lending to U.S. banks. Loans to other users, which at the end of 1968 were quantitatively much more important, expanded very little.

The impact on the supply side of this sharp rise in demand was largely concentrated on European countries. The large amounts of extra funds were obtained only with a continuous rise of interest rates in the market, which reached record levels in June. But for United States banks, the cost of borrowing Euro-dollars exceeded the (theoretical) cost of acquiring funds through certificates of deposit (CD's) by more than 4 percentage points[1] from June to

TABLE 19

United States

Selected capital account items

$ million, not seasonally adjusted

	1968 I	1968 II	1969 I
Capital account	1 040	577	3 125
Non-monetary capital[a]	–2 151	–128	–4 031
Of which:			
Transactions in U.S. private non-monetary assets	–2 782	–2 287	–2 854
Transactions in foreign holdings of U.S. securities other than Treasury issues	1 955	2 405	1 702
Errors and omissions	–727	86	–1 951
Monetary capital	3 191	705	7 156
U.S. banks' short-term claims	362	–451	–493
Liquid liabilities[b]	2 829	1 156	7 649

a) Including errors and omissions.
b) To private holders and to non-monetary international organisations.

TABLE 20

Sources and uses of funds in the Euro-dollar market

$ billion, end of period

	Dec. 1967	Dec. 1968	June 1969	Mid-Nov. 1969
Uses				
Total	17.5	25.0	(32½-34)	
Of which:				
United States and Canada	5.8	10.2	(18)	
Other	11.7	14.8	(15-16)	
Memorandum item				
U.S. banks' borrowing from their foreign branches	4.2	6.0	13.2	14.3
Sources				
United States and Canada	2.6	4.5	(6)	
Other	14.9	20.5	(27-28)	

1. After adjustment for the incidence of the 6 per cent reserve requirements on CD's. Such a requirement did not exist for funds acquired by borrowing abroad until October when a 10 per cent reserve requirement was imposed on borrowing from foreign banks and from branches of U.S. banks above the average amount of such borrowing outstanding in May.

October and was even higher than the effective prime lending rate during the same period (Chart G). In the earlier (and shorter) period of monetary stringency in the United States—from May to December 1966—the cost of Euro-dollar borrowing also exceeded the cost of CD's for several months, but only by about one percentage point. At that time, recourse to Euro-dollar borrowing was on the much smaller scale of about $ 2 billion.

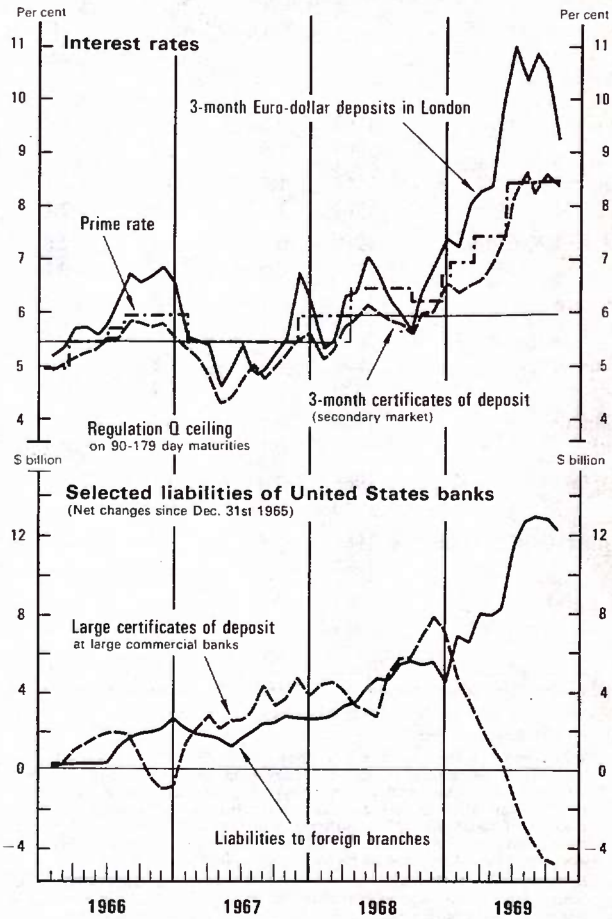
In *Germany*, Bundesbank policies designed both to discourage capital inflows into German banks and to encourage banks' exports of funds through favourable swap arrangements, resulted in recycling part of the repeated short-term capital inflows towards the Euro-dollar market. In the first nine months of the year, in spite of the final bout of speculation in favour of the Deutschemark at the end of September, German banks had a small net capital outflow. In the same period, however, the net short-term inflow into the non-banking sector exceeded $ 4 billion (over $ 1 billion in September alone), mainly as a result of recorded and unrecorded foreign credit to enterprises in Germany. Long-term capital outflows, basically private capital, were very high in the first three quarters of this year—helped, especially in the first months of the year, by the Bundesbank's policy of keeping interest rates relatively low. Capital export was also facilitated by a decrease of about a quarter in the amount of German bonds issued on the domestic market. Foreign issues accounted for about one-third of total borrowing in the German bond markets. But this did not fully offset speculative inflows so that the first nine months of the year showed a total net inflow on capital account of about $ 0.9 billion, compared with an outflow of $ 0.7 billion in the corresponding period of 1968.

Under the impact of stringent exchange controls, the *French* capital outflow in the first six months of 1969 is estimated at some $ ½ billion, compared with an estimated $ 1.8 billion and $ 1.1 billion in the first and second halves of 1968 respectively. In the third quarter some capital inflows appear to have been recorded, particularly after the devaluation of the franc, but these were probably offset in part in September as a result of renewed speculation on the Deutschemark. In all the capital account may have been in small deficit in the first three quarters of this year.[1]

1. See, however, footnote [d]) to Table 21.

CHART G

INTEREST RATE DEVELOPMENTS AND UNITED STATES BANKS' BORROWING FROM FOREIGN BRANCHES



The capital account of the *United Kingdom* was helped early in the year by the unwinding of the speculative positions taken up in November 1968, and later on by the tightness of domestic monetary conditions (see below). In spite of a considerable loss of funds in early May, the outflow of short-term non-monetary capital of 1968 was succeeded by a large inflow in the first half of 1969 as a whole. The net capital outflow was reduced to less than $ 100 million, from $ 800 million in the previous six months and $ 1.7 billion in the first half of 1968. The return to surplus of the balance on official settlements allowed the United Kingdom to start repayment of debts under various international credit

TABLE 21
Summary balances of payments
January-September 1968 and 1969
$ billion, not seasonally adjusted

		Current balance[a]	Capital movements[a b]	Balance on official settlements
United States	1968	–0.5	2.0	1.5
	1969	–1.0	2.9	1.9[c]
Germany	1968	1.7	–0.7	1.1
	1969	1.3[f]	0.8[f]	2.1
United Kingdom	1968	–0.6	–1.4	–2.0
	1969	0.5	–0.6	– 0.1[c]
France	1968	–0.5	–3.0	–3.5[e]
	1969	–1.1	–0.1	–1.2[e]
Italy	1968	2.0	–1.8	0.2
	1969	2.1	–2.7	–0.6
Canada	1968	0.1	–0.2	–0.1
	1969	–0.5	0.4	–0.1
Japan	1968	0.4	–0.1	0.3
	1969	1.4[f]	–1.0[f]	0.4
Other OECD countries	1968	–0.5	0.3	–0.2
	1969	–0.6	–1.0	–1.6[c]
Total OECD	1968	2.0	–4.8	–2.8
	1969	1.9	–0.8	1.1[c]

a) Figures for January-September 1969 are OECD Secretariat estimates.
b) Including banking funds and unrecorded transactions.
c) OECD Secretariat estimate.
d) Transactions with non-franc countries only. Data for current balances are OECD Secretariat estimates. They incorporate officially published figures for invisibles which are on a payments basis, and which are believed by the Secretariat to include a not negligible but difficult to estimate, element of disguised capital outflow. For this reason, figures for capital movements may understate actual outflows, particularly in 1968. See also notes to the balance of payments table for France.
e) Including net settlements on behalf of the overseas franc area. The figure for January-September 1969 is an OECD Secretariat estimate based on the published weekly balance sheet of the Bank of France.
f) Actual provisional figures.

lines. The third quarter was less favourable, particularly in the aftermath of the devaluation of the French franc. The climate improved somewhat in September, however, and again after the revaluation of the Deutschemark.

Domestic political uncertainties in *Italy* increased capital outflows, which were also affected by the high interest rates in the Euro-dollar and Euro-bond markets and speculation in favour of the Deutschemark. The authorities took defensive measures. As a result, in the first three quarters of the year, Italy moved from a position of exporter to one of importer of banking funds. But at the same time, the outflow of non-monetary capital—some of it financed by the export of bank notes—accelerated considerably so that the total net capital outflow exceeded $ 2½ billion, nearly $ 1 billion more than in the corresponding period of last year.

In *Japan,* the capital account swung from a small net inflow in the first half of last year to a $ ½ billion outflow in the first half of this year. Repayment of Euro-dollar borrowing by Japanese commercial banks was accompanied by a strong increase in their foreign lending, so that the outflow of banking funds, insignificant in the first half of 1968, reached $ 0.7 billion. The Japanese authorities took steps to encourage the " yen shift " (the shift of import financing from foreign to domestic sources) as well as direct placements in the Euro-dollar market by Japanese banks. In the third quarter, the total capital outflow amounted to a further $ 0.5 billion.

In *Canada,* the capital account swung from a $ 0.2 billion deficit in the first three quarters of 1968 to a surplus of the order of $ 0.4 billion in the first three quarters of this year. The swing was partly accounted for by the disappearance of the heavy speculative outflows which affected the Canadian dollar in the first quarter of last year. The total net capital outflow from *Switzerland* appears to have increased by $ 0.6 billion between the first halves of 1968 and 1969. *Austria,* the *Scandinavian* countries, *Spain* and *Portugal* also experienced a deterioration in their capital accounts.

Implications for Official Settlements Positions

Positions on official settlements for many countries have been more than normally different from the pattern of current balances. Table 21 summarises the picture; some of the figures for the first three quarters of 1969 are inevitably tentative at this stage. The recorded figures show sizeable official settlements surpluses for the United States and Germany, and deficits for France, Italy and the smaller OECD countries. The United Kingdom and Canada were in approximate equilibrium.

However, incompatibilities in the data for different countries make it hard to say at all precisely how the network of capital movements and the network of official settlements really fitted together. The apparent fall in the aggregate capital outflow and improvement in the aggregate official settlements balance of the OECD area—both of the order of $ 4 billion—seem to be overstated. The evidence for this is that the change between the two periods in the OECD current account surplus with the rest of the world, and reserve changes recorded by non-OECD countries, suggest these countries' net capital receipts fell much less than $ 4 billion. The importance of asymmetries in recording changes in official assets and liabilities by OECD countries seems to have increased considerably. Part of the explanation may be connected with the rapid growth and high interest rates in the Euro-dollar market. A rise in Euro-dollar holdings by OECD central banks can mean an increase in total official assets of the area without a corresponding rise in the reported official liabilities. [1] This asymmetry exaggerates the official settlements surplus of the OECD area as a whole and, therefore, with a given set of current balances, makes the apparent outflow of capital from the area (the difference between the two) seem smaller.

As they stand, the figures suggest that, for major countries, capital flows often tended either to offset changing current account imbalances or (in the example of the United Kingdom) acted with the improving current balance to eliminate the deficit on official settlements. Had central banks placed less funds with the Euro-dollar market, pressure on interest rates in that market would have been greater, and a given capital flow to the United States would probably have resulted in more adverse capital figures for most other countries, the difference being perhaps most marked for countries already shown to be under pressure on current and capital account combined.

Recent Developments

Recent developments have been marked on the one hand by the introduction of a floating Deutschemark at end-September and its formal revaluation on 24th October. During October, when the Deutschemark was allowed to fluctuate, the German central bank intervened repeatedly in the foreign exchange market, buying the equivalent of over $ 1 billion of its own currency. In the week following the announcement of the new parity, reserves fell again by more than $ 1 billion. By mid-November the reflux of short-term capital, valued at the new parity, probably exceeded $ 3 billion. Although the relaxation of

TABLE 22
U.S. banks' Euro-dollar borrowing and Euro-dollar interest rates

		Liabilities to foreign branches $ billion		Rate of interest
		Level	Change	
August	20th	14.7	+0.5	10.83
	27th	14.6	–0.1	10.91
September	3rd	14.4	–0.2	11.20
	10th	14.7	+0.3	11.46
	17th	14.5	–0.2	11.14
	24th	14.3	–0.2	10.68
October	1st	14.1	–0.2	11.03
	8th	14.6	+0.5	10.65
	15th	15.0	+0.4	10.43
	22nd	14.3	–0.7	9.63
	29th	13.6	–0.7	9.10
November	5th	14.4	+0.8	9.89
	12th	14.4	0.0	10.01

minimum reserve requirements early in November partially offset the effects of capital outflows, monetary conditions were quite tight at the time of writing.

This massive outflow of funds seems to have accrued mainly to the Netherlands and Belgium—especially in October, when there was speculation that they too might revalue—and also to the United Kingdom, some of the smaller countries and, more recently, France. During the first two weeks of October large amounts reached the Euro-dollar market, and interest rates there eased. When Euro-dollar borrowing by United States banks declined in the second half of October, possibly as a result of the introduction of reserve requirements on such borrowings, Euro-dollar rates dropped sharply (see Table 22). At the same time, deposits of foreign official institutions with banks in the United States increased markedly, partly reflecting a shift of funds from the Euro-dollar market to time deposits held directly in the United States. [2] Demand of United States banks for Euro-dollars revived in November after the announcement that the monetary authorities were considering the application of Regulation Q to interest rates on commercial paper issued by banks' affiliates. As a result, conditions in the Euro-dollar market tightened again and the three-month interest rate returned above 10 per cent.

1. See " Technical notes ", p. 97. The section on " International Liquidity ", on p. 53 is also relevant.
2. Interest rates on these deposits are not limited by Regulation Q.

MONETARY TRENDS AND POLICIES

The pattern of capital flows and the development of interest rates demonstrate that monetary conditions became very severe in the United States during 1969 and probably tightened there more than elsewhere. But in 1969—unlike 1968—there was also a good deal of tightening elsewhere, though varying in intensity. It now seems likely that conditions in the United States will not tighten further; some other countries are likely to maintain their present stringency or, in certain instances, to increase it.

Restrictive monetary measures have been taken in at least 19 OECD countries since November 1968 (Table 23):

— Central Bank discount rates have been raised in all but one of the countries concerned, in some several times;

— In the United States and Canada open market policies have enhanced or maintained stringency in money and credit markets;

— Eleven countries have supplemented their interest rate policy with measures (other than open market operations) more directly affecting the banks' liquidity base, either by increasing minimum required reserve or liquidity ratios, or by

TABLE 23

Summary of principal restrictive monetary measures in 19 OECD countries

November 1968-early-November 1969

	Discount rate End October 1968	Discount rate Early Nov. 1969	Pressure *a* on banks' liquidity	New or tighter credit ceilings	More restrictive hire-purchase regulations
Austria	3.75	4.75	*		
Belgium	3.75	7.50	**	**	*
Canada	6.00	8.00	*		
Denmark	6.00	9.00	**		
Finland	7.00	7.00	*	*	
France	5.00	8.00	**	**	**
Germany	3.00	6.00	**		
Greece	5.00	6.50			
Ireland	6.81	8.38		**	*
Italy	3.50	4.00			
Japan	5.84	6.25	*	*	
Netherlands	4.50	6.00		**	*
Norway	3.50	4.50	**		
Portugal	2.50	2.75			
Spain	4.50	5.50		*	
Sweden	5.50	7.00	**		
Switzerland	3.00	3.75		*	
United Kingdom	7.00	8.00		*	*
United States	5.25	6.00	*		

* One instance / ** More than one instance } of the type of measure indicated.

a) Increase in banks' required minimum reserves or liquidity ratios or decrease in banks' rediscount quotas.

TABLE 24

Selected short-term interest rates

Per cent, per annum

	1967 Dec.	1968 Mar.	1968 June	1968 Sept.	1968 Dec.	1969 Mar.	1969 June	1969 Sept.	Latest	Date
Euro-dollars	6.31	6.38	6.75	5.69	7.44	8.38	11.11	10.68	10.01	12/11
United States										
(T.b.)	4.99	5.14	5.30	5.13	6.20	5.94	6.29	7.10	7.16	21/11
(C.d.)	5.65	5.81	6.03	5.65	6.58	6.65	8.25	8.63	8.35	21/11
United Kingdom										
(T.b.)	7.48	7.11	7.24	6.58	6.78	7.78	7.88	7.81	7.70	21/11
(L.a.)	7.88	8.13	8.13	7.44	7.75	8.94	9.38	9.94	8.94	21/11
Belgium	4.40	3.95	3.75	3.80	4.75	6.00	6.55	8.35	8.50	Oct.
France	4.76	5.07	5.76	6.76	8.22	8.18	9.46	9.40	9.81	21/11
Germany	4.07	3.52	3.72	3.54	4.22	4.21	5.50	6.94	7.88	21/11
Italy	3.63	3.63	3.63	3.52	3.63	3.63	4.44	4.99	..	..
Netherlands	4.51	4.34	4.56	4.39	4.65	5.00	5.50	6.00	5.88	Oct.
Sweden	6.92	6.40	6.08	5.82	5.32	6.58	6.60	7.90	7.90	Oct.
Switzerland	4.00	2.75	3.75	3.75	4.25	4.75	5.00	5.00	5.00	15/10
Japan	7.30	8.03	8.03	8.03	7.67	7.67	6.94	8.25	8.25	15/11
Canada										
(T.b.)	5.95	6.98	6.56	5.66	6.24	6.58	7.13	7.77	7.72	21/11
(F.c.)	6.40	7.00	7.00	6.00	6.50	6.88	7.75	8.38	8.50	7/11

Note : For definitions and sources, see Chart H, and " Technical Notes ", page 97.

TABLE 25

Selected long-term interest rates

Per cent, per annum

	1967 Dec.	1968 Mar.	June	Sept.	Dec.	1969 Mar.	June	Sept.	Latest	Date
$ Euro-bonds	6.87	7.29	7.44	6.99	7.25	7.34	7.52	7.72	7.53	Oct.
DM Euro-bonds	6.26	6.15	6.18	6.00	6.05	6.19	6.17	6.47	7.06	Oct.
United States										
(G.b.)	5.35	5.42	5.15	5.09	5.82	6.07	6.04	6.41	6.57	21/11
(Corp.)	6.24	6.17	6.27	6.00	6.53	6.99	7.03	7.19	7.35	21/11
United Kingdom										
(G.b.)	7.06	7.18	7.75	7.45	8.05	8.69	9.25	9.12	9.07	21/11
(Deb.)	7.93	7.98	8.17	8.36	9.00	9.67	10.77	10.82	10.62	21/11
Belgium	5.70	5.48	5.41	5.66	5.58	5.68	5.95	6.44	...	...
Denmark	9.48	8.80	8.55	8.44	8.49	8.70	9.80	10.60	...	...
France	5.60	5.84	5.94	5.95	6.00	6.21	6.37	6.68	6.80	Oct.
Germany	6.62	6.68	6.34	6.21	6.21	6.24	6.69	7.09	7.04	21/11
Italy	5.61	5.59	5.66	5.64	5.62	5.62	5.65	5.90	...	...
Netherlands	6.11	6.12	6.24	6.25	6.34	6.61	6.83	7.42	7.77	Oct.
Sweden	6.80	6.29	6.29	6.33	6.19	6.72	6.98	7.28	...	...
Switzerland	4.55	4.35	4.34	4.34	4.33	4.60	4.69	5.37	5.34	17/10
Japan	8.58	8.70	8.83	8.09	8.66	8.95	8.80	9.01	...	...
Canada										
(G.b.)	6.54	6.91	6.62	6.60	7.30	7.22	7.50	7.81	8.11	21/11
(Ind.)	7.59	7.93	8.05	7.82	8.18	8.43	8.89	8.91	...	...

Note : For definitions and sources see Chart I, and " Technical Notes ", page 97.

reducing rediscount quotas, or by a combination of these measures. In Sweden liquidity ratios previously agreed with the banks have now been given legal force;

— Eight countries have either imposed, or have tightened, ceilings on the growth of bank credit;
— Five countries have taken steps to tighten hire-purchase credit terms.

No OECD country has adopted any measure since November 1968 that could be classified as being in any significant sense one of credit relaxation. (Reductions in reserve requirements in Germany after revaluation were designed to prevent an undue tightening of bank liquidity.)

In the following paragraphs, an attempt is made to evaluate monetary conditions by reference to four indicators: interest rates, rates of growth of the money supply, narrowly and broadly defined, and rates of growth of total domestic credit, defined as the sum of credit extended by monetary institutions to the private and public sectors. [1]

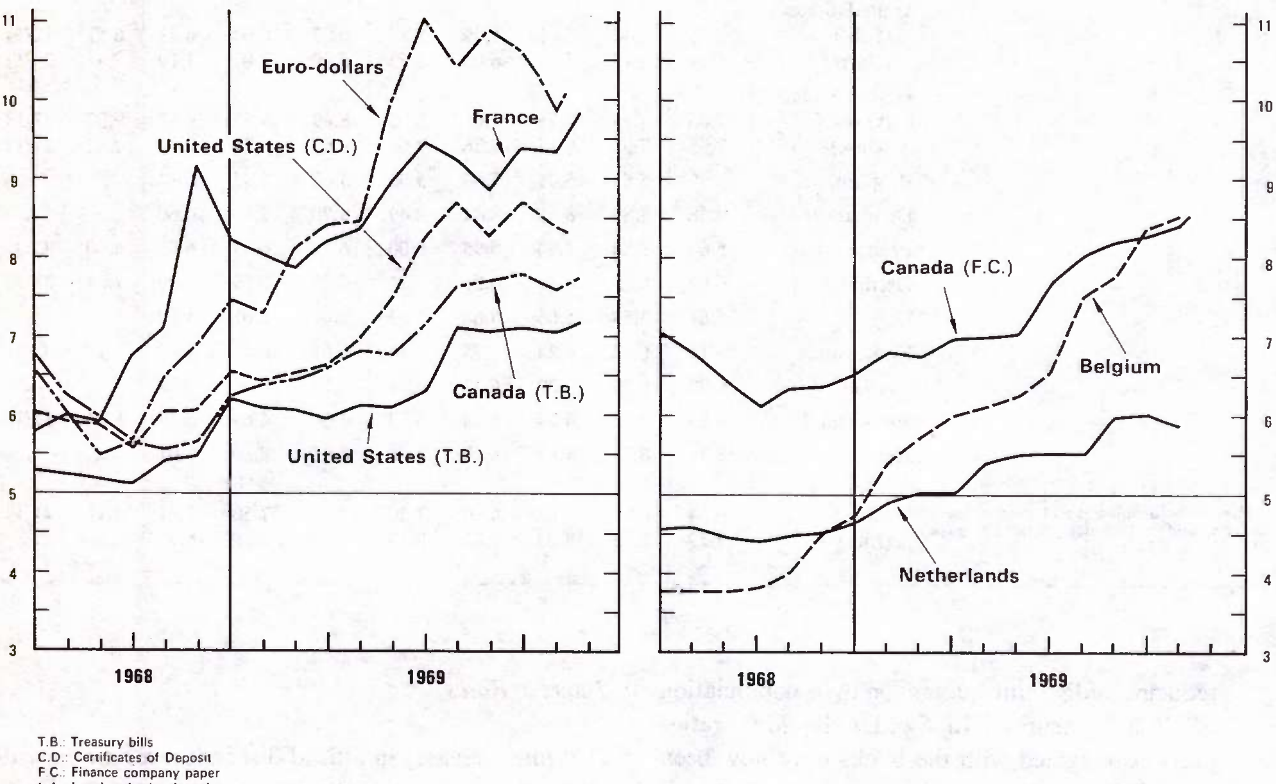
1. See " Technical Notes ", page 97.

Interest Rates

While increases in official discount rates are regarded as signals of the authorities' intention to intensify monetary restraint, the interpretation of changes in market rates can be more uncertain. In most countries, both short and long-term rates rose in 1969 well above the levels of a year ago (Charts H and I and Tables 24 and 25). In some instances higher rates were achieved principally through administrative action, usually by direct connection with the official discount rate (e.g. short-term rates in the United Kingdom) or by administrative fiat (e.g. rates charged and paid by the nationalised credit institutions in France). In Germany also, the rise in short-term rates up to the time of revaluation was mainly in response to the increases in the discount and Lombard rates. But in Canada and the United States, at least, the marked rise in interest rates through the earlier part of the year can best be regarded as the result of monetary policy primarily designed to restrain the growth of money and bank credit, in the face of an active demand for loanable funds. The particularly rapid rise in long-term rates in the United Kingdom and Denmark reflects a

CHART H

SHORT-TERM INTEREST RATES

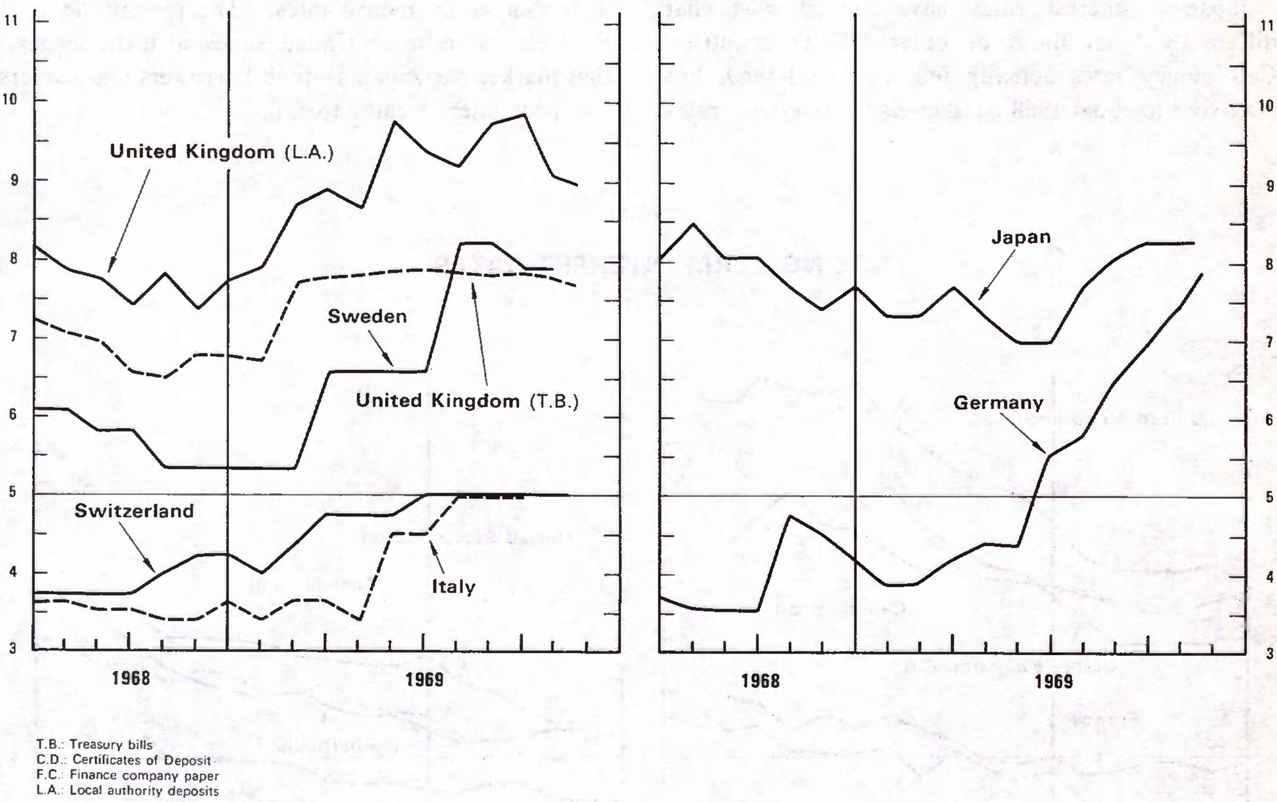


change in policy towards the long-term government securities market, intended in part to tighten domestic monetary conditions by limiting the creation of liquidity, but partly also in response to rising interest rates abroad.

Most *short-term* rates, more volatile and quicker to respond to monetary policy changes than longer-term yields, had by about mid-year risen by between one and three percentage points compared with their levels late in 1968. Chart H shows how rates on Euro-dollars and in the United States, France, Canada and Belgium moved first and most sharply. In the Euro-dollar market, the United States and France, the advance halted about mid-year, with rates since then fluctuating around or declining from their peak levels; in Canada developments in the second half were mixed. But in Belgium even in October the rise had shown no signs of abating; and in the Netherlands—where interest rates also began rising late last year—they had moved up a further step in the third quarter. In another group of countries—the United Kingdom, Italy, Switzerland and Sweden—short-term interest rates were later to rise, and also flattened out sooner. German short-term interest rates began their rise only at mid-year, but thereafter moved up sharply. Apart from the Euro-dollar rate (which is often the most volatile) most short-term rates were still, at the time of writing, quite close to their peak levels for the year. Except for Germany, Sweden and Japan, these also represent records for at least the present decade.

CHART H (cont.)

SHORT-TERM INTEREST RATES



While higher short-term rates were, in several cases, either induced or welcomed by the authorities in order to keep in step with developments in the world's principal monetary markets, in few countries did short-term market rates rise as fast as, and in no country as much as, Euro-dollar rates. In most of the larger countries—United States, United Kingdom, Germany, Canada and France—rate changes reflected policies undertaken essentially for domestic demand management purposes. Domestic influences were also important in the actions of several smaller countries, although the authorities were also motivated by rising interest rates elsewhere.

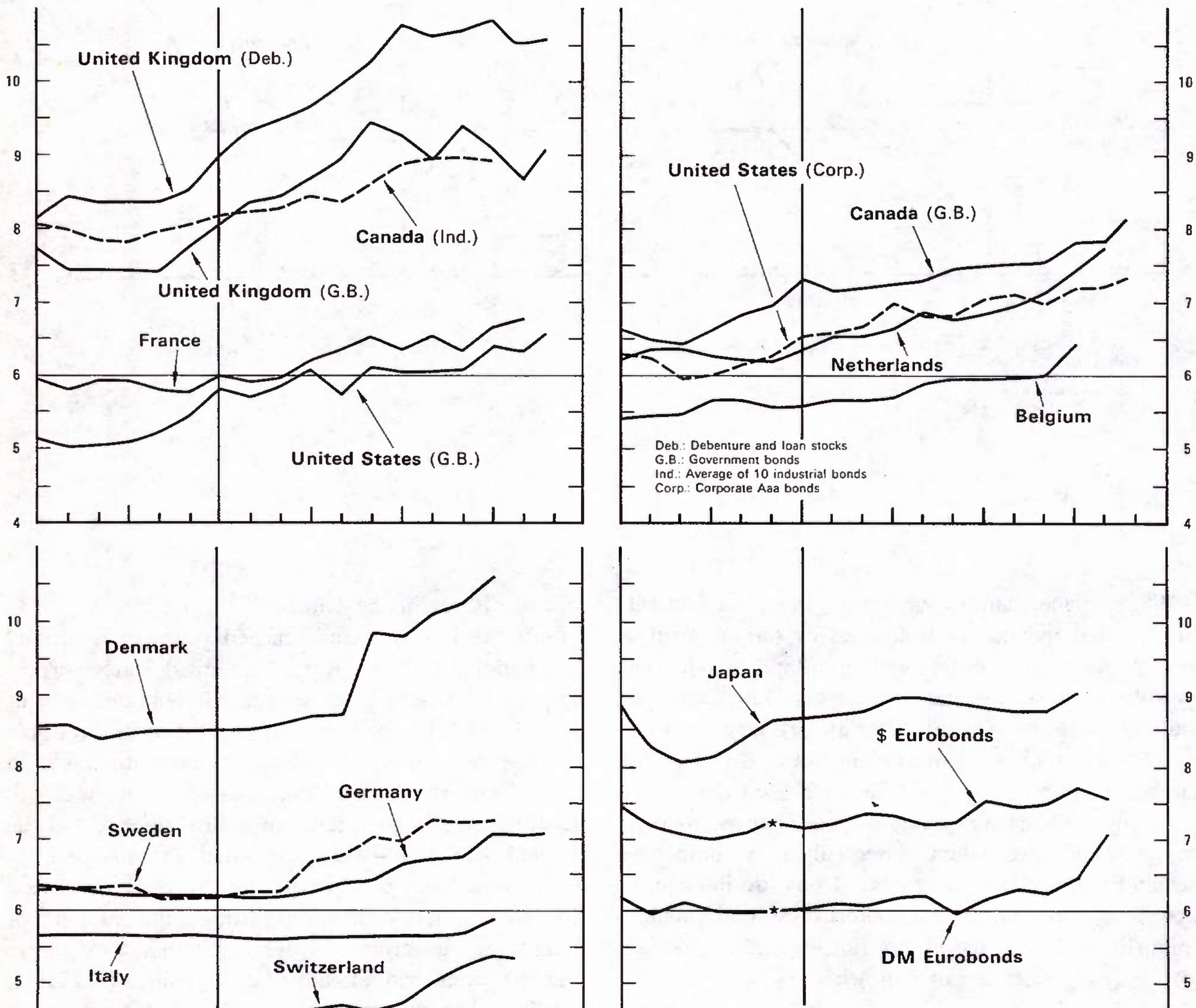
The development of *long-term* interest rates—indicated in Chart I—showed few significant differences. Rates in the United Kingdom also began to climb late last year and reached peak levels around the middle of 1969. Rates on United States corporate bonds seem to have stopped climbing only recently. And of the countries where the rise in the whole interest rate structure did not come until 1969, in two—Switzerland and Denmark—the trend was still upwards late in the year. In both Denmark and the United Kingdom—which recorded the sharpest increases—a large part was played by policy decisions to reduce money creation through the support of long-term government debt. German long-term interest rates had already begun rising in March, partly reflecting the ending of Bundesbank open-market operations in long-term securities. Interest rates in the Euro-bond markets rose rather less than in most countries and less than comparable rates in the United States and Germany. Largely reflecting speculation, the rate on Deutschemark-denominated Euro-bonds rose only very sluggishly.

Japanese interest rates have moved somewhat differently from those of other OECD countries. Call money rates actually fell until mid-1969, but later rose to equal-1968 peak levels. Long-term rates recovered to previous levels more quickly from their late 1968 drop, and moved up again late in 1969.

In general, changes in long-term rates in 1969 reflected the natural reactions of borrowers and lenders in a period of tight money and relatively high short-term interest rates. The present slope of the yield curve in the United States, at least, suggests that market participants—both borrowers and lenders—expect interest rates to fall.

CHART I

LONG-TERM INTEREST RATES



Monetary Aggregates

The movement during 1969 of the three monetary aggregates mentioned above varied considerably from country to country (see Chart J and Table 26). In Canada, all three measures advanced up to the end of the first quarter faster than in the same period of 1968; thereafter the deceleration was appreciable, with the narrowly-defined money supply actually declining. In the United States, the monetary aggregates decelerated during the first half of the year, and then either levelled out or fell. In the United Kingdom, the money supply declined at an annual rate of 0.4 per cent in the first six months, compared with an increase of 7 per cent in 1968 as a whole. Domestic credit expansion—by the United Kingdom definition, which is somewhat different from that shown in Table 26—was markedly negative in the first three quarters of 1969 compared to the increase of over £ 1 billion a year earlier (data not seasonally adjusted).

Domestic credit expanded in France at an annual rate of 22 per cent in the first five months of 1969, but then decelerated, bringing the rate for January-August to 16 per cent. Slower than in 1968, this rate still exceeded that of preceding years. Money grew far less rapidly because of the external deficit. In the Netherlands the monetary aggregates decelerated. These two countries were among those applying quantitative ceilings on bank credit: France from November and the Netherlands from end-December 1968. Since the ceilings are not applicable to all bank lending, it is not possible to assess precisely their influence on the expansion of domestic credit. Nevertheless, the ceilings probably reinforced other restrictive measures and contributed to the check to credit expansion, even though in the Netherlands the banking system as a whole was, during the third quarter, above the prescribed ceiling.

Domestic credit expansion in Denmark and Sweden in the first eight months of the year continued at about the same rate as in 1968. In both countries money, both broadly and narrowly defined, grew less rapidly than domestic credit because of the balance of payments deficit on non-monetary transactions; even so, the increase in Denmark was quite large. In Germany, the rate of expansion of domestic credit, as here measured, seems to have remained rather steady through most of the year, perhaps reflecting the ample liquidity of the private sector generally. Domestic credit expansion, on the other hand, accelerated rapidly in the first eight months of the year in Switzerland and Japan, and both countries have since reinstated ceilings on the growth

TABLE 26
Growth of money supply and domestic credit
Percentage changes at annual rates

		End 64 to End 68	End 67 to End 68	End 68 to latest month[a]	Latest month
United States	M	5	7	3	Oct.
	M+QM	9	9	–2	Oct.
	DC	10	11	0	Aug.
United Kingdom	M	7	7	0	June
	DC	8	11	–1	June
Canada	M	13	14	–7	Aug.
	M+QM	12	15	2	Aug.
	DC	14	13	6	Aug.
Belgium	M	6	7	6	July
	M+QM	9	10	11	June
	DC	11	15	13	June
Denmark	M	13	16	13	Aug.
	M+QM	12	14	12	Aug.
	DC	13	16	16	Aug.
France	M	8	9	3	Aug.
	M+QM	11	11	8	Aug.
	DC	13	18	16	Aug.
Germany	M	7	9	5	June
	M+QM	13[b]	15[b]	14	June
	DC	11[b]	11[b]	11	June
Italy	M	14	12	13	July
	M+QM	14	12	11	July
	DC	13	14	15	July
Netherlands	M	9	11	7	July
	M+QM	11	14	13	July
	DC	17	20	13	July
Sweden	M	9	13	–6[c]	Aug.
	M+QM	10	15	6[c]	Aug.
	DC	12	12	12[c]	Aug.
Switzerland	M	7	12	8	Aug.
	M+QM	9	13	19	Aug.
	DC	10	11	20	Aug.
Japan	M	15	13	27	Aug.
	M+QM	16	15	21	Aug.
	DC	17	15	19	Aug.

Note : For description of data and sources see " Technical Notes ".
M = Money ; M + QM = Money + quasi-money ; DC = Domestic credit.

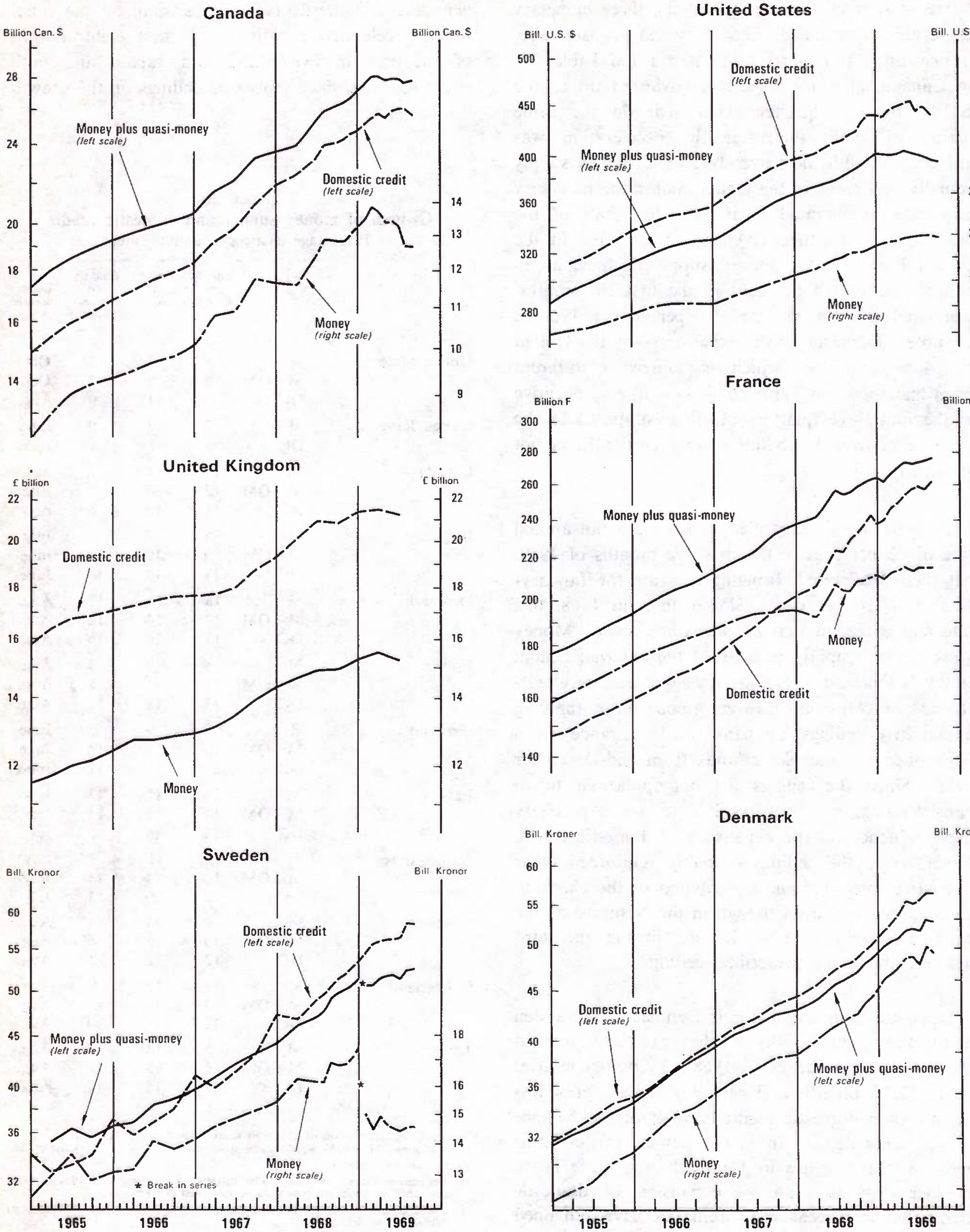
a) Seasonally adjusted.

b) Because of a break in series in December 1968, changes from 1964 to 1968 and 1967 to 1968 are based on years ended November.

c) Changes are from end-January 1969 to end-August (see " Technical Notes " for details).

CHART J

DEVELOPMENT OF MONEY AND DOMESTIC CREDIT in selected countries



of bank lending. In Japan, the balance of payments surplus on non-monetary transactions meant that the money supply grew more rapidly than domestic credit.

The monetary magnitudes thus present a rather diverse picture of developing conditions. It is clear that in the United States, the United Kingdom and also Canada, policies to restrict the growth of money supply and domestic credit have been effective. Large reductions in growth rates have been achieved and the ratios between the rate of growth of money and that of national product at current prices were also sharply reduced in 1969. But in some countries the acceleration of economic activity was accompanied by an acceleration of the growth of monetary aggregates. A general judgment may be that, at any rate up to the middle of the year, monetary stringency was severe in only a few countries.

The countries which have tightened or imposed ceilings on the growth of bank lending in addition to using other measures of restraint are the United Kingdom, France, Belgium, the Netherlands, Switzerland, Ireland, and, recently, Japan and Spain. Such limitations have been used by all these countries in previous periods of credit restraint. To some extent, the prescribing of ceilings—which are often applied also to some non-banking financial establishments—may have been seen as an alternative to even higher interest rates than have obtained. But in some countries the difficulties experienced in containing credit within the ceilings may have been aggravated by the relative cheapness of such credit compared with some other forms of borrowing.

Developments in Certain Major Countries

United States. The decision of the Federal Open Market Committee in December 1968 to conduct operations " with a view to attaining firmer conditions in money and short-term credit markets " was supplemented during the course of 1969 by an increase in the discount rate, an increase in required reserves and, more recently, by measures designed to discourage the access of banks to non-depositary funds, such as Euro-dollars. In addition, bank deposit and, therefore, asset growth was further inhibited by keeping Regulation Q ceilings on interest rates payable on time deposits well below market short-term rates.

TABLE 27
United States
Development of selected monetary aggregates
Per cent changes, seasonally adjusted annual rates

	Dec. 67 to Dec. 68	Dec. 68 to June 69	June 69 to Oct. 69
Federal Reserve credit[a]	10.2	5.9	1.8
Total member bank reserves[a]	7.1	0.7	-6.9
Money supply	7.2	4.4	0.3
Loans and investments, all commercial banks	11.0	3.0	-0.5[b]

a) Monthly averages of daily figures, adjusted for the effect of reserve requirement changes and changes in required reserves due to shifts in deposits among classes of banks.
b) June-September

Judging by the aggregates shown in Table 27 and Chart J a further tightening seems to have occurred about mid-year. Nevertheless, the increase in short-term interest rates seems to have ceased at about the same time. At the end of October short-term dollar rates generally were at, or slightly below, their 1969 peaks, with the Euro-dollar rates substantially below their record levels.

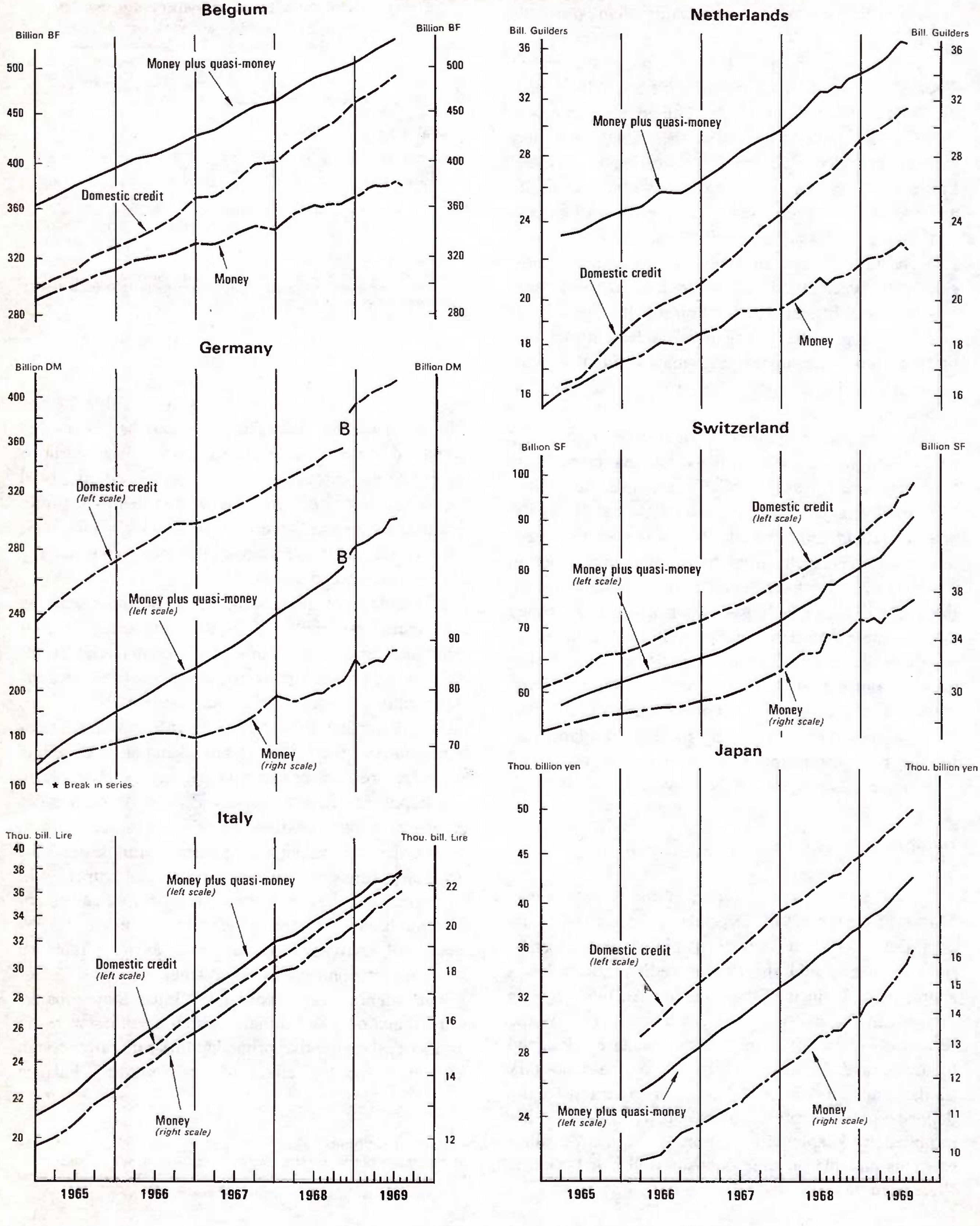
In the face of these conditions, business demand for loans, especially at large commercial banks, remained high: total loans at all commercial banks rose by $ 11.4 billion from December 1968 to June (seasonally adjusted, an annual rate of 9 per cent) and by a further $ 2.4 billion to the end of September. Banks met this high demand by selling secondary reserve assets, and by increasing resort to non-depositary funds—notably Euro-dollars and sales of assets or participations therein (including sales to parent bank holding companies, who raised the necessary funds by issuing commercial paper). In addition, the larger banks were heavy users of Federal funds [1] at rates which, during much of 1969 were well above the discount rate, as were rates on all forms of non-deposit borrowing.

The highest rates paid by United States banks were those on Euro-dollars, which at times were at, or above, the effective prime lending rate (after rough allowance for the effect of compensating balance

1. Federal funds consist of member banks' reserve balances at Federal Reserve Banks; member banks can lend these funds to each other, but this lending does not increase the total reserves available to the banking system.

CHART J (cont.)

DEVELOPMENT OF MONEY AND DOMESTIC CREDIT
in selected countries



requirements). Whether the marginal cost of such funds to U.S. banks exceeded the marginal revenue is not clear; if it did, presumably the banks felt it was worthwhile for longer-run considerations.

Deposits at " large " commercial banks (not seasonally adjusted) were lower by about $ 16 billion in October 1969 than in December 1968 but this was almost entirely offset by funds from other sources, mainly Euro-dollars and the Federal funds market. (In the same period of 1968, total deposits rose by $ 11 billion and funds raised from all sources shown in Table 28 rose by $ 18 billion.)

United Kingdom. As noted above, monetary conditions in the United Kingdom in 1969 showed a marked change from the relative ease prevailing in 1968. Complete data for the third quarter of the calendar year are not available at the time of writing (data for the first six months are shown in Table 29). Nonetheless, it seems clear that total bank credit to the domestic public and private sectors fell in the first three quarters of the year—though probably by less than in the first half alone—compared with an increase of £ 300 million in the first three quarters of 1968. Most of the swing up to the middle of the year was accounted for by transactions with the private sector, but in the third quarter advances of the London clearing banks mainly to the private sector increased about £ 150 million more than in the same quarter of 1968. Mainly because of the large favourable swing in the balance of payments, the marked improvement in the cash position of the central government, about £ 1.9 billion, resulted in a far smaller increase in net repayments to the banking sector.[1] And even that was partly offset by increased bank lending to the rest of the public sector. The more stringent monetary policy was also reflected in interest rates, which not only rose sharply from their late-1968 levels (see Tables 24 and 25 and Charts H and I), but in general widened their margin over comparable rates in the United States money and capital markets.[2]

Table 28
United States
Sources of funds, large commercial banks
$ billion

	December 1968	October 1969	Change
Demand deposits	133.0	132.0	–1.0
Time deposits	112.2	97.5	–14.7
Large CD's	(23.7)	(11.6)	(–12.1)
Other	(88.5)	(85.9)	(–2.6)
Due to foreign branches	6.9	14.3	+ 7.4
Borrowings other than from Federal Reserve (mainly Federal funds)	10.6	18.3	+ 7.7
Total, above sources	262.7	262.1	–0.6

Note : Monthly averages of Wednesday data.

Table 29
United Kingdom
Domestic credit expansion
£ million

	January-June 1968	January-June 1969	Change
Change in:			
Bank lending to public sector:	–735	–889	–154
Central government	(–790)	(–1 167)	(–377)
Other	(55)	(278)	(223)
Bank lending to private and (in sterling) to overseas sectors	810	397	–413
Total bank lending	75	–492	–567
Notes and coin in circulation	100	52	–48
Overseas lending to public sector	830	–263	–1 093
Total equals:			
Domestic credit expansion	1 005	–703	–1 708

France. Monetary developments in France since the events of May 1968 fall into three distinct periods:

— Rapid monetary expansion from May to November 1968;
— Slower but still relatively rapid expansion until the second Deutschemark crisis of May 1969;
— Apparently, a significant slowdown in recent months.

After the May 1968 events, the French authorities at first adopted expansionary policies. From May to November 1968, domestic credit expanded at a

1. There had been a deficit (borrowing requirement) of £324 million in the first three quarters of 1968, compared with a surplus (negative borrowing requirement) of £1.6 billion in the first three quarters of 1969.
2. For a more detailed discussion of United Kingdom monetary policy, see the December 1969, OECD *Economic Survey of the United Kingdom*, especially the Annex.

TABLE 30
France
Growth of monetary aggregates
Percentage change at annual rates

	End 64 to end 67	End 66 to end 67	Seasonally adjusted April to Nov. 68	Nov. 68 to May 69	May to Aug. 69
Money	*a*	*a*	14.8	4.1	3.0
Money plus quasi-money	10.5	11.8	15.9	6.2	8.2
Domestic credit	11.2	15.1	27.8	14.3	6.8

a) Rates of growth in the money supply narrowly defined are not shown, because a comparison of the year 1967 with preceding years is not meaningful. In view of institutional changes in 1967, there was a substantial shift from demand into time deposits, which affected the size of the money supply, but not that of money broadly defined (money plus quasi-money).

seasonally adjusted annual rate of nearly 28 per cent, money plus quasi-money at 16 per cent and money supply narrowly defined at a rate of 15 per cent (Table 30). All these rates of growth were significantly faster than in the recent past, the acceleration in the growth of domestic credit being sufficient to produce an acceleration in the money supply increase as well, in spite of the large decline in official reserves. Short-term interest rates were allowed to rise by about 2 percentage points, in order to discourage capital outflows, but long-term rates remained virtually stable in this period.

Monetary policy began to be made more restrictive by measures introduced in November 1968. In addition to raising the discount rate and minimum reserve ratios, the authorities imposed a ceiling on bank lending to the private sector, applicable to forms of credit which at that time accounted for about two-thirds of the total. The new policies were reflected both in interest rates and in the rates of growth of money and credit. During the period from then until May 1969, call money rates increased by almost another 2 percentage points and long-term rates (5 per cent irredeemable government bonds) by three quarters of a percentage point to about 9 and 6½ per cent respectively. The growth of domestic credit decelerated to 14 per cent (seasonally adjusted annual rate) and that of money broadly defined and money narrowly defined to 6 per cent and 4 per cent respectively.

While these growth rates were near or below the trend in the years immediately preceding 1968, they did not reduce to any significant extent the large liquidity overhang which had built up from May to November 1968. Further restrictive measures were therefore introduced in May 1969 and reinforced during the summer and autumn. These included further discount and other interest rate increases and tightening of other terms of credit, extension of the credit ceilings until June 1970, and expansion of their coverage to include practically all bank lending to the private sector. These ceilings would apparently permit little, if any, net increase over the amounts outstanding at the end of the third quarter 1969. Moreover, the Bank of France stiffened the penalties for banks which exceed the credit ceilings (see page 77). That the credit squeeze was taking hold seems to be corroborated by the survey of major industrial enterprises conducted in October by the National Institute of Statistics, in which 50 per cent of the respondents reported a difficult liquidity position, up from 41 per cent in the March and June inquiries.

Germany. The first measures of monetary restriction in Germany in 1969 were taken in March—with further steps towards tightening in four of the seven subsequent months. Through August there seems to have been little effect on the growth of money and credit; the aggregates shown in Table 26 continued to rise early in the year at about the same pace as in 1968, with the growth of the money supply in the summer months apparently a little faster. On the other hand, short-term interest rates rose during the summer and early autumn months faster than in almost all other countries, and long-term rates rose almost a full percentage point between March and September. Apart from the policy measures taken, the strength of the demand for credit (especially from abroad) appears also to have contributed to the rise in interest rates: in the early months of 1969, when the latter were rather more stable than in a number of other major countries, there were signs that the capital market was becoming choked—largely because of heavy offerings of foreign bonds.

On domestic grounds alone the German authorities would have preferred tighter monetary conditions in the period before revaluation; but the large speculative short-term capital inflows acted to keep the banking system relatively liquid, in spite of the restraint. Trade union attitude, however, seem balance of payments. The inflows thus contributed to the continued growth of money and credit at a pace presumably as rapid as the economy required at going rates of interest. Conversely, the establishment of the new parity, with the reversal of speculative capital flows, could be expected to lead to sharp pressures on bank liquidity. When this began to happen in October, the authorities took measures, effective 1st November, to offset the pressures in part. The 100 per cent reserve requirement on increments to foreign liabilities was abolished; the reserve ratio on all foreign liabilities was made equal to that on domestic liabilities; and the ratio thus generalised was lowered by 10 per cent, releasing about DM 2 billion of bank liquidity.

PROSPECTS

Monetary policies and conditions

The following paragraphs try to assess probable future trends, discussing modifications that an individual country may want to make in its monetary policy in its own interest, often largely in view of demand management considerations. The monetary policies of individual countries are, of course, influenced by the policies that each thinks other major countries will pursue. In general, domestic requirements in individual countries suggest that the time is not yet ripe for any widespread relaxation of present monetary conditions. Indeed, for some countries the increasing strength of demand pressures suggests that monetary conditions may be further tightened in the near future.

In the *United States,* signs that the anti-inflationary policies of the past fifteen months or so are beginning to bite perhaps justify the view that monetary conditions will not become more stringent. Indeed, some slow growth of bank credit and of money supply might be allowed and interest rates permitted to ease off a little. But the evidence that price increases are really slowing down is as yet inconclusive, and uncertainties continue about the extension of the income tax surcharge into 1970 and the repeal of the investment tax credit. The scope for easing demand management policies (discussed on pages 59-61 seems likely to be fairly slight.

In *Germany,* revaluation will imply some net gain in real resources to the economy and an easing of domestic pressures, but the full effects will only develop gradually. Mainly as a result of earlier increases in required reserves, the bank liquidity ratio [1] had declined from 14 per cent of deposits at the end of December 1968 to 10 per cent at the end of August. However, it was still high by historical standards, due mainly to the inflows of speculative capital that had already occurred. The measures taken at the beginning of November partially to offset the subsequent outflows have been described above; on balance, however, there has been a further tightening of bank liquidity since August—although leaving it still above the levels reached in the last tight money period of 1965-66. As the November measures demonstrate, the authorities have the weapons available to prevent too sharp a squeeze on the banks arising from capital outflows and too great a rise in interest rates. But some pressure on bank liquidity would be compatible with present anti-inflationary policies. The fall in German long-term interest rates immediately following the establishment of the new parity proved momentary; and the rate structure as a whole could rise further in the months ahead, at any rate relative to rates outside Germany.

In both the *United Kingdom* and *France,* domestic considerations suggest, *inter alia,* continued monetary stringency to help redeploy resources in favour of the balance of payments. Monetary stringency can also benefit the capital account. In *Italy,* much depends on the new wage settlements and how strongly consumer demand pressures develop, although longer-term considerations suggest the desirability of relatively easy monetary conditions to foster the growth of private investment. In *Japan,* the move in August towards a more restrictive monetary stance suggests that the authorities were beginning to feel that tighter demand management was needed and that there was little chance of achieving this through fiscal policy in the short run. By 1970 a slower growth of world trade and, in particular, further easing of demand pressures in the United States, might provide sufficient easing in Japan, without additional restrictive policies; but it would not necessarily discourage inflows of capital, especially portfolio funds, which may tend to develop. In such circumstances, the continuation of monetary policies to encourage the " yen shift " and other capital outflows would seem appropriate.

1. As defined on page 83, footnote 2.

In many of the smaller countries, notably in *Scandinavia, Belgium, the Netherlands,* and *Austria,* domestic considerations would seem to argue for present policies being maintained for the time being. During 1970, if demand pressures tend to ease, there will probably be a corresponding tendency gradually to relax monetary policies. What this may mean, particularly in terms of lower interest rates in individual countries, will depend primarily on how rates are changing in the big capital centres and the Euro-dollar market, since there will no doubt continue to be a widespread wish to protect reserves, even with the added margin provided by the first tranche of Special Drawing Rights.

The picture suggested by the preceding paragraphs would be of a downward drift in rates within the United States; reduction of United States pressures on the Euro-dollar market; probably some upward pressure on rates within Germany; increasing pull on funds from abroad, for instance by France and, possibly, the United Kingdom, which directly or indirectly might put some pressure back on Euro-dollar rates again. The most likely tendency would be for rates to fall somewhat, with a smaller premium on Euro-dollar over other interest rates.

Capital Flows and Balances on Official Settlements

There may still be some scope for a short-term capital outflow from Germany. As already noted, the speculative short-term inflow in the first nine months of 1969 was in excess of $ 4 billion; from May 1968 to September 1969 it may have approached $ 6 billion. However, in view of the importance of leads and lags, the unwinding of the remaining speculative positions in Deutschemarks might be spread over several months. So long as German interest rates remain lower than those prevailing in most other countries and in the Euro-dollar market, it is reasonable to expect outflows contributing perhaps to easier conditions in the Euro-dollar market. Such conditions would, in the short run, make it easier for United States banks to continue to borrow Euro-dollars at a cost, including the reserve requirement, no higher, and possibly lower, than recent levels. But as monetary conditions ease in the United States relatively to other countries, the incentive for additional Euro-dollar borrowing by United States banks will gradually decrease or even be reversed.

For the *United States,* if demand continues to rise in 1970 rather more slowly than in most other areas, the trade balance can be expected to improve further. The current account surplus in 1970 might be perhaps $ 1½ billion. On long-term capital account much depends on the behaviour of mutual funds operating in Europe, which were heavy purchasers of United States equities in 1968 and up to the first quarter of 1969. Judging by the behaviour of United States stock markets in previous periods of monetary squeeze, an economic pause and easing of monetary policy might be preceded or at least accompanied by a stock market recovery. This in turn might induce European investors and mutual funds operating outside the United States to resume net purchases of American stocks. The extent of such a movement is, however, difficult to gauge. There may have been a large structural once-for-all element involved in the experience of 1968 and furthermore some European countries have enacted legislation designed to limit or control in various ways outflows of portfolio capital, especially through mutual funds. A return to net purchases as high as in 1968 seems perhaps improbable, and there is also the possibility of increased attraction of e.g. Japanese stocks.

Another important factor will be outward direct investment. If present plans for 1970 were fulfilled, a large increase would take place. But it is not yet clear how large a rise in outward flows will be authorised in the balance of payments programme. Foreign financing through bond issues may partly depend on this, but could also be facilitated by lower interest rates in the Euro-bond market. The balance on a liquidity basis could thus well continue in deficit. The prospect for the balance on official settlements will depend heavily on Euro-dollar flows.

For *Germany,* the forecasts described earlier suggest that the current account surplus could fall away rapidly. Whether further offsetting steps to control monetary conditions in the period ahead were thought desirable on domestic grounds would depend on several factors, including how fast the external surplus on goods and services were falling and what other policy instruments might be available. A situation of narrowing or even reversed interest differentials—between Germany and, especially, United States and Euro-dollar rates—carries with it the chance of eventual capital inflows.

For the *United Kingdom* a current account surplus perhaps at much the high rate reached in the last few months can be envisaged. This could, depending on how the authorities manage relative interest rates, be combined with a rather favourable capital account to produce a marked surplus on official settlements.

For *France* the prospect can be expected to be better from now on, on both current and capital account, but how radically is still hard to judge. A return of confidence could be accompanied by large capital nflows.

Japan seems likely to continue in large current account surplus and, if monetary conditions were to be tighter (and interest rates higher) relative to ther countries than recently, it could potentially be in large official settlements surplus.

For *Italy* interest differentials and the speculative pull of the Deutschemark have been factors increasing recent capital outflows. Looking ahead the current account seems likely to continue in substantial—though falling—surplus while there could be less pull on the capital account.

Thus, during 1970, with a changing balance of monetary conditions, a new pattern of capital flows and a new pattern of official settlements surpluses and deficits may develop. In principle the changes in capital flows that might develop could be mitigated if some countries other than the United States were to make more use of fiscal policy and less use of monetary policy to counter inflationary pressures, and if the United States relaxed fiscal policy more, and monetary policy less, as the need for demand restraint becomes less acute. It is an open question, however, whether in practice the range of variation regarding policy mixes would suffice in the short run to make an appreciable difference to capital flows.

INTERNATIONAL LIQUIDITY

In the last issue of *Economic Outlook* the factors affecting the supply and demand of official international liquidity in the 1960's were examined in some detail, with a view to throwing light on future prospects and needs for reserve creation.[1] Since then, the IMF General Meeting has approved the activation of the Special Drawing Rights scheme. This section discusses recent developments, and looks briefly at possibilities in 1970, when the first allocation of the new reserve asset will be made.

The earlier article suggested that much of the rise of published reserve figures in recent years could be attributed to the creation of assets that did not have all the characteristics traditionally associated with reserves. A concept of " adjusted reserves " was introduced in order to analyse underlying developments. Broadly speaking, adjusted reserves exclude creditor countries' holdings of currency assets arising from support operations and the rise in South African gold holdings since the introduction of the two-tier gold market.[2]

Within the 1960's, three periods have been distinguished. In the first, from end-1960 to end-1965, world reserves on an adjusted basis rose steadily, with an average annual increase of nearly $ 2 billion, largely accounted for by the United States deficit on official reserve transactions and by gold purchases from the private sector. During the intermediate period from end-1965 to September 1967 the supply of dollars arising from the U.S. deficit was reduced, there were small net sales of gold to the private sector, and official reserves increased only slightly. The most recent period, covering the two years from end-September 1967, saw a sizeable U.S. official surplus and substantial gold sales from official holdings: yet official reserves increased by a small amount, for reasons that will be explained below (Table 31 and Chart K).

The lower half of Chart K divides the last two years into three sub-periods. The first is the six-month period covering the sterling devaluation and the gold crisis in March 1968. Global reserves fell by around $ 3 billion. The impact of gold losses to the private sector through Gold Pool operations greatly outweighed the influence of a United States official deficit and large-scale support operations to the United Kingdom.[3] The second sub-period, the eight months from April to November 1968, was marked by the French events and the first of the

1. *Economic Outlook*, No. 5, pp. 45-59.
2. Historically, they also included the United Kingdom dollar portfolio prior to its official incorporation in the United Kingdom's reserves. For a detailed description and explanation of the adjustments made, see *ibid*, pp. 50-51.
3. This was aggravated by the fact that most of the total loss resulted in gold sales by the United States.

TABLE 31

Development of official international liquidity[a]

$ billion, amounts outstanding at end of period. Estimates

	1960	1965	1967 Sept.	1969 Sept.
Gold				
Recorded	37.9	41.4	40.4	38.8
Adjusted	37.9	41.4	40.4	38.4
Currency assets				
Recorded	19.7	24.3	27.1	35.0
Adjusted	21.1	24.8	26.0	28.4
Reserve position in the IMF	3.6	5.4	5.9	6.7
Total				
Recorded	61.2	71.0	73.4	80.5
Adjusted	62.5	71.6	72.2	73.6

a) Foreign reserve assets of national monetary authorities. The concept of adjusted reserves is explained on page 51.

heavy bouts of speculation on a Deutschemark revaluation, terminated by the announcements following the Bonn conference. Some $ 1¼ billion of reserves were created during this period, largely as a result of heavy support operations in favour of the United Kingdom and France; the reserve-destroying potential of the United States official surplus of nearly $ 1 billion was to a great extent offset by the fact that it was financed almost entirely by an increase in United States reserves, including gold purchases from France.

Recent Developments

The final sub-period spans the ten months to September 1969, which were dominated by tight monetary conditions in the United States and the two massive speculative movements into Deutschemarks in May and in late summer. The French devaluation was effected during the relatively quiet month of August, and the period culminated in the decision at the end of September to let the Deutschemark rate float. It is unsatisfactory to have to interrupt the account at the end of September, thus cutting off before the reflux of speculative capital from Germany. Between the end of September and mid-November German reserves fell by $ 3 billion. But it is too early yet to be able to say what the effect may have been on global international liquidity.

The ten months to September 1969 witnessed a surplus of $ 2½ billion in the U.S. balance on official reserve transactions. Even so, some $ 3 billion of official liquidity was created in the period, on the adjusted basis, as a result of:

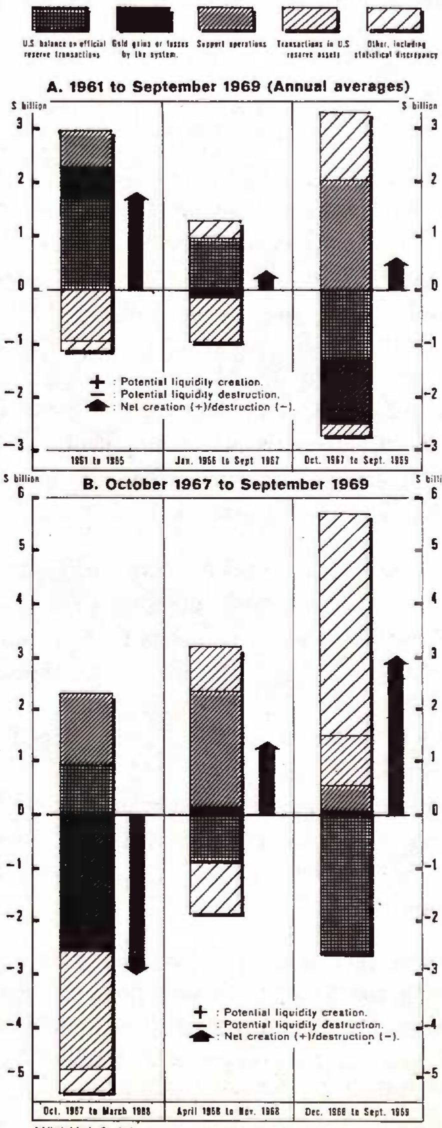
i) A rise of about $ ¾ billion of sterling area countries' official holdings of sterling, following the Basle Facility Agreement; this is included in the Chart as part of " Other ";

ii) Support operations (including credit tranche drawings at the IMF) of about $ ½ billion, mainly in favour of France;

iii) Increased U.S. reserve asset holdings of nearly $ 1 billion, offsetting to that extent the liquidity-destroying potential of the official surplus. In

CHART K

SOURCES OF OFFICIAL INTERNATIONAL LIQUIDITY*



* Adjusted basis. See text.

part the rise was due to French gold sales, the remainder being essentially an increased reserve position in the IMF;

iv) Increased gold holdings outside South Africa of about $ 100 million;

v) Unidentified reserve creation of some $ 3½ billion.

This last item is of such over-riding importance that it clearly warrants examination. Over the earlier periods this item—which corresponds roughly to the statistical discrepancy between recorded official assets and liabilities—had averaged approximately zero. The main reason for the enormous figure in the latest period appears to be that official holdings of dollars have increasingly been in the form of claims in the Euro-dollar market. The apparent rapid spread of this practice has meant that it has been possible for the United States to be in official settlements surplus without the large-scale liquidity destruction that would otherwise have taken place. There seems indeed to have been a certain degree of over-compensation; and the possibility of a reversal must be borne in mind in assessing future prospects.

The rise in reserves over the ten-month period was unevenly distributed (Table 32). As already mentioned, United States reserves increased by nearly $ 1 billion. Those of Japan grew by $ ½ billion. German reserves rose by around $ ¾ billion, but this figure does not mean a great deal in view of the extraordinary fluctuations that have taken place during the last year: a slightly later terminal date would show a radically different result. Reserves of other major countries changed little, though the stability in the gross reserves of the United Kingdom and France is somewhat misleading; the former repaid debts over the period and the latter increased its indebtedness. Most of the smaller OECD countries—particularly the Scandinavian countries—lost reserves, to a total of over $ ½ billion. The non-OECD area as a whole increased its holdings by over $ 1 billion, thus continuing a development that has been uninterrupted since 1962.

Developments since end-September have been dominated by the reflux from Germany; that country's reserves fell by $ 1½ billion in October and by a further $ 1½ billion in the first two weeks of November. Much of the outflow appears to have gone to neighbouring countries, in particular the Netherlands, which recorded a reserve increase of $ ½ billion in October as well as repaying swap drawings on the United States; Belgium also unwound

TABLE 32
Official reserve assets of individual countries
$ billion; estimates

	Reserves *a* end-Sept. 1969	Change: End-60 to end Nov. 68 Annual average	Change: End Nov. 68 to end Sept. 69
Large OECD countries, adjusted			
United States	12.9	–0.93	0.94
United Kingdom	2.4	–0.33	–0.08
Canada	2.9	0.11	0.07
Japan	3.2	0.09	0.51
France	4.0	0.21	0.02
Germany	10.9	0.40	0.70
Italy	5.2	0.23	0.10
TOTAL, OF ABOVE	41.6	–0.21	2.30
Smaller OECD countries, recorded			
Austria	1.4	0.09	–0.01
Belgium	2.2	0.10	–0.15
Denmark	0.3	0.02	–0.12
Finland	0.3	0.01	–0.08
Ireland	0.6	0.03	0.10
Netherlands	2.4	0.07	–0.04
Norway	0.6	0.04	–0.05
Portugal	1.4	0.09	0.03
Spain	1.0	0.07	–0.10
Sweden	0.5	0.04	–0.33
Switzerland	3.7	0.18	0.13
TOTAL, OF ABOVE *b*	15.1	0.75	–0.55
TOTAL OECD Adjusted	55.4	0.36	1.92
Recorded	62.0	1.32	2.28
NON-OECD *c* Adjusted	18.2	0.65	1.13
TOTAL WORLD Adjusted	73.6	1.01	3.05
Recorded	80.5	2.03	3.31

a) Large countries' reserves have been adjusted as far as possible for the factors mentioned on p. 51. It has not been possible from published information, however, to allocate to particular countries the whole of the adjustment made to global reserves, much of which was derived from data on liabilities. Information was especially difficult to obtain for the smaller countries, for which recorded figures have therefore been given.

b) Including Greece, Iceland and Turkey.

c) Excludes Finland throughout.

its United States swaps. The United Kingdom and, more recently, France also seem to have received part of the reflux, enabling some debt repayment. Some indication of the total debt repayment that took place in October can be obtained from the fact that United States holdings of currency assets fell by nearly $ ½ billion.

Prospects for 1970

The first allocation of Special Drawing Rights (SDR's) will be made in January 1970, with the result that some $ 3½ billion of official liquidity will be added to the system. It is not yet certain whether all IMF members will participate in the first allocation. If all members participate, the United States will receive almost one quarter of the total allocation, the United Kingdom 12 per cent, EEC countries

18 per cent, and other OECD countries 14 per cent. Of the 31 per cent of the total allocated to non-OECD countries, some 4 per cent would go to the developed primary producers and the remainder to less-developed countries. Allocations of $ 3 billion each year will follow in 1971 and 1972.

A country participating in the SDR scheme will be allowed, provided such a step is considered appropriate in the light of its balance of payments and reserve positions, to use up to the whole of its cumulative allocation at a given moment, so long as over the whole of the " basic period " (in the first instance, the three years 1970-1972) its average net use does not exceed 70 per cent of its average cumulative allocation during the period. [1] " Use " means the transfer of SDR's to another participant in exchange for an equivalent amount of convertible currency. The extent to which a participant will be obliged to accept SDR's—again subject to its balance of payments position and reserve position—will be limited to twice the amount of its cumulative allocation, i.e. to the point where its total holding of SDR's is equal to three times its cumulative allocation. Net users will pay, and net " excess holders " receive, a small rate of interest.

There seems no reason to doubt that countries will regard the new asset as part of first-line reserves. The reconstitution obligation attaching to use in excess of 70 per cent of cumulative allocations might perhaps suggest that only 70 per cent of each allocation should be regarded as an addition to *unconditional* reserves. Even that, however, would represent a substantial planned increase in official international liquidity.

The development of other components of liquidity is likely, in the absence of any new arrangements covering newly-mined gold, to hinge on two main groups of factors:

i) The United States official balance, together with the forces that tend to offset its impact;
ii) The progress made by the United Kingdom and France in repaying swaps and other short-term assistance.

It has been suggested earlier that the United States official surplus is unlikely to persist in 1970 and that it could give place to a deficit. In that case, there would be the possibility of additional reserve creation. Two sets of forces might, however, tend to offset such a development. First, the deficit might at least partially be financed by United States reserve assets—gold, reserve position in the IMF, or SDR's—rather than by increased liabilities to foreign monetary authorities. Secondly, a United States official settlements deficit might be partly connected with—and its liquidity creating effects partly offset by—some decline in other monetary authorities' holdings in the Euro-dollar market. The net outcome of this complex of factors cannot be foreseen.

It is also difficult to assess the extent to which the United Kingdom and France will repay debt in the near future; current account prospects suggest that progress during 1970 could be substantial. Repayments to the United States or repurchases in the IMF credit tranches would have the effect of reducing total adjusted reserves one for one. [2] Repayments to countries other than the United States would have no effect on the total of global adjusted reserves, but would imply a redistribution within the system. [3]

One other feature of importance in the course of 1970 will be the increase in IMF quotas by about one third, including selective increases of more than the average for certain countries whose importance in the international economy is inadequately reflected in the present distribution of quotas. The quota increase will not in itself have any effect on the total of countries' reserves, since there will be a transfer of gold from countries to the IMF equal to the increase of countries' reserve positions in the IMF. [4] But the growth of conditional liquidity—the short to medium-run credit facilities available to countries in balance of payments difficulties—will be substantial. This fact, combined with the greater stability that can be expected in the system following the recent parity changes, suggests that less resort may be needed in the near future to ad-hoc inter-central bank credit.

1. A country that received allocations of, say, $ 350 million, $ 300 million, and $ 300 million at the beginning of the three years 1970, 1971 and 1972, would have an average cumulative allocation over the whole period of $ 650 million; its authorised maximum average use would therefore be $ 455 million.

2. At end-June 1969, the latest date for which figures are available, combined United States Treasury and Federal Reserve holdings of sterling and francs amounted to $ 2.8 billion; these holdings have probably been reduced since that date. At end-September, 1969, the United Kingdom and France had credit tranche drawings outstanding of a further $ 2.8 billion. The sum of these figures ($ 4.9 billion for the United Kingdom and $ 0.7 billion for France) gives an approximate idea of the amount of liquidity destruction that could ultimately result from full debt repayment.

3. Published reserve totals would however be reduced. *Economic Outlook*, No. 5, p. 51.

4. Unless the IMF made gold deposits or gold investments with countries.

DEVELOPMENTS IN MAJOR COUNTRIES

UNITED STATES

By the second quarter of 1969, the growth of real output had decelerated to an annual rate of 2 per cent—about half the estimated potential growth rate. While the third quarter showed no further deceleration, the last quarter of the year is likely to see a considerable new slowing-down. Price performance has so far been disappointing; during the first half-year the rise gathered pace and only recently has it showed signs of easing. Moreover, significant evidence of underlying improvement of the current external balance is, as yet, lacking.

Monetary restraint has been considerably increased since about mid-year, and official statements suggest that no significant relaxation is in prospect for the near future. On this assumption, and given the fiscal programme at present planned by the Administration, the real rate of growth in the first half of 1970 should be very modest, with further increases in the unemployment rate and decreases in demand pressures. There should, thus, be a more moderate price rise and some improvement of the current external balance. The second half of 1970 seems likely to see a new acceleration of growth, perhaps to the capacity rate, or above.

One concern of policy will, clearly, have to be to ensure that existing restrictive policies do not lead to an undesirably sharp or prolonged slowing-down; this danger does not, at present, seem great. On the other hand, doubt must exist whether prices will respond satisfactorily to the degree of easing of demand pressures now envisaged—particularly if, from mid-1970, economic activity begins to speed up again rather considerably. A third point of concern may be that the adjustment period seems unlikely to produce, in the course of 1970, a current surplus on external account commensurate with the longer-term needs of the balance of payments.

Demand and Output
UNITED STATES

Percentage changes, volume
Seasonally adjusted
at annual rates
Estimates and forecasts

	1968 billion $	From previous year 1968	1969	1970	From previous half-year 1968 II	1969 I	1969 II	1970 I	1970 II
Private consumption	536.6	5.2	3	2½	4.8	2.9	1½	2½	3¾
Public expenditure	200.3	6.0	1	–¾	3.1	1.2	–1¾	–1½	1¼
Private fixed investment	119.0	5.5	5¼	–½	1.7	10.1	0	–2½	3
Final domestic demand (excluding stocks)	855.9	5.4	3	1½	4.0	3.6	¾	1	3
*plus change in stock building	7.3[a]	0.0	0	–¼	0.8	–0.6	¾	–¾	0
*plus change in foreign balance	2.5[a]	–0.4	0	¼	–0.1	–0.3	¼	¼	0
GNP at market prices	865.7	4.9	2¾	1½	4.7	2.6	1¾	½	3¼
GNP implicit price deflator	..	4.0	4¾	4	4.2	4.7	5	3¾	3¾
Industrial production	..	4.6	4¼	¾	3.9	6.3	2¾	–1½	3½

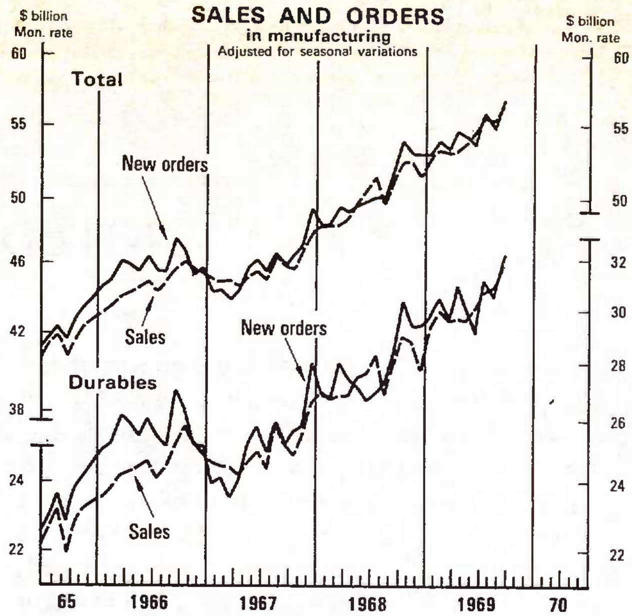
* The yearly and half-yearly rates of change refer to changes in stock building and in the foreign balance expressed as a percentage of GNP in the previous period. These two figures plus the rate of change of final domestic demand broadly equal the rate of change of GNP. In practice, however, divergences are possible because the rate of change of final domestic demand is not expressed as a percentage of GNP.

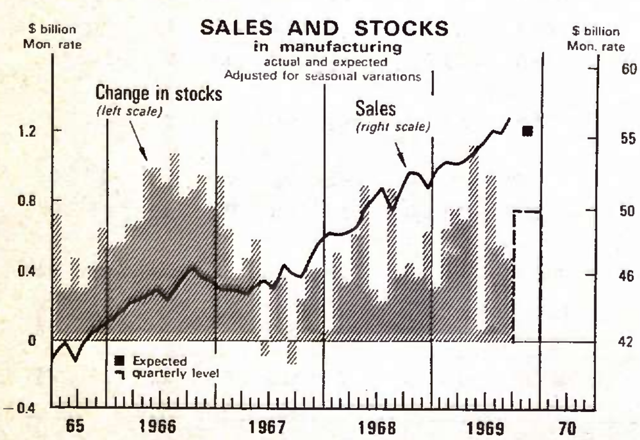
a) Actual level of stock building and foreign balance

Recent Trends

The growth in real final sales (GNP less inventory accumulation) slowed very substantially in the second and third quarters, falling to an annual rate of increase of 1 per cent. Real GNP, however, failed to show any further deceleration in the third quarter, as the rate of inventory accumulation was stepped up; the annual rate of growth stayed at about 2 per cent. On the other hand, the industrial production index showed a considerable further slowing-down, actually falling in August through October.

Most major demand components contributed to the slowing-down in real final sales during the two quarters. Federal government purchases were declining (but for the third quarter pay increase, in value terms as well as in volume). Through the second quarter, state and local government purchases had been accelerating; but as borrowing became more difficult there was no further increase in the third quarter. The boom in business expenditures on fixed capital continued, but tapered off considerably from the earlier pace. Residential construction felt the bite of stringent monetary conditions. After rising substantially up to the first quarter, housebuilding declined in the second quarter, and fell still more sharply in the third. The growth of consumption spending slackened sharply after the first quarter surge, with successively smaller increments in the following two quarters. At 5.3 per cent of disposable income, the personal saving rate in the first two quarters had been well below the average level of recent years, and also low by longer-term standards. The third quarter slowdown in the advance of consumer spending—purchases of durables actually fell—occurred in the face of a large increase in real disposable income (households were benefitting from the Federal government's pay increase and had completed unusually heavy final payments on their 1968 tax liabilities); the personal saving rate rose by one and one-half percentage points. The higher rate of inventory accumulation in the face of slower gains in final sales suggests some degree of involuntary stockbuilding, but stock-sales ratios, while rising on the retail level, do not indicate that inventory imbalances are as yet large.





Pressures on resources have now eased considerably since their peak in the second half of 1968. In the third quarter, real output was slightly below the estimated potential GNP,[1] compared with a peak excess of 1.35 per cent a year earlier. Labour markets have been slow to register easing demand pressures. The overall unemployment rate had only risen from the 3.3 per cent low-point of December-February to 3.5-3.6 per cent in July-August, as employment grew more rapidly than past relationships with output would have suggested. In September, however, a sharp increase occurred, to 4.0 per cent,[2] receding only to 3.9 per cent in

1. As estimated in U.S. Department of Commerce *Business Conditions Digest*, based on trends in productivity and available man-hours. Full potential is defined so that on average it corresponds to roughly a 4 per cent unemployment rate.
2. The rate for males over 25 rose from 2.1 to 2.4 per cent. The increase was concentrated among " blue collar " workers, for whom the rate rose from 3.8 to 4.4 per cent.

October. Business may now be beginning to release some excess labour built up earlier in the year. If so, the effects of lower pressure on the labour market may now begin to be felt.

The increase in the seasonally adjusted index of labour compensation per man-hour (private sector) slowed down in the first three quarters of 1969, to a rate below the quarterly average of 1968. Since labour markets were, if anything, tighter during this period, the explanation lies probably in the easier schedule of new wage agreements which have typically been " front-loaded "[1] in the recent past. But with employment rising at a substantial rate in the face of slackening output, the private economy's output per man-hour fell in the first two quarters and rose only slightly in the third. As a result, unit labour costs and the private GNP deflator have risen more rapidly than during 1968. Prices, however, have risen more slowly than unit labour costs, and decelerated somewhat in the third quarter (Tables 33 and 34). Profits of non-financial corporations (before taxes and excluding inventory gains or losses) per unit of real corporate output have been declining since mid-1968, and fell in absolute terms in each of the first three quarters of 1969. With unemployment rising less rapidly late in the year, productivity performance has probably improved, and the trend in unit labour costs may have slowed down somewhat.

Price trends seem to have been easing somewhat in the second half-year. The GNP price deflator rose at an annual rate of more than 5½ per cent in the third quarter, compared with an average rate of 5 per cent in the first two quarters of the year. But this speed-up was more than accounted for by the federal government salary increase. Excluding this, the rate of increase was below 4½ per cent. The rise of wholesale prices has flattened out, largely because prices of farm products have fallen, after an earlier fast climb. Wholesale prices of industrial commodities had accelerated sharply early in the year, led by an extremely large increase in timber prices, but the movement flattened out as these fell back sharply. In the summer and early autumn wholesale prices of industrial commodities were rising at an annual rate above 4 per cent, similar to the average first-half rate, and faster than in the last half of 1968. The upward trend of consumers' prices eased somewhat

1. Meaning that a disproportionate share of the increase in benefits is concentrated in the first year of the contract.

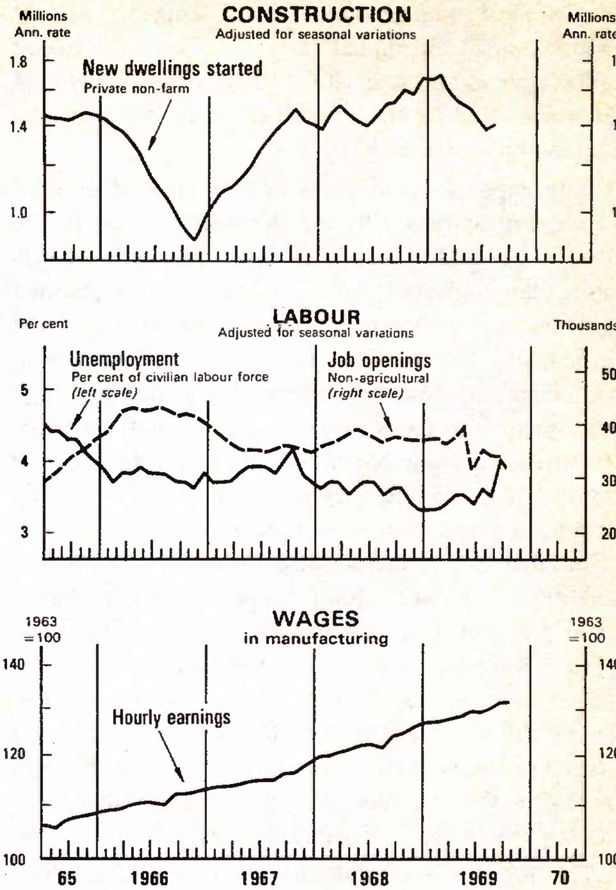


TABLE 33
Compensation, productivity, costs and prices
Private economy, seasonally adjusted annual rates of change ; per cent

	1968 Q1	1968 Q2	1968 Q3	1968 Q4	1969 Q1	1969 Q2	1969 Q3
Compensation per man-hour	11.3	5.9	7.4	10.4	6.6	5.3	7.4
Output per man-hour	4.8	3.8	2.0	4.1	−1.3	−1.2	0.8
Unit labour costs	6.1	2.1	5.3	6.3	7.6	6.8	6.6
GNP deflator (private sector)	3.3	4.1	3.5	4.1	4.8	5.2	4.6

TABLE 34
Price Trends
Annual percentage rates of change

	June 68 to Dec. 68	Dec. 68 to March 69	March 69 to June 69	June 69 to Oct. 69
Wholesale prices	2.0	7.1	5.5	2.1
Industrial commodities	2.6	6.7	0.7	4.3
Consumer prices	4.7	6.3	6.5	5.3
Commodities	3.7	5.2	6.2	4.0 *a*
Commodities less food	3.7	5.7	4.2	2.4 *a*

a) June to September.

in the third quarter but still amounted to nearly 5½ per cent at an annual rate. The seasonal easing in food prices and a levelling off of mortgage interest rates should help the consumer price index in the later months of the year.

Both exports and imports in the first half of 1969 were greatly affected by the dock strike early in the year. The strike seems to have affected exports more than imports. Some shipments were pushed back into the previous half-year or forward into the second quarter, but there was also a substantial permanent net loss of perhaps $ ¾ billion. Rough adjustment for these factors suggests that, but for the strike, the trade balance would probably not have deteriorated; whether there would have been any significant improvement is more problematical. Unfavourable export factors also included poor foreign conditions for agricultural exports, and a flatter trend in deliveries of civilian aircraft. The third quarter saw some recovery in the trade balance, but the surplus was still below pre-1968 levels. The deterioration of the balance of other current account items has mainly reflected a large rise of investment income payments, due to higher interest rates and the large increase in Euro-dollar borrowings.

The long-term capital account (seasonally adjusted) also deteriorated substantially in the first half of the year. The largest part affected U.S. corporate assets and liabilities, reflecting substantially larger direct investment outflows, and reduced new issues of securities abroad. There was also a sharp decline of foreign purchases of U.S. stocks in the second quarter, probably because of the weakness of U.S. stock prices and the increased attractiveness of Euro-dollar deposits.

Monetary stringency in the United States has induced sizeable flows of short-term funds, with divergent effects on the two official balance of payments measures. U.S. banks, with their reserve positions under heavy pressure from restrictive Federal Reserve policies, borrowed heavily from the Euro-dollar market through their foreign branches. This helped bid up short-term yields in the Euro-dollar market, attracting, in turn, substantial short-term capital outflows from the United States, some of which were apparently not recorded. Some of these outgoing funds flowed to the foreign branches of U.S. banks, and were then loaned to their home offices. However, the banking inflows were much larger than the outflows mentioned above, the difference representing a net inflow of foreign funds that produced a large official settlements surplus. These banking inflows, however, did not improve the official liquidity balance, since on this account they are classified as financing, rather than reducing, the deficit. On the other hand, the outflows contributed to the deterioration of the liquidity balance, which registered a deficit of unprecedented size. [1]

Recent Policy Measures

The Administration's fiscal proposals have so far been only partially enacted by Congress. An extension of the 10 per cent surcharge to 31st December was passed as requested by the Administration, but the surcharge has not yet been further extended to mid-1970 at the 5 per cent rate. The retroactive repeal of the investment tax credit was included in a controversial package of tax reform measures which has passed the House of Representatives, and is now being considered by the Senate. Congress imposed a federal spending ceiling of $ 191.9 billion [2] for the current fiscal year (ending June 30th, 1970), $ 1 billion below the earlier Administration estimate, but with an additional $ 2 billion allowance for further increases in " uncontrollable " programmes. [3] Uncontrollable increases are likely to exceed this amount, and the Administration has ordered further budget cuts to bring the total back to the original Administration target of $ 192.9 billion. Defence spending plans have been cut by $ 3 billion as part of this programme. In view of rapidly climbing construction costs, the Administration has ordered a 75 per cent cut-back in Federal construction contracts which will gradually affect spending later in the fiscal year. Table 35 presents the Federal budget for the 1969 and 1970 fiscal years on the national income accounting basis.

Monetary policy, which began moving towards greater restraint late in 1968, has been further tightening since about mid-year. Net borrowed reserves, a widely used index of pressure on bank reserve positions, climbed progressively over the first five months. Since May they have fluctuated around the $ 1 billion level, compared with an average of

1. For a further discussion see section on capital movements and monetary developments, pp. 33-50.
2. Compared with a $ 184.8 billion outturn in the previous fiscal year.
3. Including social insurance and medicare payments, interest and agricultural price supports.

TABLE 35

Federal government expenditure and revenue

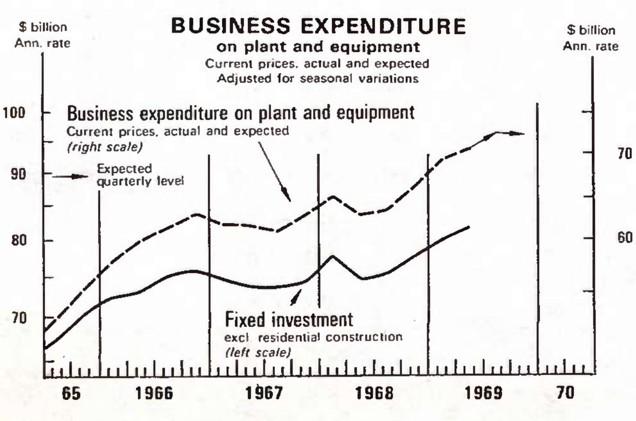
Fiscal year ending 30th June ; $ billion

	1968-69	1969-70
Receipts, total	192.3	201.2
Personal income tax and non-tax receipts	90.5	94.7
Other *a*	101.8	106.5
Expenditure, total	187.4	196.1
Purchases of goods and services	101.2	101.5
Domestic transfers	48.3	53.5
Other *b*	37.9	41.1
Surplus	4.9	5.1

a) Including corporate profit tax accruals, indirect business tax accruals, and contributions for social insurance.

b) Including grants-in-aid to State and local governments, net interest paid, subsidies and foreign transfers.

$ 300 million last December. Pressure on bank reserve positions has been a combined result of a declining trend in seasonally-adjusted unborrowed reserves (reflecting the restrictive open market policy of the Federal Reserve system which has been accentuated since mid-year) and the use of Regulation Q by which the ceiling rates payable by banks on certificates of deposit (CDs) have been held well below market rates of interest. As a result of Regulation Q, banks have suffered a large run-off of CDs, which bear a lower reserve requirement than demand deposits. The effect of this deposit loss on the banks' reserve position was partially offset by increased Euro-dollar borrowing which, until September, was not subject to any reserve requirements. Total bank reserves (seasonally adjusted) declined sharply in the third quarter after having been held about level over the first six months. The money stock (seasonally adjusted), which grew by 4.3 per cent (at an annual rate) during the first half, was held virtually constant over the next four months. Commercial bank business loans (seasonally adjusted) continued to grow at a rapid 17 per cent annual rate during the first half, as banks reduced their security portfolios to meet customer demands, but the rate has since fallen to about 5 per cent. As yet there are no signs that the monetary authorities are easing their policy stance.



Prospects

The present forecast assumes that there will be no early substantial reversal of monetary policy; that the Administration will obtain its proposed extension of the surcharge (at a 5 per cent rate) and repeal of the investment tax credit; and that present expenditure control targets are met, or nearly so. This combination should ensure against any significant speed-up of economic growth in the first half of 1970 that might interfere with continued progress against inflation. On the other hand, the present forecast assumes that there will soon be some very modest degree of easing in monetary conditions, mainly reflecting weaker credit demand, but with a renewed, though moderate, growth of the main monetary aggregates. It also assumes that there will be no very sharp break in business or consumers' expectations, and that firms are able to adjust production so as to avoid substantial inventory imbalances. Under these conditions, a severe or extended contraction of economic activity should be avoided.

In the fourth quarter, the gain in real final sales is not likely to be very different from the small increase in the third quarter. The volume of government purchases will probably continue to decline, and the movement of housing starts indicates a further decline of residential construction. Business capital outlays, according to the SEC/Commerce survey published in September, will level off in value terms, implying a decline in volume. Net exports, on the other hand, are likely to increase again; and empirical income-consumption relationships would suggest a somewhat larger increase in consumers' expenditure than occurred in the third quarter, with possibly some fall in the saving rate. If output adjusts reasonably well to final sales, inventory accumulation should not increase further from the third quarter rate, and might well decline somewhat. If, however, output continued to increase at its third quarter pace, there would be a further increase in the rate of inventory investment, implying substantial involuntary accumulation and imbalances which would set the stage for a sharp adjustment in the following period.

A main uncertainty for 1970 lies in how enterprises will adjust their capital spending plans in the light of slow growth, possible further declines in profits, and continued monetary stringency. Some recent private surveys have suggested a fairly strong growth rate of 7-9 per cent in value. It seems likely that relatively weak sales and unfavourable financial conditions will lead to some scaling-down from these figures. On the other hand, these surveys, together with other evidence—business capital appropriations, orders, and a growing carry-over of unfinished investment projects—would seem to reduce the possibility of a decline of business fixed investment in 1970. The present forecast is based on the assumption of a 6 per cent increase (value).

Housing starts (seasonally adjusted) have been on a declining trend since January and financial developments seem almost certain to produce further decreases into early 1970. Given the monetary policy assumptions adopted—some modest easing around the end of the year—housing starts could begin a recovery next spring. The actual volume of residential construction will probably continue to decline in the first two quarters of 1970, but may turn up thereafter. Federal government purchases are planned to continue to decline, but state and local governments are likely to continue to expand their spending, perhaps at a somewhat dampened pace. Net exports should continue to rise. Although the growth of personal income is likely to be dampened by slower—perhaps occasionally negative—growth in employment, disposable income will be boosted by the halving of the tax surcharge on 1st January (by about $ 4 billion at an annual rate) and the increase planned for social insurance benefits in April (about a $ 3 billion annual rate). Empirical relationships suggest that the first half's saving rate may be somewhat lower than it was in the third quarter of 1969. If so, consumption should continue to grow fairly steadily.

The present forecast, therefore, would imply real growth of under 1 per cent at an annual rate over the three quarters ending mid-1970, with the possibility that for a short time a small absolute decline might occur. Unemployment might rise to 4½ per cent or above by mid-year. There is a fairly heavy collective bargaining schedule in late 1969 and 1970. Strike activity could intensify significantly in coming months. But negotiations will be taking place in a rather different environment than in the last year or two; the increase in hourly earnings should ease further and, if a more normal growth in labour productivity is resumed, costs should rise less rapidly. The considerable easing of demand pressures thus produced should entail a significant improvement in price performance. The increase in the private GNP deflator might be reduced to close to 3 per cent by mid-year.

Balance of payments
UNITED STATES

Value, million dollars
Estimates and forecasts

	1968	1969	1970	1968 II	1969 I	1969 II	1970 I	1970 II
SEASONALLY ADJUSTED								
Exports	33 598	36 500	40 150	17 262	17 057	19 450	19 900	20 250
Percent change[a]	(9.4)	(9.5)	(10)	(14.1)	(–2.0)	(29.0)	(4½)	(4½)
Imports	32 972	35 850	37 750	17 024	17 167	18 700	18 700	19 050
Percent change[a]	(23.4)	(8.5)	(5)	(13.9)	(2.3)	(18.0)	(0)	(3½)
Trade balance	626	650	2 400	238	–110	750	1 200	1 200
Services and transfers, net[b]	–910	–1 250	–900	–503	–610	–650	–500	–400
Current balance	–284	–600	1 500	–265	–720	100	700	800
Long-term capital[b]	–1 320			–721	–1 758			
Short-term capital and unrecorded	–956			482	–2 178			
Balance on non-monetary transactions	–2 557			–504	–4 656			
Change in reserves[c] (increase = +)	10			1 260	88			

a) Over previous period at annual rates, customs basis.
b) 1968 data include waived debt obligations payable by the United Kingdom.
c) Not seasonally adjusted.

An acceleration of growth is likely after mid-1970. The April social insurance benefit increase will be followed at mid-year by the removal of the remaining half of the surcharge, and probably another Federal government pay increase. These should give considerable stimulus to consumption in the second half, although the saving rate will probably rise somewhat to dampen the impact. Easier financial conditions should produce a recovery in residential construction. The extent of the general acceleration is obviously uncertain, and will depend heavily on the policy attitude taken by the authorities. It will clearly be a priority aim of the authorities to keep unemployment from rising to unacceptable levels. But a strong recovery might endanger further progress towards price stability and a sustainable balance of payments position.

The expected slowdown should also help to produce some improvement in the current account of the balance of payments, although the position reached after two years of below-capacity growth seems likely to remain less than satisfactory. Merchandise exports are likely to grow at a fairly rapid rate in 1970, perhaps above 10 per cent. This assumes growth in export markets of about 10 per cent, and includes an allowance for the recovery from the effects of the 1968-69 dockworkers' strike and a substantial increase in commercial aircraft deliveries. On the other hand, recent poor price performance may tend to dampen exports for some time to come. Imports are likely to be restrained by slower growth and easing demand pressures, especially in the first half, and may grow by no more than 5 per cent in 1970. The trade balance (balance of payments basis) could improve to nearly \$ 2½ billion from the expected surplus of about \$ ¾ billion in 1969. Lower short-term interest rates may reduce income payments abroad. Thus the current account, after two years of deficit, is likely to move into surplus, perhaps of the order of \$ 1½ billion. At the same time, capital account developments, very difficult to forecast, might be unfavourable. In particular, the inflow of funds through U.S. banks seems likely to diminish or be reversed. If so, the official settlements balance would deteriorate. The liquidity and non-monetary balances, however, should improve from the very large deficits of 1969.

CANADA

The unexpectedly strong expansion experienced in 1968 and early 1969, heavily influenced by the buoyancy of exports, gave way to a slight decline of real GNP in the second quarter, reducing growth for the first half below the capacity rate. The second half-year seems to have seen some further easing of demand pressures. But the rise in labour costs and prices has remained strong, and restoration of better price stability remains a major policy problem. With the likelihood of slow growth in the United States, and with domestic policies aimed at a further easing of demand pressures, the advance of activity in 1970 would seem likely to stay below the capacity growth rate, entailing some further rise in unemployment. The easier demand conditions should have some stabilising impact on costs and prices, but it is uncertain how rapid the progress will be. Given the difficulty of arresting the price/wage spiral by the use of demand management policy alone, strong efforts are being made to develop an incomes policy. The new Prices and Incomes Commission is seeking to secure agreement among business, labour and professions on a voluntary programme of income restraint. Trade union attitudes, however, seem unfavourable to the introduction of guidelines or voluntary restraints on wage increases. The government has announced that it is considering tax and tariff measures to combat inflation, should other efforts fail; the possibility of wage-price controls and credit restrictions was also mentioned.

Demand and Output
CANADA

Percentage changes, volume
Seasonally adjusted
at annual rates
Estimates and forecasts

	1968 billion $ Can.	From previous year			From previous half-year				
		1968	1969	1970	1968 II	1969 I	1969 II	1970 I	1970 II
Private consumption	40.9	4.5	5	4	5.8	5.1	4	4	4½
Public expenditure	13.3	1.1	3½	2½	5.0	2.9	3½	2	2½
Private fixed investment	12.8	–1.8	5¼	5¼	1.5	11.0	-2	7½	8½
Final domestic demand (excluding stocks)	67.0	2.7	5	4	4.8	5.8	2¾	4¼	5
*plus change in stock building	0.7[a]	0.8	½	0	1.7	0.3	½	0	0
*plus change in foreign balance	–0.3[a]	1.0	–½	0	–0.8	–1.1	0	–¼	–¼
GNP at market prices[b]	67.4	4.7	5	4	6.6	4.7	3¼	4	4¾
GNP implicit price deflator	..	3.6	4½	4	3.3	5.1	4	4	3¾
Industrial production	..	5.3	5	4	7.7	6.2	¼	5½	5

* The yearly and half-yearly rates of change refer to changes in stock building and in the foreign balance expressed as a percentage of GNP in the previous period. These two figures plus the rate of change of final domestic demand broadly equal the rate of change of GNP. In practice, however, divergences are possible because the rate of change of final domestic demand is not expressed as a percentage of GNP.

a) Actual level of stock building and foreign balance

b) Including errors and omissions.

Recent Trends

The rise of activity slowed down considerably in the first half of 1969, with real GNP growing somewhat below the capacity rate.[1] Final demand increased rather faster than earlier, but stockbuilding rose less and the foreign balance deteriorated. The second quarter, in fact, saw a slight fall of real GNP, with substantial declines for exports and stockbuilding, and a slower advance for most other major demand components. Strikes were an important factor in the decline, together with weaker import demand from the United States and restrictive fiscal and monetary policies. In the second half of the year, the expansion seems to have continued at a reduced rate. There was a moderate rise of exports in the third quarter, and government purchases of goods and services are rising only slowly in real terms. Recent information, including the October survey of investment intentions, points to levelling-off or slight decline for fixed capital formation.

Business fixed investment is probably still rising, but less than earlier, and residential construction is falling substantially after the lower starts in the second and third quarters. The unemployment ratio, although moving rather erratically during the summer months, has been on a rising trend since the spring, exceeding 5 per cent in October.

The price rise has accelerated. The GNP deflator in the first half-year increased at an annual rate of 5 per cent, as against about 3½ per cent in the preceding half. Consumer prices have been rising at a similar rate but levelled off in the autumn with a seasonal fall in food prices. Wholesale prices were rising even faster until the second quarter, with particularly strong increases in prices for animal products, timber and other construction materials, and non-ferrous metals. In the summer months, however, there was no further increase, with the September figure slightly below June. While shortages due to strikes may have been a factor in the price rise, it has mainly reflected earlier demand pressures and the rapid increase of labour costs. The average annual increase of base rates provided by major wage settlements in the first three quarters of the year was 7.6 per cent per employee, only slightly down from the 8 per cent recorded in 1968. With the growth of output slowing down, the advance of productivity in the first half year was very modest, so unit labour costs rose at an annual rate of 7 per cent in the whole economy and around 5 per cent in manufacturing. Corporate profits before taxes have levelled out at the end-1968 level.

1. National accounts data have recently undergone substantial revision. Quarterly data on the new basis, however, are not yet finalized. Therefore, the present discussion is based on unrevised figures, and conclusions drawn must be tentative.

The deficit on the current account of the balance of payments increased sharply to an annual rate of U.S. \$ 850 million in the first half of the present year (from \$ 250 million in the second half of 1968). The rise of imports accelerated strongly and more than offset the advance of exports, and the deficit on non-trade items continued to grow. Given the trends recorded in the third quarter, the increase of both exports and imports will probably have slowed down in the second half of the year, but the current account deficit would seem unlikely to have changed much. The long-term capital inflow was sufficient to cover the current deficit in the first half, but the outflow of commercial bank funds attracted by high interest rates in the United States entailed a slight decline in official reserves (including the IMF position). At the end of October, the reserves stood at about U.S. \$ 3 billion, little changed from the end-1968 level.

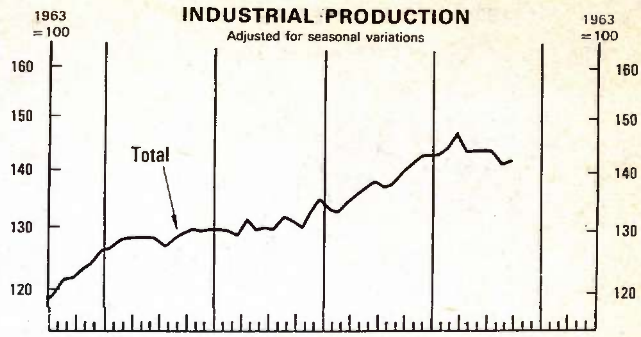
Recent Policy Measures

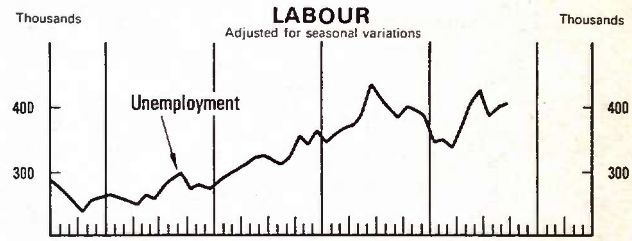
No new fiscal measures have been taken since June, when the federal budget presented for the fiscal year ending March, 1970, showed a surplus of Can. \$ 575 million on a national accounts basis following a small deficit of \$ 67 million in 1968/69; the swing represented more than 1 per cent of GNP. According to a later statement, the surplus might be substantially above the June estimate.

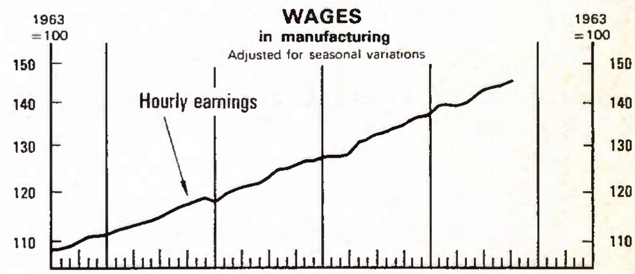
The Prime Minister stated in August that official projections call for a slower growth in federal spending in the coming fiscal year. Following the marked tightening of monetary policy in the first half of the year, bank rate was increased further from 7½ to 8 per cent in July, mainly in order to stop the outflow of banking funds to the United States from increasing. Market rates have continued to rise. The money supply (public holdings of currency plus demand deposits) had advanced at an 8 per cent annual rate over the first six months of 1969 but fell somewhat in the third quarter.

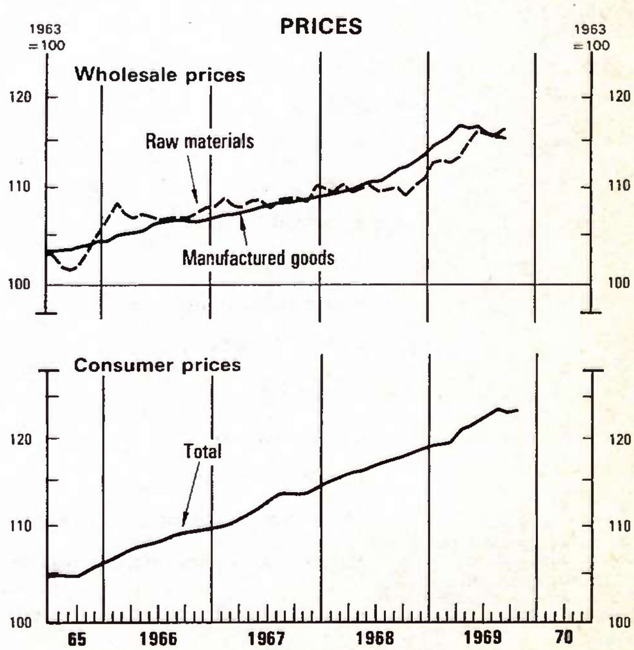
Prospects

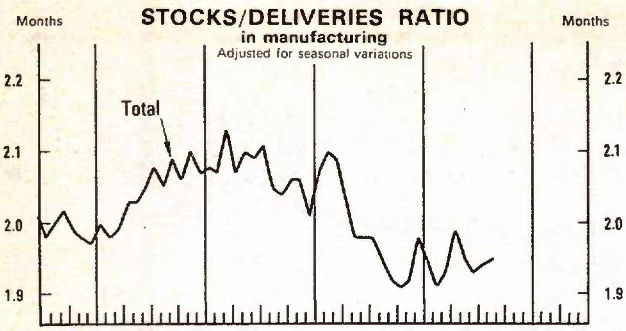
It is assumed that the present degree of fiscal restraint will be maintained in the budget year beginning next April. Monetary conditions are also expected to remain tight; but market yields could ease off somewhat early next year in response to

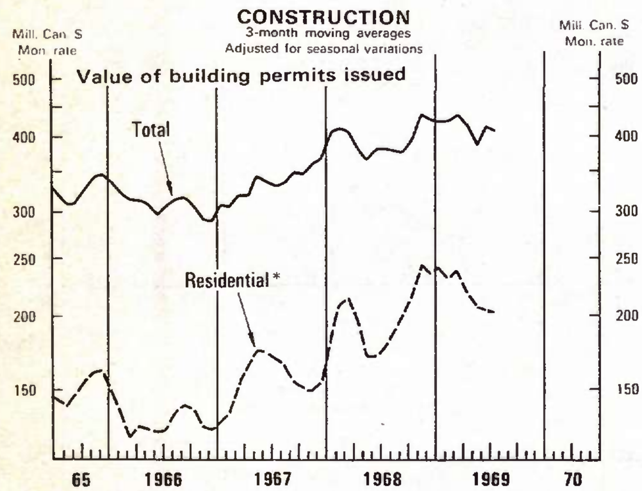












weaker credit demand. On this basis, the rise of activity seems likely to be rather moderate in 1970. Exports may increase only modestly, given the outlook for world trade and, particularly, the probable slow increase of U.S. imports. Official statements point to slower growth of public expenditure on goods and services. The availability of mortgage funds could increase somewhat next year since other types of credit demand may ease off; and given the underlying strength of housing demand, it has been assumed that residential construction could show a recovery. The outlook for business fixed investment is particularly uncertain. It is difficult to judge the impact on investment demand of tight monetary conditions and a possible weakening of inflationary attitudes. In the light of the October survey of intentions, it has been assumed that business fixed asset formation will show a somewhat larger real increase than in 1969, but mainly because 1969 was upset by strikes. As there has been no indication of any involuntary build-up, it is expected that the change in inventory accumulation will be small. Private consumption may be a dynamic demand component; the growth of labour incomes is likely to continue to be strong, and shifts in the age-distri-

Balance of payments
CANADA

Value, million dollars
Estimates and forecasts

	1968	1969	1970	1968 II	1969 I	1969 II	1970 I	1970 II
SEASONALLY ADJUSTED								
Exports	13 153	14 450	15 350	6 710	7 103	7 350	7 500	7 850
Percent change[a]	(19.0)	(10.5)	(6)	(8.6)	(14.4)	(6.0)	(4½)	(9)
Imports	11 453	13 200	14 150	5 920	6 503	6 700	6 900	7 250
Percent change[a]	(13.7)	(15.0)	(7)	(12.5)	(24.5)	(2.0)	(8)	(9½)
Trade balance	1 700	1 250	1 200	790	600	650	600	600
Services and transfers, net[b]	–1 787	–1 900	–1 950	–897	–945	–950	–950	–1 000
Current balance	–87	–650	–750	–107	–345	–300	–350	–400
UNADJUSTED								
Current balance	–87	–650	–750	144	–579	–50	–600	–150
Long-term capital[b]	1 393			664	960			
Short-term capital and unrecorded	–789			–133	–123			
Balance on non-monetary transactions	517			675	258			
Change in reserves (increase = +)	557			251	–201			

a) Over previous period at annual rates, customs basis.
b) 1968 data include waived debt obligations payable by the United Kingdom.

bution of the population have tended to lower the saving rate.

On these assumptions, real GNP could rise by about 4 per cent from 1969 to 1970, considerably faster than in the United States. As in the United States, the expansion may be slower in the first half with a recovery in the second, although the difference between the two half-years may be smaller in Canada. Since the labour force is growing rapidly, unemployment would seem likely to average around 5½ per cent in 1970. Nevertheless, given the lag with which prices tend to react to changes in demand conditions, progress towards the restoration of better cost and price stability may be relatively slow.

The current external deficit may rise next year, probably exceeding U.S. $ 1 billion for the first time since 1966. With growth faster in Canada than in the United States, the trade surplus will probably fall, and the upward trend of the deficit on non-merchandise items is likely to continue—reflecting, in particular, the steady growth of net interest and dividend payments. As usual, the deficit seems likely to be financed by long-term borrowing, mainly in the United States.

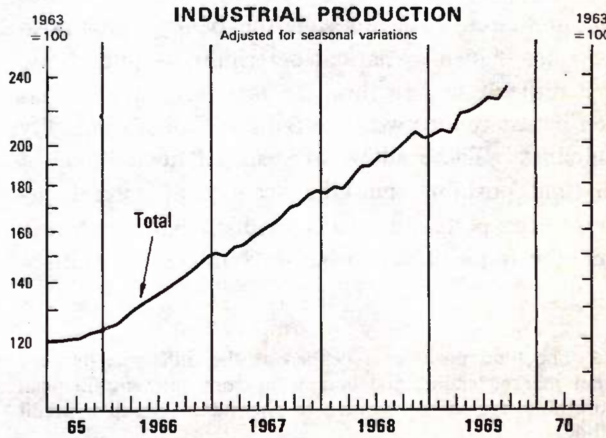
JAPAN

After a short-lived weakening of the boom early in 1969 the Japanese economy has resumed a vigorous upward trend. The external position has remained very strong, but the rise of prices accelerated, prompting the authorities for the first time since the war to take restrictive measures for purely domestic considerations. Given ambitious investment plans and the relatively comfortable liquidity position of private business, the main impact of monetary restraint may not be felt until 1970, when the export boom may be easing off and capacity may be increasing faster than actual output. Policy needs, therefore, to be kept flexible if a capacity rate of growth of the economy is to be sustained. In a situation where some price pressures have strengthened and the balance of payments is in large surplus, an acceleration of plans to dismantle the remaining import restrictions, possibly including unilateral tariff reductions, would seem the most appropriate policy.

Recent Trends

A temporary slowing-down of economic activity at the beginning of the year was due to stock adjustments and some hesitation of business in reaction to the unusually strong expansion of productive investment in the latter part of 1968. Contrary to earlier expectations, the export boom continued unabated: a vigorous revival of all main domestic expenditure components has taken place since April. The index of industrial production picked up strongly, rising, seasonally adjusted, more than 4 per cent between the second and third quarters. The falling tendency of imports has been sharply reversed since June, assisted by a marked upturn of the stock cycle.

The renewed buoyancy of the economy was associated with a significant strengthening of price and wage increases. The price situation has, however, been heavily influenced by developments in overseas markets and the behaviour of food prices. The consumer price index excluding seasonal products



Demand and Output
JAPAN

Percentage changes, volume
Seasonally adjusted
at annual rates
Estimates and forecasts

	1968 billion yen	From previous year			From previous half-year				
		1968	1969	1970	1968 II	1969 I	1969 II	1970 I	1970 II
Private consumption	26 666	9.4	9	10	9.7	7.0	12	10	8½
Public consumption	4 280	6.9	6¼	5½	6.0	7.2	5	5½	6½
Fixed investment	17 352	22.9	19	15½	20.6	15.9	23¼	13¾	12
Final domestic demand (excluding stocks)	48 298	13.6	12¼	11½	13.1	10.2	15½	11	9¾
*plus change in stock building	2 353[a]	0.3	0	¼	2.4	–2.1	1½	–1½	2
*plus change in foreign balance	441[a]	1.0	¾	0	0.6	1.5	–½	–½	¾
GNP at market prices	51 092	14.2	12½	11¼	15.7	9.0	16	8½	12
GNP implicit price deflator	..	4.0	5	4¾	5.0	4.8	6	4	4½
Industrial production	..	17.3	16¼	15½	18.4	13.6	20	13	17

* The yearly and half-yearly rates of change refer to changes in stock building and in the foreign balance expressed as a percentage of GNP in the previous period. These two figures plus the rate of change of final domestic demand broadly equal the rate of change of GNP. In practice however, divergences are possible because the rate of change of final domestic demand is not expressed as a percentage of GNP.

a) Actual level of stock building and foreign balance.

continued to rise rather steadily, at an annual rate of some 5 per cent. The unusually sharp rise of wholesale prices can be attributed almost wholly to foodstuffs, iron and steel and, particularly, non-ferrous metal whose movements are closely related to international developments. The annual increase of average cash earnings accelerated from 14.2 per cent in 1968 to almost 18 per cent in June-August, suggesting an increase of unit labour costs in industry of about 1 per cent for 1969 as a whole.

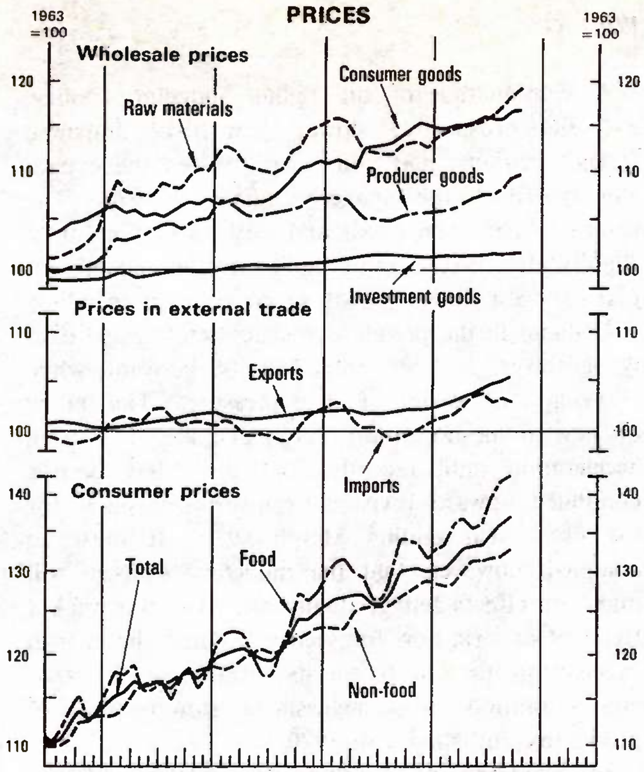
Commercial bank lending has increased sharply in recent months; the expansion in outstanding loans and discounts in the second quarter was twice as high as a year earlier and in the third quarter was 60 per cent higher. At the end of September, the volume of outstanding credit of all banks was 18 per cent up on the year as compared with 15 per cent in March. As a result, the banks' fund position[1] has shown a marked deterioration since May. It is difficult to say how far this development has been in accordance with the Bank of Japan's liquidity guidelines. These allow for seasonal fluctuations of the fund position and take account of special circumstances pertaining to individual banks. Moreover, the Bank of Japan has encouraged the shift of import financing from foreign to domestic sources (' Yen shift ') by tolerating a worsening of the fund position of city banks.

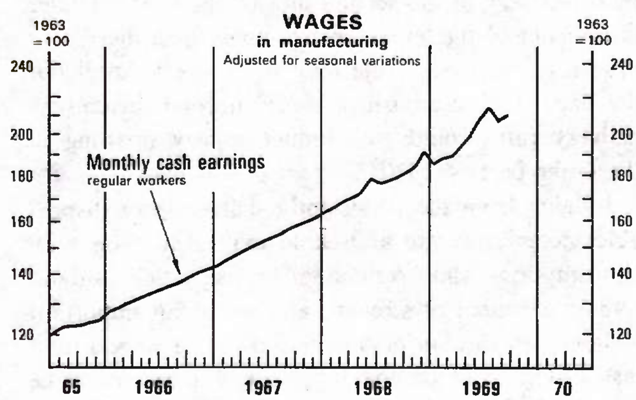
A vigorous recovery of imports since June has halted the rapid rise of the current balance of payments surplus; the long-term capital balance has swung back into deficit. On the other hand, with seasonal factors favourable and a slowing-down of the Yen shift in response to reduced interest rate differentials, official reserves have been rising again since August, after four months of virtual stability. The commercial banks' net short-term position vis-à-vis non-residents showed an excess of claims over liabilities in July, probably for the first time during the post-war period.

Recent Policy

In view of the strong expansion of demand, output and money supply, the Bank of Japan adopted a somewhat tighter policy. The official discount rate was raised from 5.84 per cent to 6.25 per cent from 1st September, and the reserve requirements ratio for short-term deposits went up by 0.5 to 1.5 per cent from 5th September. A tightening of fund position guidance was also announced. For the period October-December, the expansion in outstanding loans and discounts of city banks is reported to have been limited to 115-116 per cent of the credit expansion in the corresponding period of the previous

1. The fund position is defined as the difference between money market lending and borrowing from domestic financial institutions (including recourse to the Bank of Japan credit facilities).

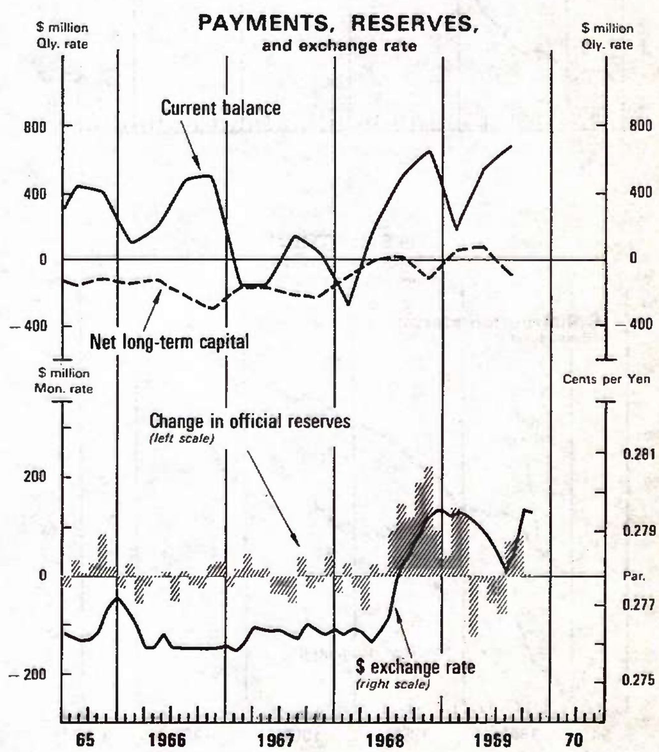




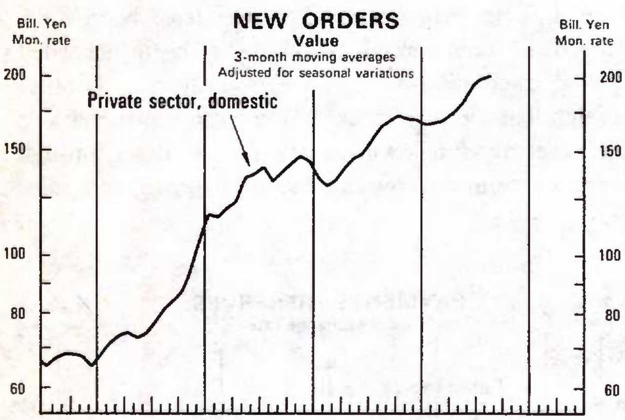
year (it reached 185 in the third quarter) which would bring the year-to-year increase in outstanding credit down from 23 per cent in September to 19 per cent in December.

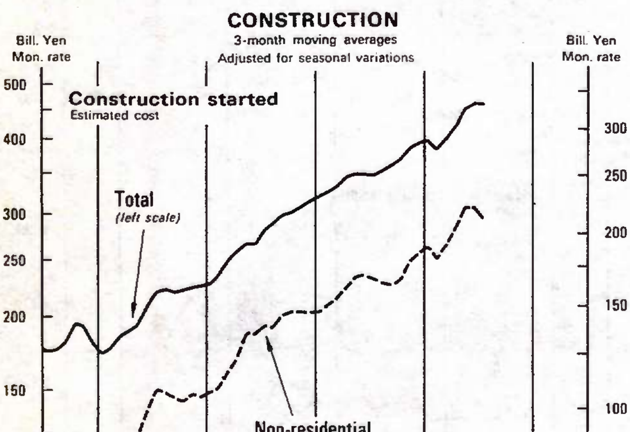
With both receipts and expenditure rising faster than originally foreseen, the overall deficit on income-effective transactions of the public sector in fiscal 1969 (ending March 1970) is likely to be of the same order of magnitude as a year earlier (some 2.5 per cent of GNP). The share of total government spending on goods and services in GNP at both current and constant prices will decline further. The Central Government's general account budget deficit is expected to turn out smaller than initially estimated and should also drop below the actual deficit of the preceding fiscal year. Reserve funds and spending cuts may not suffice to accommodate the important unbudgeted pay increases for civil servants; but tax receipts are likely to exceed original estimates by a large margin, possibly allowing the bond issue programme to be cut from Yen 480 billions in fiscal 1968 to less than Yen 350 billion.

In the field of foreign trade and payments, the Japanese authorities have taken a number of further steps to keep the accumulation of official reserves within reasonable limits. Following the increase of tourist and business travel allowances last April, restrictions on transfers of non-residents' earnings and profits have been lifted as from September. To discourage borrowing from abroad, the Ministry of Finance has recently imposed restrictions on loans other than trade credits by fixing maximum interest rates and tightening terms for short-term borrowing. Moreover, commercial banks have been accorded special facilities to repay Euro-dollar and other foreign loans and to invest in the Euro-dollar market; the necessary funds will be provided to them through market operations by the Bank of Japan and sales



of foreign exchange by the Treasury foreign exchange account with forward cover at a flat rate. Measures have been envisaged to " soften " the terms of foreign aid by reducing interest rates and increasing the grant element. To encourage imports of consumer goods, the compulsory import deposit rate was lowered from 5 to 1 per cent of the import bill in October. Imports may also be stimulated by the decision to raise the period for which importers can obtain credit without official permission from three months to six. The removal of the remaining restrictions on commodity imports is under discussion. The present target is to remove quantitative restrictions from at least 53 out of 118 items before the end of 1971. The first move in this direction, however, is not likely before April 1970 and may involve the liberalisation of only a relatively small number of items.





Prospects

A continuation of the tighter monetary policy, and the prospective slower growth of Japanese foreign markets, may somewhat weaken the expansionary drive in the Japanese economy in 1970. The external surplus on goods and services may contract slightly after two years of rapid increase and present plans suggest slower growth of government spending.

Demand in the private domestic sector seems likely, however, to keep total activity buoyant while allowing some easing of price pressure. The inflow of new domestic orders for machinery has been accelerating until recently, and there has been a continued upward revision of investment plans for the fiscal year ending March 1970. It must be assumed, however, that the monetary squeeze will make its effects felt gradually and that the weaker trend of exports now foreseen will damp the growth of investment. The recent stabilisation of the capacity utilisation ratio suggests a slower pace of productive investment in 1970. [1]

Stockbuilding may follow the pattern of the previous two years, with a weak first half succeeded by a recovery in the second half of the year. Under the impact of tighter monetary conditions, the recent upturn of the stock cycle may soon reverse itself but the need to reestablish a more normal inventory-delivery ratio could well induce a new upswing in the latter part of 1970.

Judging from the persistently sharp rise of disposable income, private household expenditure on both consumption and residential construction should remain a source of strength and act as an important stabilizer of the business situation. The wage round last spring involved the biggest pay increases since the early post-war period; given growing tensions in the labour market and the favourable profit situation, there would seem little reason to assume any significant flattening of the trend. Farm incomes may advance more slowly than previously, since the Government has decided to keep the purchase price of rice unchanged, but the erosion of incomes through price increases may become less important.

1. The share of private productive investment in GNP at constant 1965 prices has passed the previous peak of 18.3 per cent (1961) and is likely to attain 21.5 per cent in 1969. The ratios of total fixed investment and gross savings to GNP at current prices may work out at as much as 34.5 per cent and 40 per cent, respectively.

Balance of payments JAPAN

Value, million dollars
Estimates and forecasts

	1968	1969	1970	1968 II	1969 I	1969 II	1970 I	1970 II
SEASONALLY ADJUSTED								
Exports	12 751	15 700	17 650	6 736	7 494	8 200	8 550	9 100
Percent change[a]	(24.2)	(24.0)	(13)	(23.4)	(28.2)	(18.0)	(10½)	(13)
Imports	10 222	11 900	13 850	5 303	5 483	6 400	6 700	7 150
Percent change[a]	(11.4)	(16.0)	(16)	(17.9)	(4.3)	(40.0)	(8)	(12)
Trade balance	2 529	3 800	3 800	1 433	2 011	1 800	1 850	1 950
Services and transfers, net	–1 481	–1 600	–1 800	–770	–785	–800	–850	–950
Current balance	1 048	2 200	2 000	663	1 226	1 000	1 000	1 000
UNADJUSTED								
Current balance	1 048	2 200	2 000	1 152	721	1 500	500	1 500
Long-term capital	–239			–111	133			
Short-term capital and unrecorded	293			87	61			
Balance on non-monetary transactions	1 102			1 128	915			
Change in reserves (increase = +)	826			887	131			

a) Over previous period at annual rates, customs basis.

World trade appears to be entering a less expansionary phase. But, even so, the patterns of trade foreseen suggest little change from the present rate of current account surplus for Japan. The recent sharp rise of imports has been associated with the upward stock cycle and may therefore not continue into 1970. There is strong evidence that the import saving manifest in the first halves of 1968 and 1969, which was a key element in the spectacular improvement of Japan's balance of payments situation, has lowered the level of imports permanently below the previous trend line.[1] Assuming that the import elasticity with respect to total demand returns to a more normal rate in 1970 and that the growth of exports is almost halved from the 24 per cent rate likely to be attained in 1969, the current balance of payments surplus may still reach $ 2 billion, with little change in the course of the year. A net outflow of long-term capital may continue for some time, but it may be difficult to reduce the surplus on the basic balance to a size that could easily be offset by short-term capital exports.

1. See the latest OECD *Economic Survey of Japan*, August 1969, p. 18-25.

UNITED KINGDOM

The outlook is significantly more favourable than it appeared six months ago. The long sequence of restrictive fiscal measures and tighter monetary policy have brought the growth of domestic demand under better control. There was a marked improvement in the balance of payments in the first two quarters of 1969 and probably further improvement in the third quarter. Owing to weaker home demand, there was no rise in output in the first half-year, but it may have accelerated to a capacity rate in the second half; both exports and investment demand seem to be buoyant. A major objective of economic policy must continue to be the restriction of the growth of domestic demand and incomes to rates compatible with a further shift of resources to net exports. The decisions to restrict the foreign currency travel allowance to £ 50 for a further period, and to continue the import deposit scheme for another twelve months, indicate the need there still is for a basic strengthening of the external situation.

Recent Trends

Economic activity appears to have been accelerating since its dip early in 1969 and there has been a marked shift in the pattern of demand towards improvement of the foreign balance. The fall of demand and output in the first quarter had two main causes. The volume of personal consumption fell back, reflecting the after-effects of anticipatory purchases late in 1968, tax increases and tighter hire purchase terms. In addition, some fixed investment had been speeded up to take advantage of temporary fiscal incentives which expired at the end of 1968, and investment in housing was checked, probably reflecting financial constraints. By the second quarter there was some recovery in components of demand, but for the half-year total domestic demand was still below the level of the previous six months and the level of GDP was maintained by the rise of net exports. With no rise in output, unemployment rose. By the summer, the rate (seasonally adjusted) was 2½ per cent—the same as a year earlier—but, even so, a number of sectors were reported as experiencing difficulty in recruiting skilled workers.

Since the middle of the year there seems to have been a further rise in private consumption: the official preliminary estimate is a rise at an annual rate of 2 per cent between the second and third quarters, and the fall in the outstanding total of hire-purchase debt seems to have levelled out. Housing investment probably continued to be sluggish, though the

Demand and Output
UNITED KINGDOM[a]

Percentage changes, volume
Seasonally adjusted
at annual rates
Estimates and forecasts

	1968 billion £	From previous year 1968	1969	1970	From previous half-year 1968 II	1969 I	1969 II	1970 I	1970 II
Private consumption	27.1	2½	½	2½	½	–¼	2	2½	2½
Public consumption	7.7	½	0	1	–1½	0	1½	½	½
Fixed investment	7.8	3½	½	4½	3	–4	6	4	4
Final domestic demand (excluding stocks)	42.6	2½	½	2½	½	–1	2¾	2½	2½
*plus change in stock building	0.2[b]	½	½	0	1½	½	–½	0	½
*plus change in foreign balance	–0.4[b]	½	1	½	1½	½	2¼	¼	–½
GDP at market prices	42.3	3½	2	3	3½	0	4½	2¾	2½
GDP implicit price deflator	..	3¾	4¼	3	5	4½	3¼	3	2¾
Industrial production	..	5.8	4	3½	5.5	3.6	3	4	3½

* The yearly and half-yearly rates of change refer to changes in stock building and in the foreign balance expressed as a percentage of GDP in the previous period. These two figures plus the rate of change of final domestic demand broadly equal the rate of change of GDP. In practice, however, divergences are possible because the rate of change of final domestic demand is not expressed as a percentage of GDP.

a) The figures shown for the past (up to 1969 I) are based on a compromise between the three estimates of GDP.

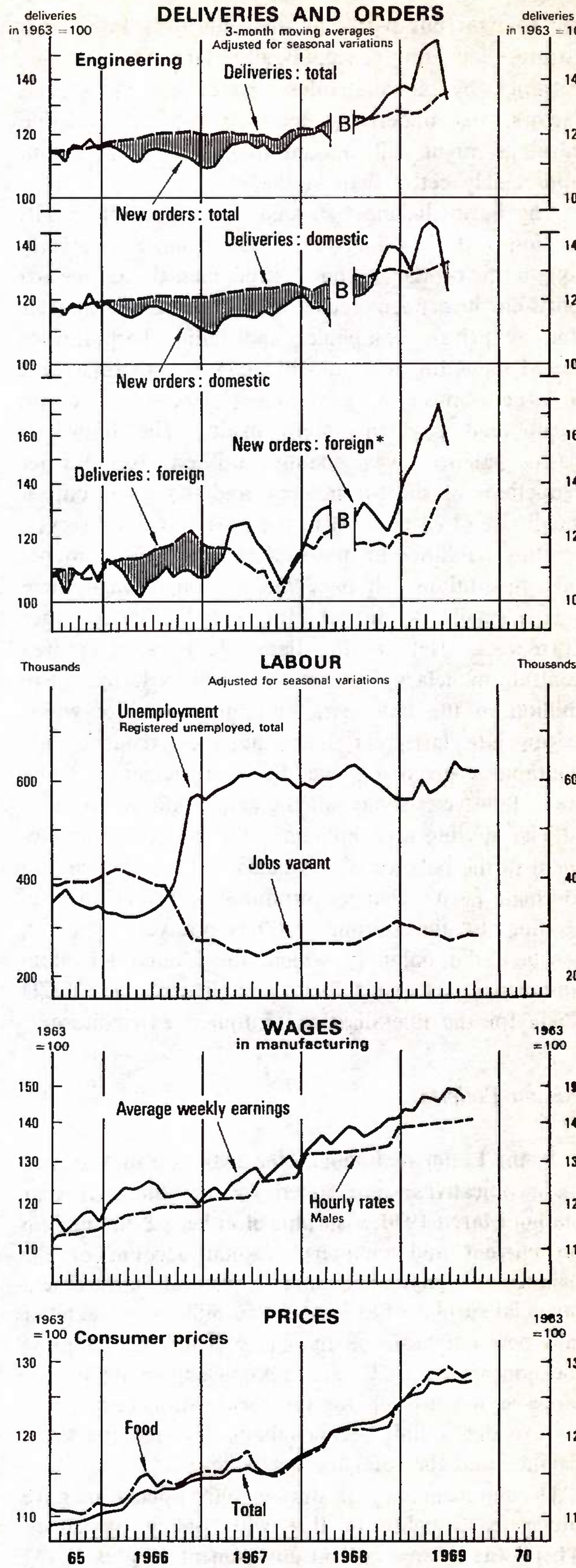
b) Actual level of stock building and foreign balance.

recent increase in net deposits with building societies would permit some recovery in private house-building. For private industrial investment the latest official intentions enquiries, carried out in August and September, imply a sharp rise in the second half-year. The monthly trade figures show a further marked improvement in net exports. Partial indicators suggest some further increase in stocks. Other evidences of rising activity are the upward trend of industrial production and the change in labour market indicators. Job vacancies rose and unemployment fell back a little after August.

The rise of hourly wage rates was modest up to September. Agreements for construction workers and engineers had pushed rates up at the end of 1968, but relatively few workers had had increases in the first nine months of 1969. The index of retail prices was 5½ per cent higher in October than a year earlier. The domestic price level has been pushed up not only by higher labour costs but also by the rise of import prices and the quite substantial effects of increased rates of indirect taxation.

The current account of the balance of payments improved markedly in both the first two quarters, resulting in a surplus of $ 223 million for the first half year, compared with a deficit of similar size in the second half of 1968 (seasonally adjusted and corrected for the under-recording of exports). The trade account improved by $ 155 million and the balance on invisibles by $ 285 million. The strong upward trend of exports, led by machinery and transport equipment, had been set back in the first quarter by the U.S. dock strike, and deliveries of ships and aircraft, which can fluctuate considerably in the short-term, were also low. Growth has since, however, been resumed. In the three months to October the value of exports was about 7 per cent higher than in the previous three months; about 3 percentage points of this very sharp rise stemmed from more complete recording, including that of goods exported earlier. Imports have remained fairly stable after their strong surge in early 1968. The first ten months of 1969 showed an increase (excluding arrivals of U.S. military aircraft) of 4 per cent in value but only about 1 per cent in volume over the same period of last year.

Net earnings of invisibles in the first half of 1969 were about 50 per cent higher than the 1968 average. The increase was partly brought about by high earnings from direct investment abroad and flourish-



ing tourism but partly by elements of a less stable nature, including exceptionally large figures for earnings by oil companies. Excluding the special factors, the underlying monthly rate of invisible earnings might still amount to about $ 100 million, appreciably better than in 1968.

The basic balance showed a surplus of $ 115 million in the first half-year. The balance on private long-term capital account strengthened, as inward portfolio investment recovered in the second quarter and as private companies and public corporations raised loans on international markets; but there was a large outflow of government capital as certain exceptional payments were made. The improved basic balance was mainly utilised for further reductions of short-term debt, and there was only a small rise ($ 22 million) in the gross official reserves. Sterling liabilities to non-sterling area central monetary institutions fell by $ 958 million, though there was a small rise in net official liabilities in other currencies. Net sterling liabilities to sterling area central monetary institutions increased by $ 646 million in the half-year, continuing the rise which began late last year following the exchange rate guarantees given by the Basle agreement. There was, however, some fall in net liabilities to non-official sterling area holders. The marked improvement in the balance of payments and the French and German parity changes produced a firmer tone in sterling by the autumn. It has not yet, however, reached the point at which the United Kingdom authorities feel able fully to comply with the OECD Code for the liberalisation of tourist expenditure.

Recent Policies

In the Letter of Intent to the IMF late in May two main objectives were stated for the financial year ending March 1970; a surplus of at least £ 300 million on current and long-term capital account of the balance of payments, and a central government financial surplus of at least £ 850 million. The letter laid new emphasis on monetary policy by adopting the concept of DCE, and acknowledging its importance as a yardstick for the formulation of policy. [1] It provides a link between bank lending, the fiscal balance and the total foreign balance.

Developments so far during 1969 appear to have proceeded roughly in line with policy objectives. There was a large central government surplus (£ 151 million) in the first half of the financial year—the second and third calendar quarters of 1969—a period when the deficit has in past years been large (£ 550-£ 950 million). And the apparently small rise in the money supply, seasonally adjusted, in the same period illustrates the severe squeeze on credit that has been obtained. Interest rates remain high: yields on government long-term bonds in mid-November stood at about 8¾ per cent, over ½ per cent lower than during the peak periods of May-June, but the fall may mainly be attributable to confidence factors following the improved balance of payments. Short-term rates have scarcely fallen since mid-year ; bank rate remains at 8 per cent, and effective rates were given some further boost by the announcement of an increase of one half per cent in the interest on overdrafts in September.

The authorities have stated that no easing of fiscal and monetary policies can be expected in the present situation; on the contrary, the need for continuous efforts towards attaining a more stable base for the country's economic growth and its external payments position has again been stressed. Hence the decision, in October, not to let the import deposit scheme lapse in December but to maintain it for another year with the rate of deposit reduced from 50 to 40 per cent of the value of the imports covered.

Prospects

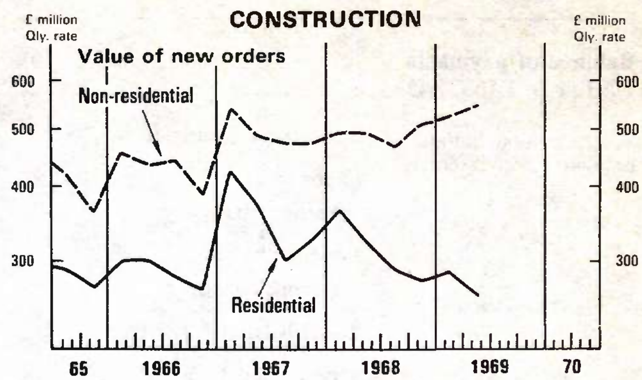
The forecasts assume that the 1970 budget entails no significant relaxations on either the revenue or expenditure side, and that monetary policy remains stringent. The overall picture is somewhat more optimistic than the forecast up to mid-1970 published in *Economic Outlook*, No. 5 last July. The domestic demand picture is broadly unchanged, but the forecast on external account has been revised because the current balance in the first half of 1969 turned

1. Domestic credit expansion (DCE) can be regarded as a measure of credit flowing through specified channels, namely the banking system, and from overseas to the public sector; and as a measure of changes in the money supply adjusted for the effects thereon of the balance of payments. It is defined as the sum of bank lending to the private and public sectors, changes of currency in the hands of the non-bank public, and overseas lending to the public sector. Alternatively, it can be defined from the borrower's side as public sector borrowing (excluding sales of debt to the non-bank private sector) plus bank lending to the private sector. See also *OECD Economic Outlook*, No. 5, p. 81.

out considerably stronger than anticipated.[1] A smaller improvement in the current balance, but from a better starting point, is now envisaged; merchandise exports after the middle of 1969 are expected to rise more briskly than previously expected, but faster import growth and a fall in net invisibles from the unusually high level attained in the first half are also forecast.

The expansion of world trade seems likely to slow down next year by about a third from the exceptionally high rates experienced over the last two years. The growth of the United Kingdom's export markets may, in particular, fall to around 10-11 per cent. Nonetheless, world trade conditions should provide the basis for a further improvement of the United Kingdom's balance of payments. The competitive position should, on the evidence of 1969, remain strong; with capacity utilisation in the major export industries already at a high level, some small loss of market shares may take place, but it should be nowhere near the rate of loss which prevailed in the years before the devaluation. Between the second halves of 1969 and 1970 the volume of exports of goods and services may rise by about 3½ per cent.

Prospects for private sector fixed investment are subject to great uncertainty. Profits have been quite well maintained this year, pressure on capacity is strong in many industries, and the balance of payments performance may have improved business confidence in future expansion. To some extent, tighter monetary conditions may represent a real constraint on the ability of firms to invest, but given the buoyancy of reported investment plans, private non-residential fixed investment could rise by as much as 6 to 7 per cent between the second halves of 1969 and 1970.[2] Private housing is not expected to change much over the same period. For



public housing the authorities seem to be planning some recovery.

If—as assumed—the 1970 budget makes no substantial change in fiscal conditions, more normal growth of private consumption in relation to other demand can probably be expected. There seems no reason to expect the growth of employment incomes to be any less than it has been during the past year or so and pressures for somewhat larger increases are quite likely. With probably little change in employment, disposable incomes could rise at a rate of about 5 per cent. The rise in prices may slow down to something near past average rates (always on the assumption of no important new increases in indirect tax rates). In such conditions, the personal savings ratio could rise a little. In all, the growth of consumption might be at a rate of around 2½ per cent from now on, much more than it has risen over the past year and not far below the long-run average.

On these assumptions, aggregate demand (including exports) could rise by something like 3 per cent. The rise of imports may accelerate somewhat. As the devaluation effect wears off, the earlier tendency for the import propensity to rise may reappear. The volume of imports of goods and services could increase by 4½ per cent between the second halves of 1969 and 1970. Domestic output may rise at close to a capacity rate of increase.

The current account of the balance of payments seems likely to show some further improvement over the next year. With regard to the value of merchandise trade (including imports of U.S. aircraft) no further improvement in the balance is expected between the second halves of 1969 and 1970, as both

1. *OECD Economic Outlook*, No. 5, last July forecast a current account deficit of $ 150 million in 1969, first half, compared with a surplus of $ 223 million actually recorded. The difference ($ 373 million) was made up as follows:

Inclusion of unrecorded exports (goods)	$ 167 million
Higher exports	$ 80 million
Higher invisible earnings (net)	$ 172 million
Less higher imports	$ 46 million
	$ 373 million

2. The August/September Board of Trade enquiry into investment intentions suggests a 10 per cent rise in manufacturing investment between 1969 and 1970 (after adjustment of the first quarter 1969 figures which were depressed by the removal of the temporary fiscal investment incentives at the end of 1968).

Balance of payments UNITED KINGDOM

Value, million dollars
Estimates and forecasts

	1968	1969	1970	1968 II	1969 I	1969 II	1970 I	1970 II
SEASONALLY ADJUSTED								
Exports[a]	14 959	16 800	18 300	7 783	8 047	8 750	9 050	9 250
Percent change[b c]	(6.8)	(12.5)	(9)	(18.2)	(7.0)	(20.0)	(5½)	(5½)
Imports[d] *	16 584	17 350	18 450	8 438	8 546	8 800	9 100	9 350
Percent change[b e]	(5.8)	(5.0)	(7)	(5.8)	(3.5)	(7.0)	(7)	(6½)
Trade balance	–1 625	–550	–150	–655	–499	–50	–50	–100
Services and transfers, net[f]	903	1 250	1 350	437	722	550	650	700
Current balance	–722	700	1 200	–218	223	500	600	600
Long-term capital[f g]	–476			5	–108			
Basic balance	–1 198			–213	115			
UNADJUSTED								
Basic balance	–1 198			–347	269			
Short-term capital and unrecorded[h]	–972			–228	550			
Balance on non-monetary transactions	–2 171			–576	819			
Change in reserves (increase = +)	–274			–263	23			
**Of which:*								
Progress payments on military aircraft purchases from the United States	262	200	100	132	115	100	50	50

a) Including allowance for under-recording in the customs figures.
b) Over previous period at annual rates, customs basis.
c) Does not take into account the elimination of under-recording in the course of the forecast period.
d) Including progress payments on military aircraft purchases from the United States.
e) Excluding United States military aircraft.
f) 1968 data include waived debt obligations payable to Canada and the United States.
g) Adjusted for special transactions under offset arrangements with Germany.
h) Including the exchange adjustment on pre-devaluation forward deals.

exports and imports may rise by about 5-6 per cent. But net invisible earnings seem likely to rise somewhat after falling back from the high level reached in the first half of 1969. The current account surplus may thus not increase much beyond the rate which seems likely to have been achieved in the second half of 1969, but this would, nevertheless, imply a surplus of about \$ 1¼ billion in 1970 as a whole. The long-term capital account will depend heavily on monetary conditions and interest rates both in the United Kingdom and abroad. Assuming continued tight conditions at home, the net outflow of long-term capital could well remain low. Should overseas borrowing of long-term funds by private and public enterprises continue, and confidence in sterling further revive, a net long-term capital inflow might, indeed, develop. The immediate target of achieving a surplus on the current and long-term capital account of \$ 720 million (£ 300 million) in the fiscal year ending March 1970 may be attained. If the long-term capital account were in approximate balance, the earlier aim of a surplus running at an annual rate of \$ 1.2 billion (£ 500 million) might be reached by early 1970.

FRANCE

In the spring and early summer, the French economy experienced a faster rise of demand than the authorities had intended, and a serious crisis of confidence. Capacity limitations developed in a number of branches of activity. Wages grew faster than officially expected. Imports surged upwards, partly because of the rise of real demand but also in anticipation of exchange rate changes. Heavy capital outflows from the non-banking sector continued until mid-year. The new Government devalued the franc by 11.1 per cent in August, took steps to restrain demand and set itself certain precise targets for the restoration of equilibrium at the time when the $ 985 million IMF credit was granted. The primary aim is to bring the current account back into balance by the middle of 1970 (from a deficit which was probably running at an annual rate of more than $ 1 billion, on a transactions basis, in the middle of 1969) and into some surplus thereafter. Success will depend not only on the adherence of the authorities to the budgetary and monetary aims they have set themselves, but on the extent to which public opinion can be convinced that the recent inflationary era is being ended.

The Situation Before August

The main expansionary force on the side of domestic demand had been business fixed investment. Industrial enquiries show that new orders for capital equipment placed by industry, already rising fast in the second half of 1968, jumped sharply in the early part of 1969 and were expected in June to increase further in the second half-year. Buoyant profits—reflecting the steep advance of productivity and output in the second half of 1968, tax relief, government subsidies and price increases— together with capacity shortages and favourable demand expectations were the main driving force in this investment boom. The tax incentives to investment and the extremely ample supply of medium and long-term credit no doubt acted as additional stimuli. And expectations of higher prices and doubt concerning the future parity of the franc probably also played a role. The situation was further influenced by some bunching of investment because of delays in projects planned for 1968. The trend of investment was also strong outside industry—in private housing and, to a smaller extent, in central government.

Demand and Output
FRANCE[a]

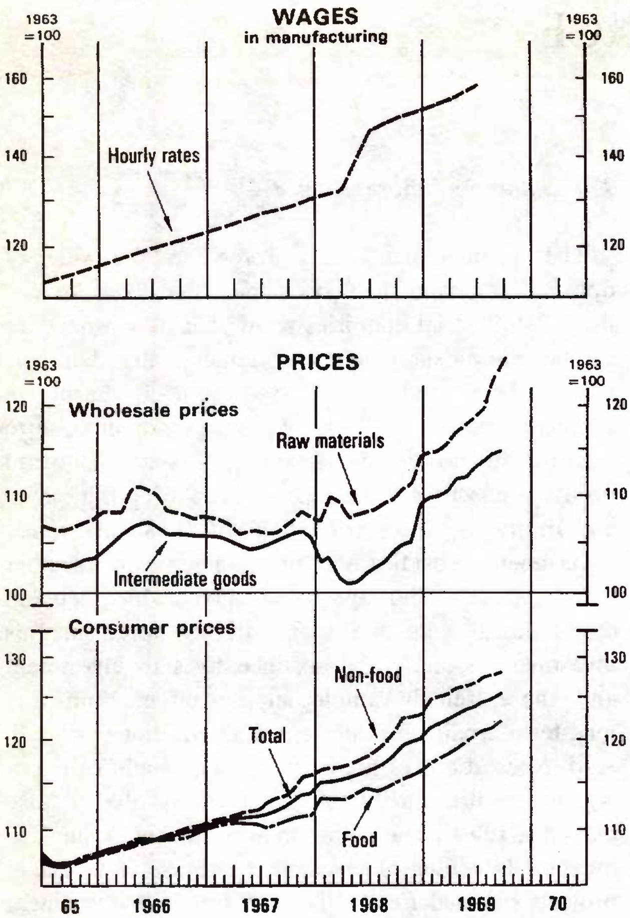
Percentage changes, volume
Seasonally adjusted
at annual rates
Estimates and forecasts

	1968 billion francs	From previous year 1968	1969	1970	From previous half-year 1968 II	1969 I	1969 II	1970 I	1970 II
Private consumption	380.4	4.5	7	3½	14.6	4.5	5	3½	2½
Public consumption	79.6	4.2	5	2	4.1	6.8	2½	1½	2
Fixed investment	157.5	5.6	9½	5½	16.4	7.5	7	5	5½
Final domestic demand (excluding stocks)	617.5	4.7	7½	4	13.6	5.5	5	3½	3
*plus change in stock building	7.7[b]	–0.2	2	–1	8.3	0.7	–1½	–1	¼
*plus change in foreign balance	–0.9[b]	–0.3	–1	1	–1.3	–1.0	–¼	1¾	1
GDP at market prices	624.3	4.2	8¼	4	21.3	5.1	3¼	4¼	4¼
GDP implicit price deflator	..	5.0	6½	5½	7.0	6.2	6½	5½	4½
Industrial production	..	5.0	12	5	32.9	6.8	4½	5	5½

* The yearly and half-yearly rates of change refer to changes in stock building and in the foreign balance expressed as a percentage of GDP in the previous period. These two figures plus the rate of change of final domestic demand broadly equal the rate of change of GDP. In practice, however, divergences are possible because the rate of change of final domestic demand is not expressed as a percentage of GDP.

a) All the figures shown in the demand and output table refer to the new series of French national accounts, converted to the SNA system.

b) Actual level of stock building and foreign balance.

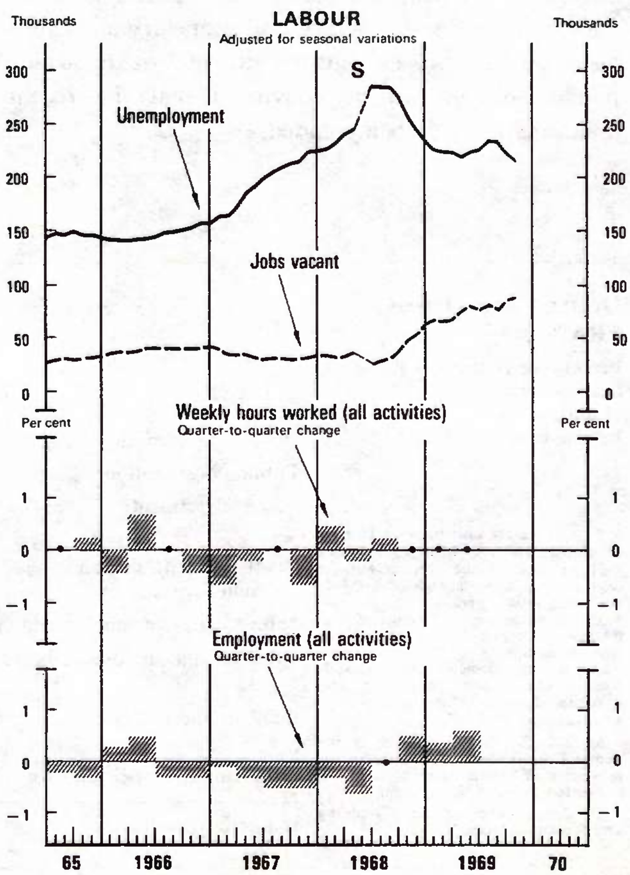


Uncertainty about prices and the franc seems also to have influenced consumer spending. There was a slight setback early in the year, following the buying spree partly provoked by anticipations of the TVA increase late in 1968. But private consumption then rose steeply despite some tightening of consumer credit conditions in early May. Partial indicators, such as the absolute fall in net deposits held by the savings institutions in the second quarter, point to a decline of the household savings ratio. The wage rise was relatively rapid but real wages improved only moderately, given the continued steep price rise. The growth of employment accelerated; the decline of average work-hours, reflecting implementation of the Grenelle Agreement, may not have influenced wage earners' incomes much. The trend of non-wage incomes was no doubt buoyant. The incidence of direct taxation on household spending may not have increased significantly, given the delays accorded for tax payments in the first half-year. Public consumption rose relatively fast, reflecting some catching-up after the postponement of various types of current spending in the later months of 1968.

Stockbuilding activity contributed to the buoyancy of domestic demand, especially in retail trade and probably also by importers, partly in response to anticipatory purchases. Producers' stocks of finished goods, in contrast, continued to be judged low, with a recovery only in the consumers' goods branches.

Supply conditions became progressively less flexible. In June the average capacity utilization rate in industry exceeded the previous peak of mid-1964, many branches experienced severe shortages of qualified labour and some encountered difficulties in supply of industrial materials. Although order books continued to lengthen, therefore, the growth of industrial production levelled off, with the July-August level no higher than at the end of 1968.

Apart from the mechanical price effects of the TVA increase in January (officially estimated at 1-1½ per cent) the index of retail prices rose at annual rates close to 4 per cent between January and



July, much less fast than during the second half of 1968. Even including the TVA effect, there was a marked moderation of the rise of service prices, most of which have in principle been blocked since November 1968, and some slowdown of the price rise in manufactured consumer goods, which were subject to a more liberal regime. The rise of food prices, in contrast, accelerated strongly, partly because of poor agricultural output. The relatively steep wage rise—average hourly rates rose at an annual rate of 8.3 per cent between January and July—mainly reflected increases granted at the enterprise level, and probably entailed some increase in unit labour costs in industry.

The trade balance on a transactions basis, seasonally adjusted, deteriorated strongly after the first quarter, because of surging imports. The import rise seems to have been particularly pronounced in consumer goods. The trend of exports remained strong, with some gain in French market shares abroad. On current invisibles the underlying position may not have changed significantly on a transactions basis and the underlying deficit on current account probably rose from the second half of 1968 to the first half of 1969. [1]

A heavy outflow of non-monetary capital—including payments leads and lags and disguised capital exports which were registered in the service and transfer account—was resumed in the spring under the twin influence of the new burst of speculation in favour of the Deutschemark and political uncertainty at home. A large reflow of bank money early in the year, in response to restrictions on the foreign exchange position of the banks, cushioned the fall of net official assets. Nonetheless, these declined by $ 1.1 billion in the seven months to July.

Policies

There has been a succession of new measures to tighten demand management. In May-June, when it became apparent that the measures taken since November 1968 were inadequate to secure the necessary slowdown of domestic demand and restore confidence in prices and the franc, certain steps were taken to achieve more restrictive monetary conditions. The authorities announced the restriction of the supply of medium-term discountable credit and long-term mortgage credit. Quantitative restrictions on short-term bank credit were prolonged until the end of 1969. Bank rate and certain bank lending rates were raised, and there was a significant tightening of conditions for consumer credit. Immediately before and following the devaluation, further restrictive measures were taken on a wider front.

The most important steps taken by monetary authorities since last summer are as follows:

i) Conditions for consumer credit were again severely tightened until at least the end of January 1970. To discourage private consumption further, new incentives to personal savings were introduced.

ii) To check the growth of investment, the granting of discountable medium-term credit for equipment and construction was suspended in September. It has risen so fast that the expansion of this type of credit foreseen for the whole of 1969 had already been exceeded by 8 per cent. A similar suspension was announced for long-term lending by the Crédit National. In November, the quantitative restrictions on essentially short-term bank credit were prolonged for another six months, leaving virtually no scope for the expansion of such credit from the autumn of 1969 through June 1970, and a decree foreseeing stricter penalties for banks failing to comply was announced. Additionally, limits—more generous than those for short-term credit—were set for medium-term discountable credit and long-term mortgage credit. [2]

1. The figures in the Balance of Payments table show a substantial decline of the deficit on current invisibles. This is because the estimates given for the second half of 1968, which are based on official estimates on a settlements basis, are thought to be considerably affected by payments leads and lags and speculative factors, influences which are assumed to have diminished in the first half of 1969.

2. The ceiling for essentially short-term bank credit (September 1968 = 100) is 107 for June 1970, compared with 107 for December 1969 and 104 for June 1969 and December 1968 The expansion of medium-term discountable credit will be limited to 6 per cent during the first half of 1970. Long-term mortgage credit should expand at a monthly rate of F 265 million against some F 450 million in the period August-December 1969. The figures below give a rough idea of the relative importance of these types of credit (credit to private non-banks F billion):

	Outstanding Dec. 1968	Outstanding Aug. 1969
Short-term	145.4	147.1
Medium-term discountable	47.2	52.3
Medium-term not discountable and long-term	102.1	

iii) Some lending rates, notably of the Crédit National and the Economic and Social Development Fund, were raised in September. On 8th October, Bank rate was increased from 7 to 8 per cent.

The credit measures were supplemented by fiscal action bearing directly on the financial position of companies—in particular, reduction of depreciation allowances, acceleration of corporate tax payments, and early abolition of tax incentives to investment. On the expenditure side of the 1969 budget, some F 5.6 billion of " autorisations de programme " were frozen in July-August. The impact of this on budget expenditure in 1969 will be small, but government orders for capital equipment and construction works are expected to be more importantly affected.

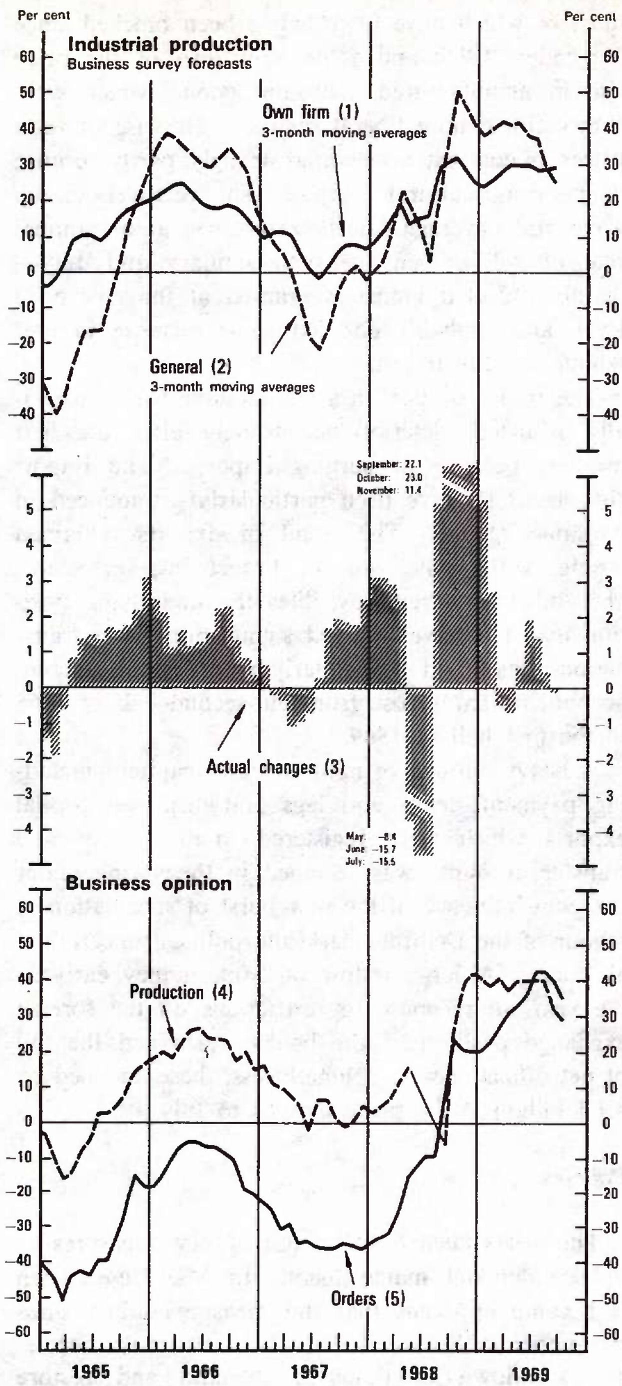
Since there was a risk that devaluation might lead to excessive price adjustments, profit margins for imported goods were blocked at the time of devaluation and a price freeze was introduced for domestic goods and services until 15th October. Detailed rules were announced for price increases in the period after that date.

The Government's proposals for the 1970 budget entail important restraint on the expenditure side but some discretionary relaxation in respect of taxes. Non-financial expenditure is to increase by only 4½-5 per cent over the likely outcome for 1969—about half the expected rate of increase of money GDP. New appropriations for central government fixed investment have been reduced, though total real fixed investment by central and local government as a whole would rise somewhat faster than from 1968 to 1969. Public enterprise investment is expected to fall slightly, as a result of lower government subsidies; the policy in respect of housing implies that the volume of new government-aided dwelling starts will be only just maintained.

As against these restrictive features, a number of tax cuts are envisaged which not only eliminate the important fiscal drag on households which would have resulted next year, but somewhat reduce the share of household incomes absorbed by direct taxation. In contrast, the burden of direct taxation on enterprises, in particular corporations, is to increase, partly because of discretionary fiscal action.

The general government's own real claim on resources in 1970 would rise, on a national accounts basis, by only 2.5 per cent, compared with the 4.8

SURVEY OF BUSINESS OPINION



Source : I.N.S.E.E., Notes rapides.

Series 1, 2, 4, and 5 give the difference between the positive and negative answers to business surveys.
1. Expectation for 3 to 4 months of production of own firm.
2. Expectation for 3 to 4 months of total industrial production.
3. Rate of change of the index of industrial production (3-month moving averages over three months).
4. Judgment on current trend in production.
5. Judgment on unfilled orders.

per cent now expected for 1969. On the other hand, its current savings expressed as a percentage of GDP would not rise from the 1969 level. Some idea of the impact of the budget on incomes may be obtained from the change in the central government's balance on non-financial transactions. This swings from a probable deficit of F 1½ billion in 1969 to a surplus of F 2 billion in 1970—a swing of ½ per cent of GDP.[1] The impact on private demand may be somewhat less than this insofar as part of the change is concentrated on the enterprise sector and is therefore more akin to a monetary squeeze.

Developments Since Early August

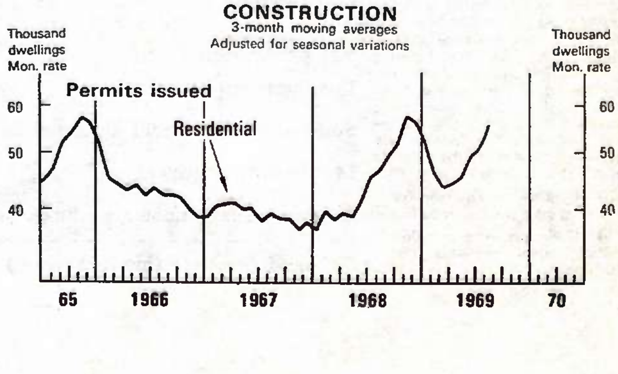
The growth of demand probably started to moderate in the course of the autumn although several economic indicators, most of which do not go beyond the month of September, continued strong. The sharp rise in retail sales in August (seasonally adjusted) was reversed in September and they have probably remained flat in October. The marked recovery of the savings institutions' net deposits may not reflect an increase of the household savings ratio but simply a shift in savings in response to the improved terms for such deposits. The September-October business enquiries show stocks of finished goods low, foreign orders buoyant and own production prospects continuing to be judged favourable. But opinions on the general production outlook deteriorated strongly, domestic order books shortened, and an increasing number of firms reported liquidity difficulties. Industrial production, however, increased in September and in September-October unemployment fell for the first time since the spring. The consumer price index rose by only 0.2 per cent in August, but by 1.1 per cent in the next two months, despite the price freeze.

Particularly heavy trade deficits were experienced in August and September. They probably reflected temporary disturbances to exports caused by devaluation, the immediate adverse effects of devaluation on the terms of trade, the still strong underlying trends of demand and activity and, possibly, inadequate adjustment for seasonal factors in August exports. In October, exports turned up strongly, the growth of imports levelled off and the trade deficit fell to nearly the average level experienced in the three months preceding devaluation. In August, net official foreign assets increased a little. They fell again in September and early October, when speculation in favour of some foreign currencies again affected the figures, but increased somewhat in the weeks following the revaluation of the DM.

Prospects

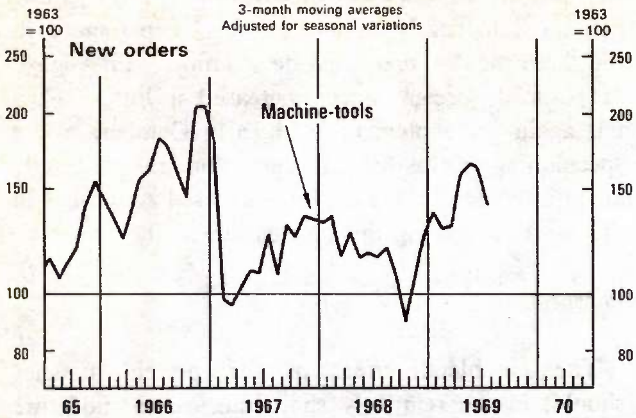
The combined effect of the present policies should, in the relatively short run, be to moderate the growth of demand. In particular, the hire-purchase restrictions should influence consumers' purchases of durable goods from the autumn onwards with favourable effects on imports, given the relatively high marginal import content of this type of consumption. But if the restrictions are removed in January as announced, they may only have served to put off purchases until 1970. The extent to which the new incentives to personal savings dampen private consumption will largely depend on the success or otherwise of government policies to restore reasonable price stability and reduce inflationary expectations. The 1970 budget, with tax cuts and large transfer payments to households, does not appear likely to exert an important restraining effect on private consumption. Business investment, the most buoyant sector of domestic demand in recent months, may be somewhat moderated by removal of the special tax incentives and cuts in depreciation allowances. But the course of demand in this sector is likely to depend mainly on the new—and apparently more forcible—measures which the authorities have introduced to contain the credit expansion and, more fundamentally, on the extent to which official policy succeeds in damping down consumers' expectations.

CONSTRUCTION
3-month moving averages
Adjusted for seasonal variations



1. Between the two years expenditure rises by F 7½ billion and receipts (after net tax reductions of F 3.2 billion) rise by F 11 billion.

ORDERS IN INDUSTRY
3-month moving averages
Adjusted for seasonal variations



In present circumstances, its is more than usually difficult to put forward forecasts for the period up to the end of 1970. Despite the restrictions taken in the field of credit, and the restraints on the growth of government expenditure, much will depend on how the state of public confidence moves and on the price-wage climate. The following estimates assume that the price rise will be lower than, and the wage rise roughly the same as, during the first half of 1969, though both would remain rather higher than in the pre-strike years. In particular, it is assumed that total wage earnings will not rise more than 8.5 per cent between 1969 and 1970. The forecasts thus contain an important normative element.

A strong deceleration of business fixed investment in 1970 would seem probable as a result of the restrictive monetary policies, the increase of business taxation, and the poorer outlook for demand. Public enterprise investment is likely, as already noted, to change little and general government investment is expected to rise only moderately, although somewhat faster than in the present year. The restrictions on new recruitment in the government sector, education apart, point to a slowdown of the increase of government consumption. The outlook for demand in the main French overseas markets is very favourable and the recent parity changes should also facilitate a rapid expansion of the volume of French exports. Stockbuilding activity, a particularly volatile element, might return to a more normal level assuming that stocks are roughly replenished in the course of 1969.

Employment is not likely to increase during 1970 and average work hours should decline. The decline in hours might largely reflect the further implement-

Balance of payments
FRANCE[a]

Value, million dollars
Estimates and forecasts

	1968	1969	1970	1968 II	1969 I	1969 II	1970 I	1970 II
SEASONALLY ADJUSTED								
Exports	11 310	13 400	15 450	6 180	6 600	6 800	7 500	7 950
Percent change[b]	(11.6)	(17.5)	(14)	(45.0)	(13.9)	(3.5)	(20)	(12½)
Imports	11 330	14 150	14 900	6 300	6 900	7 250	7 350	7 550
Percent change[b]	(12.7)	(24.5)	(5)	(55.7)	(18.5)	(10.0)	(2½)	(5)
Trade balance	–20	–750	550	–120	–300	–450	150	400
Services and transfers, net	–840	–550	–350	–540	–300	–250	–150	–200
Current balance	–860	–1 300	200	–660	–600	–700	0	200
UNADJUSTED								
Current balance	–860	–1 300	200	–660	–600	–700	0	200
Long-term capital	–713			–436				
Short-term capital and unrecorded	–1 678			–1 281				
Multilateral settlements	43			46				
Balance on non-monetary transactions	–3 208			–2 331	–1 775			
Change in reserves (increase = +)	–1 908			–971	–590			

Note: Estimates for net services and transfers are subject to a considerable margin of error. Data for 1968 are based on officially published statistics on a settlements basis. As such they probably incorporate disguised capital flows and an acceleration of transfers and are not indicative of the underlying trend. In the absence of statistical information for any period of 1969 it has been assumed that these exceptional factors would gradually disappear and that the balance on invisibles would return to its underlying position in 1970.

a) Balance with non-franc countries on a transactions basis.

b) Over previous period at annual rates, customs basis, total trade.

ation of the Grenelle Agreement and would, therefore, not have significant adverse effects on wage incomes. The development of non-wage incomes would seem likely to become less buoyant. Finally, the household saving ratio might increase slightly in response to strengthened confidence, less favourable employment prospects and the incentives provided for personal saving. These developments, if they materialize, could entail a substantial moderation of the growth of real private consumption even should the rise of hourly wage earnings remain relatively steep and the price rise moderate somewhat.

On these assumptions, the current account of the balance of payments could improve significantly. The immediate impact of devaluation was probably negative, because of the terms of trade effects. The impact can be expected to turn increasingly positive in coming months and the Deutschemark revaluation has facilitated the task of restoring better balance. While the parity changes may contribute in no small measure to improving the current balance of payments in 1970, the outcome may depend importantly on demand management. It is clearly difficult to suggest how much of the pre-devaluation deficit on current account reflected excess demand and speculative attitudes. But it may be significant that in the second quarter of 1969 imports were 50 per cent higher than two years earlier, whereas the trend relationship between imports and industrial production would suggest only a 40 per cent rise, or $ 100 million a month less than the actual figure. Although it is possible that an upward shift in import propensities has occurred, imports would hardly increase between the second quarter of 1969 and the second quarter of 1970, if abnormal imports of this order of magnitude disappeared and the rise of industrial production were some 5 per cent—a rise consistent with the official target of a 4 per cent increase in real GDP from 1969 to 1970.

If the above assumptions were realised, the deficit on current account with non-franc countries (transactions basis, seasonally adjusted) could disappear in the first half of 1970 and a surplus of perhaps $ 200 million could result in the second half-year. The change would mainly reflect an improvement of the trade account. The swing in the current balance, from a deficit of some $ 1.3 billion in 1969, would imply a shift of domestic resources to the balance of payments corresponding to about 1 per cent of GDP. This would be roughly in line with the official balance of payments target.

GERMANY

In the months immediately preceding the revaluation, expansion continued with undiminished strength, capacity constraints became increasingly severe and the price rise accelerated. The need for revaluation was underlined by the fact that severe pressure on resources had apparently produced little reduction of the underlying current external surplus. Continuing strong inflationary pressures in the immediate future, leading to rising unit labour costs, combined with the effect of the 9.3 per cent change in parity should reduce the current account surplus to a point rather close to equilibrium in 1970 with perhaps a slight deficit in the second half of the year. The revaluation should lead to an important reduction of demand pressures in the course of 1970. The withdrawal of speculative capital has already caused some tightening of monetary conditions which the authorities have only partially offset by reducing the reserve requirements of the banking system. The erosion of the external surplus on current account should also exert a strong disinflationary effect. It may, however, be important to recognise that better domestic cost and price trends are likely to follow the revaluation only with some time-lag, and to avoid policies which impart an unnecessarily strong downward bias to total demand.

Recent Trends

By mid-year the economy was showing clear signs of overheating. Since then, final domestic demand has continued to grow strongly, at a seasonally adjusted annual rate of perhaps some 10 per cent in volume, compared to a growth of output of around 8 per cent. Stockbuilding seems to have fallen back from the abnormally high level experienced in the first half-year. The external surplus on goods and services recovered somewhat from the level to which special factors (the timing of the introduction of the border tax changes) had reduced it early in the year, but the underlying trend was downwards. A buoyant order inflow produced a further lengthening of order books. By September, total orders on hand in manufacturing represented 4.3 months' production against a peak of 4 months in the 1960 boom. The backlog was most marked in the investment goods' industries, where domestic orders continued to grow steadily until mid-year. Pressure on resources became considerably stronger than at the peaks of the 1960/61 and 1964/65 booms. By the middle of the year, industrial capacity utilisation had attained an all-time record level and unemployment (seasonally adjusted) was down to some 0.7-0.8 per cent of the dependent labour force, a figure which could hardly be further reduced. By September, job vacancies were nearly five times as high as the number of unemployed. The number of foreign workers employed in Germany reached 1.5 million compared with some 1.3 million at the peak of the 1965 boom.

Growing pressure on resources has been increasingly reflected in domestic price developments. In October industrial producer prices were 3.9 per cent higher than a year earlier, and during the three months to October they were rising at an annual rate of almost 6 per cent, the highest rate since the Korean boom. In September export prices were 7¼ per cent higher than a year earlier. A recovery of building activity led to a strong rise of construction prices. Forward-looking indicators suggest that producer prices will rise at an accelerating pace in the months ahead. This may be reflected increasingly in prices for consumer durables which have so far remained relatively stable.

The strong expansion has led to a faster increase of wages and salaries. During the first half of the year, gross wages and salaries per employed person were rising at an annual rate of some 8 per cent. Wage settlements during the second quarter provided increases in hourly rates averaging not more than 6-7 per cent for some 8 million workers, but with rising pressure wage drift seems to have increased. Increasing productivity kept unit labour costs stable until quite recently, but labour costs seem now to be rising much more rapidly than output. The relatively peaceful wage climate changed dramatically in September when a wave of strikes led to advanced contract renegotiations for iron and steel workers,

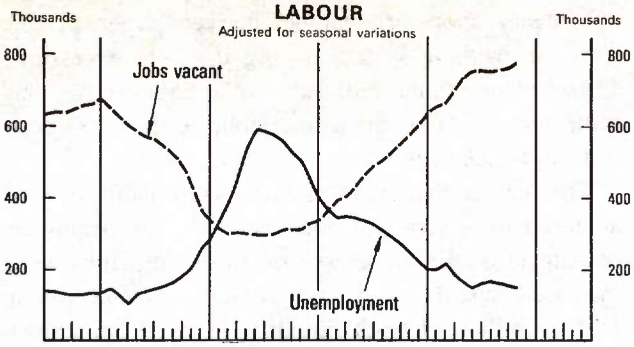
Demand and Output
GERMANY

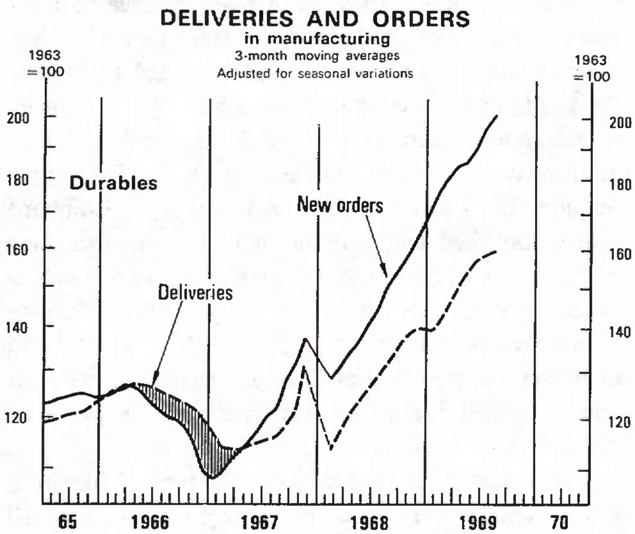
Percentage changes, volume
Seasonally adjusted
at annual rates
Estimates and forecasts

	1968 billion DM	From previous year			From previous half-year				
		1968	1969	1970	1968 II	1969 I	1969 II	1970 I	1970 II
Private consumption	297.3	3.6	7	6½	6.8	6.9	8½	6	5½
Public consumption	83.6	0.1	4	4½	1.9	7.3	0	7	4½
Fixed investment	121.3	7.8	15	8	21.5	8.3	21	6	1½
Final domestic demand (excluding stocks)	502.2	4.0	8½	6½	9.3	7.3	10	6	4½
*plus change in stock building	10.2[a]	2.8	½	−½	0.2	1.8	−2	0	0
*plus change in foreign balance	18.4[a]	0.4	−1	−1½	1.5	−2.3	0	−1¾	−1¾
GNP at market prices	530.8	7.0	7¾	4½	10.6	6.4	7½	4	2½
GNP implicit price deflator	..	2.2	3	4¼	2.4	2.8	4	5	3
Industrial production	..	12.3	13	6	15.0	15.0	7½	7	2¾

* The yearly and half-yearly rates of change refer to changes in stock building and in the foreign balance expressed as a percentage of GNP in the previous period. These two figures plus the rate of change of final domestic demand broadly equal the rate of change of GNP. In practice, however, divergences are possible because the rate of change of final domestic demand is not expressed as a percentage of GNP.

a) Actual level of stock building and foreign balance.





miners and civil servants. North Rhine-Westphalian iron and steel workers obtained an effective pay increase of some 12 per cent from 1st September, three months before the contract was due to expire. For miners, the increase was even greater. Civil servants reacted with demands for pay increases ranging from 13-15 per cent. The trend towards wage and salary increases much in excess of productivity growth is spreading to other sectors of the economy. According to official estimates, hourly earnings in the whole economy in the fourth quarter will be 12 per cent higher than a year earlier.

With costs and prices rising rapidly in other important trading countries, overheating of the economy has so far produced only a small reduction in the current surplus. The second quarter, on balance relatively little affected by special factors, saw a sharp recovery in the current account surplus. During the third quarter it was at a seasonally adjusted annual rate of some $ 2½-3 billion, around the same level as during the first nine months of 1968, in spite of the fact that imports have been growing proportionately more rapidly than at the peak of the previous boom. Long-term capital exports totalled some $ 3½ billion during the first nine months of the year and the basic deficit amounted to more than $ 2 billion. But in spite of this, official reserves rose by some $ 2 billion of which some $ 1 billion resulted from a fresh wave of speculation immediately before the election in September.

Monetary expansion has continued at a high rate. In September the total volume of money [1] was 10 per cent higher than a year earlier. During the greater part of the year the banks experienced some pressure on liquidity and the liquidity ratio [2] fell from 14 per cent of total deposits during the final months of 1968 to 10 per cent in August. The liquidity losses resulted mainly from the external deficit on non-monetary transactions, [3] increased minimum reserve requirements, and the restrictive impact of public finances. The reduction of bank liquidity was interrupted during May, when an extremely large speculative inflow of capital from abroad brought an average net liquidity gain of more than DM 12 billion. The effect of this massive addition was, however, more than reversed by late August, mostly as a result of policy measures. During September speculation brought another DM 3½ billion net liquidity gain which was, however, fully reversed in the subsequent month. By the end of October the liquidity ratio was roughly back to the end-August level. With the reversal of speculative flows continuing during November, bank liquidity continued to fall. The reduction of DM 2 billion in banks' minimum reserves, effective from 1st November 1969, was only a partial offset.

By late November more than two-thirds of the net speculative inflow from February to September, estimated at some $ 5 billion, had left Germany. Money market rates reacted to this drain on bank liquidity with a sharp upward movement, quickly reaching the Lombard rate ceiling (7.5 per cent). It is difficult to forecast the extent and timing of further outflows, but the possible amount is

1. Including time deposits up to three months.

2. Excess cash reserves, domestic and foreign secondary liquid assets and unexhausted rediscount facilities as per cent of total deposits.

3. In the eight months to August there was a deficit on non-monetary transactions of DM 3.6 billion.

still large and could continue to reduce bank liquidity. But what happens to liquidity will depend also on any action by the monetary authorities.

Restrictive Central Bank measures have also resulted in a general upward pressure on interest rates. The cost of short-term bank loans rose by 1.5 percentage points from February to August and has risen further since then. During the same period the average bond yield rose by some $\frac{3}{4}$ percentage points to about $7\frac{1}{4}$ per cent and the yield on Euro-deutschemark bonds rose by more than $1\frac{1}{4}$ per cent to almost 8 per cent compared with some $8\frac{1}{4}$ per cent for Euro-dollar issues. During recent months banks have reduced their purchases of bonds, which had been exceedingly high since the beginning of 1967.

Recent Policies

Further fiscal and monetary measures were taken from the spring onwards to relieve strains on the economy. In accordance with the recommendations of the Financial Planning Council (see *OECD Economic Outlook*, No. 5, p. 69) overall public sector budgets are likely to exert some deflationary impact in 1969 with a swing from a financial deficit in 1968 of DM 5 billion to a surplus of DM $5\frac{1}{2}$ billion. This swing reflects discretionary policy measures only to a small extent; it results mainly from the extra growth of revenue arising from a growth of GNP far above that assumed in the original budget calculations.

During the first nine months of the year the public authorities used cash surpluses of almost DM 3 billion to redeem short-term money-market paper placed with the banking system during the 1967 recession. These transactions reduced bank liquidity in the same way as an increase in public authorities' central bank balances.

The further tightening of monetary conditions was achieved by a series of measures. At the beginning of August minimum reserve ratios of the banks were increased again by 10 per cent, absorbing about DM 1.8 billion of bank liquidity. On 1st September a change in the Central Bank Act came into force, enabling the Bundesbank to increase reserve requirements on all foreign deposits to 100 per cent. Another change in minimum reserve regulations was designed to reduce the attractiveness of 'currency round-about operations' which do not produce additional short-term capital exports.[1] The introduction of special supplements to the Lombard rate,[2] abolished again at the end of September, was intended to reduce the attractiveness of bank refinancing from this source, which had become considerably more important during 1969. At the end of September the Central Bank increased the discount and Lombard rates to 6 per cent and $7\frac{1}{2}$ per cent respectively.

The revaluation of October 27, 1969, brought a new situation. In order partially to offset the fall in bank liquidity the Central Bank reduced minimum reserves as from 1st November 1969 by DM 2 billion. In an attempt to cool off wage demands the Federal Government decided on a tax cut for workers and employees in lower and medium income brackets of some DM 1 billion. It also proposed to abolish pensioners' sickness insurance payments (DM 0.7 billion), to increase tax incentives for small savings and to raise pensions for war victims by DM 1 billion. These measures if adopted would add almost $\frac{3}{4}$ percentage point to personal disposable income with the impact concentrated in the second half of 1970. Finally, it has been decided fully to offset the income loss for farmers that would have automatically followed from revaluation. This will increase net subsidies by some DM $1\frac{3}{4}$ billion, of which DM $\frac{1}{4}$ billion (net) will be paid by the EEC agricultural fund.

TABLE 36
General government budget

	1968 DM billion	1969[a] Percentage change
Total receipts	212.5	$13\frac{1}{2}$
Of which :		
Direct taxes paid by households	99.1	$13\frac{1}{2}$
Total expenditure	217.5	$8\frac{1}{2}$
Of which :		
Purchase of goods and services	82.9	$9\frac{1}{2}$
Transfers, etc.	84.2	$7\frac{1}{2}$
		DM billion
Financial savings	–5	$5\frac{1}{2}$

a) OECD Secretariat estimate.

1. 'Round-about operations' took place when the Bundesbank provided forward cover at rates below the market rate.
2. Rate on bank borrowing against collateral not subject to quota.

Prospects

The forecasts for 1970 are based on the following policy assumptions:

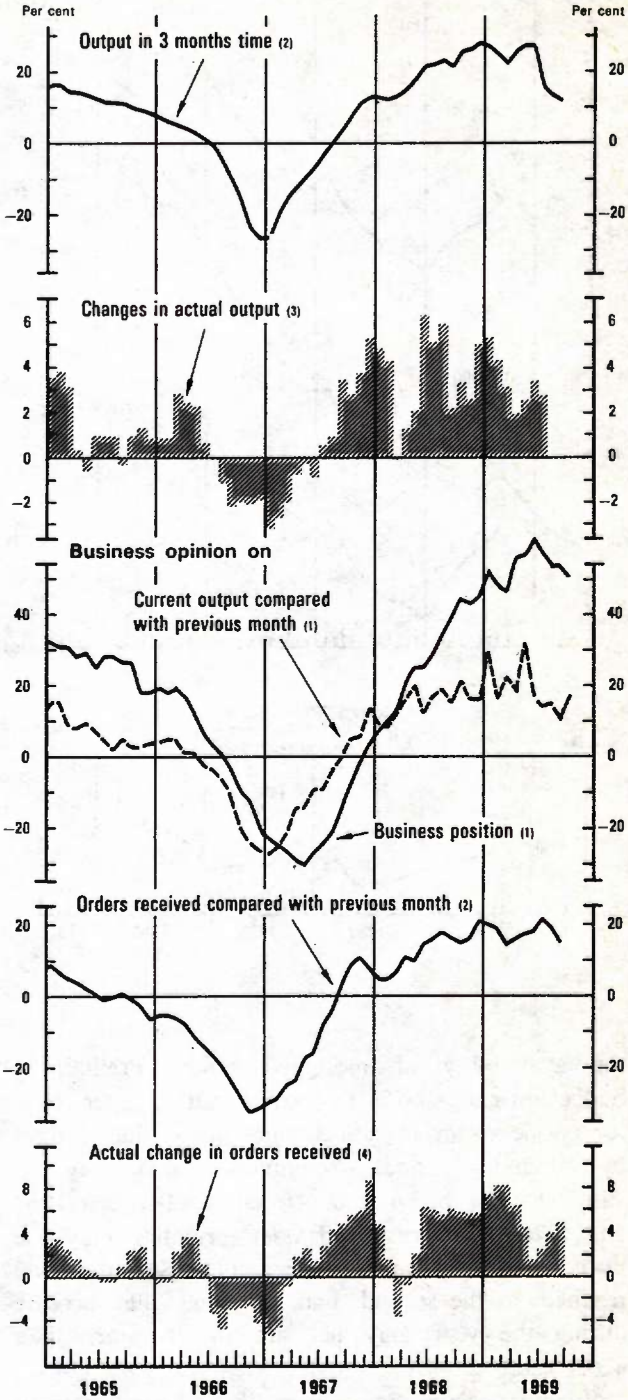
a) Fiscal policy will not be tightened much further, and may be relaxed somewhat in the second half. Total revenue and expenditure will grow at roughly the same rate, implying a financial surplus little changed from the 1969 level.

b) The monetary authorities are assumed to let some tightening of liquidity work through the economy in support of the objective of bringing inflationary pressures down to a tolerable level in the course of 1970. It is not assumed that tight monetary policy will be pursued to a point where it would affect employment to any significant extent.

On this basis, total aggregate demand might continue to grow during the first half of 1970 at an annual rate of some 6 per cent in volume. But with the rise of output limited by capacity, imports would continue to increase very fast, further reducing the current external surplus. During the second half of the year, the growth of total demand may fall to an annual rate of some 4 per cent, and the strain on the economy should ease. With increasing effects from revaluation, the current balance might move into small deficit.

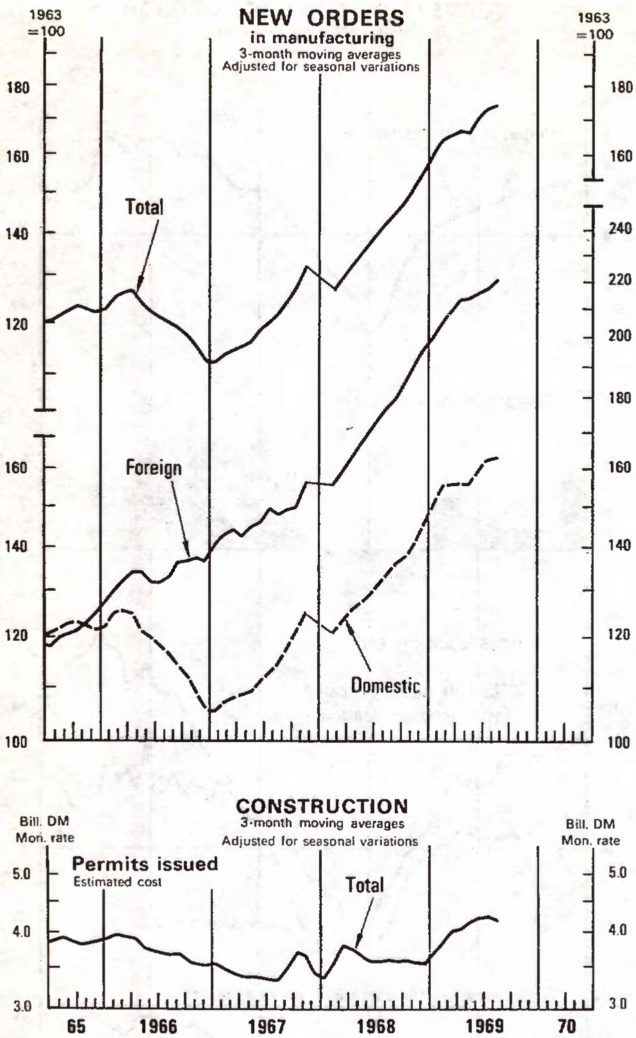
The coming year may see a pronounced shift in the pattern of expansion from autonomous to endogenous demand components, typical of the final phase of a business upswing. Trends in both exports and private fixed investment are likely to be weaker and consumption to rise strongly. The IFO-test, taken in September but under the expectation of an imminent deutschemark revaluation, suggested a 15 per cent value increase in investment in manufacturing between 1969 and 1970, implying little growth from the rate reached by the latter part of 1969. The high level of capital goods orders on hand points to a continued rise in business fixed investment in the first half of 1970, but the second half may see a flattening-out influenced by narrower profit margins, tighter monetary conditions and the prospect of slower growth. Residential construction may show a moderate decline; the underlying trend has been weak for some time and somewhat tighter monetary conditions would probably have an adverse effect on

SURVEYS OF BUSINESS OPINION
Manufacturing industry



Source : I.F.O. - Institut fur Wirtschaftsforschung, Munich.

1. Answers to the survey are judgements on own firm, and the series show the difference between positive and negative replies, seasonally adjusted, for the months in which the survey was taken.
2. 3-month moving averages.
3. Percentage changes in the seasonally adjusted index of manufacturing production (3-month moving average over previous 3-month).
4. Percentage change in the index of new orders received by manufacturing industries (3-month moving averages over 3-month). Before January 1968 the index of new orders included indirect taxation: these figures have been reduced by 5 per cent to make them comparable with the 1968 figures.



the availability of mortgage funds. Preliminary budget estimates point to a somewhat stronger trend for public sector investment, notably capital outlays by "Länder" and Communes which may be stimulated by buoyant tax receipts. Between 1969 and 1970 total gross fixed asset formation may rise by some 8 per cent in volume, but given the level reached in the second half of 1969 the increase during the year may not amount to more than 4 per cent.

Private consumption seems likely to continue to rise strongly, reflecting the rapid rise of wages and salaries and a probable decline of the saving ratio. Current wage negotiations and the more militant attitudes of the trade unions point to an average increase in hourly earnings of at least 11 per cent between 1969 and 1970. Because of the effects of the revaluation, especially on food prices, consumer prices as a whole may not rise much faster than they have done recently. Private consumption could well increase by some 6½ per cent in real terms.

On these assumptions, and with no major stimulus likely from stockbuilding, real GNP could rise by some 4½ per cent from 1969 to 1970. During the first half of 1970 total output might continue to grow at a seasonally adjusted annual rate of some 4 per cent, roughly in line with the growth of capacity. In the second half, however, the effects of the revaluation on the foreign balance combined with the probable flattening-out of investment activity, could produce a slowdown in the growth of GNP to an annual rate of around 2½ per cent. With the domestic labour force hardly changing, the immediate effect of a slowdown on unemployment may be modest, but earlier periods of slower growth suggest that the number of foreign workers may be reduced. An easing of labour market conditions would seem likely to have a moderating influence on new tariff settlements towards the end of the year and wage-drift could fall back relatively quickly. Nevertheless, unit labour costs are likely to rise sharply between 1969 and 1970. With wages and salaries per hour rising by, perhaps, 13 per cent (of which 2 per cent reflects the estimated cost to employers of the new payments during periods of sickness) and productivity unlikely to show an increase of more than 4½ per cent, unit labour costs in the whole economy may increase by around 8-9 per cent, with a 7 per cent rise in manufacturing. The price rise may, therefore, remain relatively strong in the first half of 1970, with the GNP deflator increasing at an annual rate of around 5 per cent; in the second half, with revaluation effects coming through and demand pressures easing, the rise in the GNP deflator may slow down to an annual rate of about 3 per cent. Profit margins, now high, seem likely to be squeezed quite markedly.

The current balance of payments may change sharply in 1970, perhaps running into deficit in the second half of the year. The revaluation may lead to a deterioration of over $ 1 billion for 1970 as a whole,[1] but with the first half rather less affected.

1. This is the estimated year-on-year change in the current balance due to the revaluation. Comparing the forecast for 1970 with the annual rate in the second and third quarters of 1969—which were not much affected by special factors—the total change in the balance, due both to revaluation and to cyclical factors, could exceed $ 2 billion.

Balance of payments GERMANY

Value, million dollars
Estimates and forecasts

	1968	1969	1970	1968 II	1969 I	1969 II	1970 I	1970 II
SEASONALLY ADJUSTED								
Exports	24 820	28 750	32 100	13 190	13 760	15 000	15 900	16 200
Percent change[a]	(14.3)	(15.5)	(12)	(32.3)	(5.0)	(25.0)	(10)	(4)
Imports	19 140	23 850	27 700	9 940	11 425	12 400	13 500	14 200
Percent change[a]	(16.1)	(23.5)	(16)	(20.9)	(28.3)	(18.0)	(18)	(10)
Trade balance	5 680	4 900	4 400	3 250	2 335	2 600	2 400	2 000
Services and transfers, net	–2 842	–3 400	–4 000	–1 512	–1 665	–1 750	–1 900	–2 100
Current balance	2 838	1 500	400	1 738	670	850	500	–100
UNADJUSTED								
Current balance	2 838	1 500	400	1 584	866	650	700	–300
Long-term capital[b]	–2 900			–1 748	–2 395			
Short-term capital and unrecorded[c]	1 202			523	2 786			
Balance on non-monetary transactions	1 140			359	1 257			
Change in reserve (increase = +)	1 328			1 144	359			

a) Over previous period at annual rates, customs basis.
b) Excluding special transactions.
c) Including advance payments for military imports.

In the second half, with the likelihood of slow growth in world trade and some loss of market shares by Germany, the export rise may be very slow. The rise of imports is also likely to slow down, given the outlook for activity, but should be much higher than the increase of exports because of the effects of revaluation. The deficit on invisibles is likely to be increased by the revaluation. The outflow of long-term capital seems likely to fall from the exceptionally high rate in the first three quarters of 1969. But how large an outflow persists, and what movements of short-term funds develop depends very much on future relative monetary conditions and interest differentials.

ITALY

The expansion of activity accelerated strongly until it was upset by the wave of strikes which began in the third quarter. Domestic demand was strong, reflecting among other things the measures taken in late 1968 and 1969 and the faster increase in wages. Export demand was very strong. At this stage, effects are uncertain, but as a result of the strikes the year-to-year change of real GDP in 1969 might be only about 6 per rent, over 1 per cent less than it might have been. The current external surplus may remain about $ 2½ billion. At the time of writing the prospect is over-shadowed by continuing disturbances. It seems likely that the rising trend of exports will weaken from now on, a factor tending to reduce the underlying growth of activity. But home demand seems likely to be strong. An end to disturbances and making good at least some of the production lost this year could result in a rather large rise in total output between 1969 and 1970—perhaps over 7 per cent. But there would still be slack in the economy at the end of the year.

Despite the scope for raising output, the prospective rise of wages around the turn of the year suggests that labour costs could rise quite fast in the short run, leading to some faster rise of prices. The social unrest, and the likelihood that unused resources

Demand and Output
ITALY

Percentage changes, volume
Seasonally adjusted
at annual rates
Estimates and forecasts

	1968 billion lire	From previous year 1968	1969	1970	From previous half-year 1968 II	1969 I	1969 II	1970 I	1970 II
Private consumption	29 740	4.3	6	7½	4.5	6.6	7	8½	6
Public consumption	6 313	4.1	3½	4	5.1	3.0	3	4½	4
Fixed investment	9 045	7.4	10	10½	5.9	12.2	10	12½	7
Final domestic demand (excluding stocks)	45 098	4.9	6½	7¾	4.9	7.2	7	9	6
*plus change in stock building	185[a]	–0.8	0	1¼	2.0	0.6	–3½	3½	1½
*plus change in foreign balance	1 140[a]	1.4	–½	–1	–0.9	–0.1	–1	–1	–1½
GDP at market prices	46 423	5.4	6	7¾	5.9	7.7	2½	11½	6
GDP implicit price deflator	..	1.5	3½	4¾	1.2	3.6	4½	5	5
Industrial production	..	6.4	5¾	10½	7.0	9.0	–2	20	5

* The yearly and half-yearly rates of change refer to changes in stock building and in the foreign balance expressed as a percentage of GDP in the previous period. These two figures plus the rate of change of final domestic demand broadly equal the rate of change of GDP. In practice, however, divergences are possible because the rate of change of final domestic demand is not expressed as a percentage of GDP.

a) Actual level of stock building and foreign balance.

will continue to coexist with a large current account surplus—perhaps near $ 2 billion in 1970—would seem to call for the avoidance of restrictive demand management. But the wage prospect points to the need for caution even if there is some scope for a relative increase of Italian costs without endangering the competitive position of industry. The situation is complicated by the persistently large capital outflow. Although some further loss of external reserves should not by itself give cause for concern, it is clearly desirable that action should be taken to correct the institutional and fiscal factors contributing to the capital outflow.

Recent Trends

In the first half of 1969, real GDP was rising at an annual rate of more than 7 per cent, reflecting both a marked acceleration of the growth of exports and the vigorous advance of domestic demand, notably fixed investment. The rise of private consumption accelerated in line with hourly wage earnings and employment, but remained smaller than that of GDP. Hourly rates in manufacturing—which had risen relatively slowly up to the first quarter—increased sharply in the second, when 50 per cent of the regional differentials between minimum rates were abolished and the rise of the cost-of-living index entailed an automatic adjustment of wages.[1] Consumer prices increased at an annual rate of about 4 per cent in the first nine months, including a slightly faster rise of food prices.

Economic activity was considerably disrupted in the second half of the year by widespread strike movements, affecting mainly manufacturing industry and to a smaller extent construction and the service industries. Few statistical indicators are yet available for the affected period. The index of industrial production in September was 2.5 per cent lower than a year earlier and it may have stayed at about the September level in October and November. In earlier months it had been averaging about 9 per cent more than a year earlier. Final demand may not have been affected very greatly; the main consequence so far has probably been a considerable reduction of stocks. Fixed investment (especially residential construction) has probably been hampered. The effect on private consumption may have been small, with losses of income[2] being partly offset by drawing on savings. Foreign trade may have

1. The cost-of-living adjustment covers the wages of employees in agriculture, industry, commerce, and part of transport. It is applied quarterly (with a one quarter lag) if the rise in a special cost-of-living index (rounded to the nearest unit) amounts to one point (about two-thirds of one per cent) or more. It has been estimated that a two points adjustment represents an increase of about one half of one per cent of total labour earnings in the private sector (excluding employers' social security contributions).

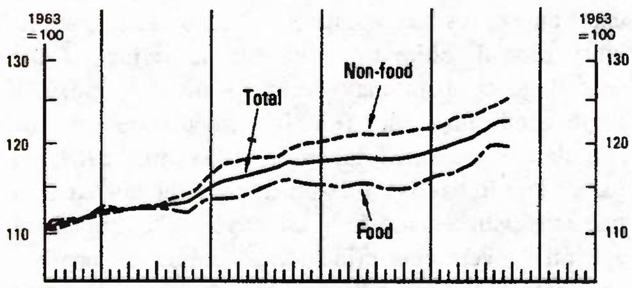
2. The strikes were mainly sporadic movements which had significant disruptive effects on production although most workers reported to work and were presumably paid.

been disrupted, but at the time of writing no statistics were available beyond August.

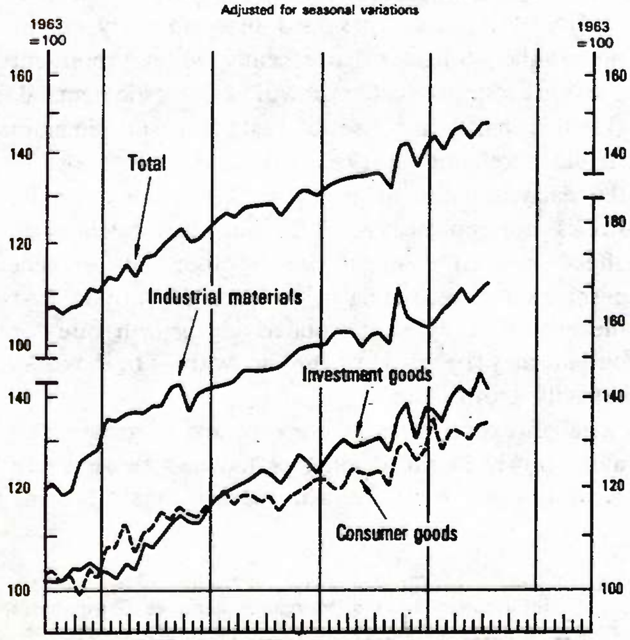
The surplus on current account of the balance of payments in the first half of the year (seasonally adjusted and on a transactions basis) remained at an annual rate of around $ 2.6 billion, the same as in 1968. Net invisible earnings rose, but the trade surplus fell somewhat as the sharp increase of exports was more than offset by imports, the latter possibly influenced by advance purchases caused by expectations of exchange rate changes. Because of a large capital outflow,[1] the balance on non-monetary transactions (not seasonally adjusted) showed a deficit of $ 872 million. With a repatriation of banking funds, following the instructions of the authorities, the deficit on official settlements was smaller—about $ 360 million. Net reserves rose somewhat in July and August to $ 4.6 billion (including the IMF position but excluding medium and long-term assets of the monetary authorities). But in September there was a fall in net reserves of $ 218 million, probably influenced by speculation on the Deutschemark.

As the strikes may have hampered exports more than imports, the current account surplus may show a substantial temporary deterioration in the second half of the year.

CONSUMER PRICES



INDUSTRIAL PRODUCTION
Adjusted for seasonal variations



Recent Policy Measures

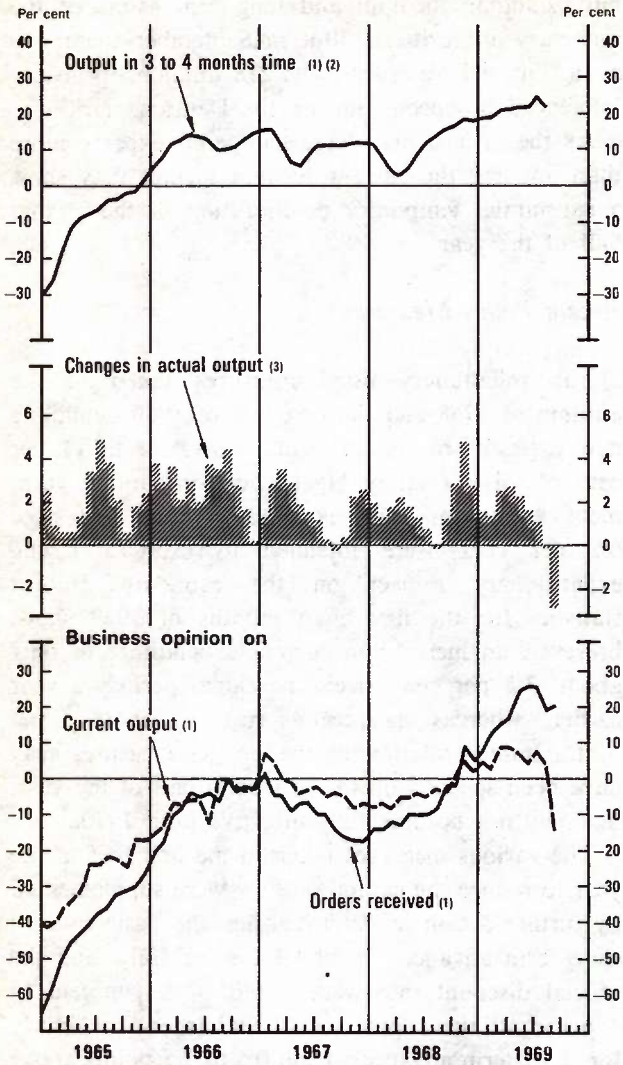
The reflationary fiscal measures taken in the autumn of 1968 and the first half of 1969—entailing new expenditure commitments equivalent to 1½ per cent of GNP (mainly higher pensions and government employees' salaries) and revenue losses of 0.2 per cent—were intended to exert a strong expansionary impact on the economy. Budget statistics for the first eight months of 1969 show, however, an increase in current expenditure of only about 3.5 per cent over the same period a year earlier, whereas tax receipts rose by about 5 per cent. Implementation of the budget measures may have been speeded up in the second half of the year, but may not become fully effective until 1970.

The various measures taken in the first half of the year to reduce the capital outflow were supplemented by further action in August, when the basic rate on short-term advances by the Bank of Italy and the official discount rate were raised by ½ per cent to 4 per cent; the supplements established previously for short-term advances (from 0.5 to 1.5 points above the basic rate in the event of a bank's continued recourse to such credit) remained unchanged and so did the penalty rate of 1.5 points applicable to rediscount of commercial paper above a certain ceiling.[2] Moreover, the interest rate on one-year

1. According to data on a settlements basis, during the nine months to September the capital outflow was more than $ 2.5 billion (against $ 0.9 billion a year earlier) largely financed by illegal banknote remittances which amounted to $ 1.6 billion up to September.

2. The rates actually paid may have risen to 5½ per cent. The average rate of short-term advances into July was 4.94—i.e. the official rate plus an average supplement of 1.44—and as from August, the average rate may well be about 5½ per cent assuming no change in the average supplement paid. The volume of rediscount of commercial banks in August was above the ceiling established for the penalty rate of 1.5 points, which should (at least in many cases) take the rate actually paid for rediscounts to 5½ per cent.

SURVEYS OF BUSINESS OPINION
Manufacturing and extractive industries



Source: I.S.C.O. Congiuntura Italiana.

1. Answers to the survey are judgements on own firm, and the series show the difference between positive and negative replies, seasonally adjusted, for the months in which the survey was taken.
2. 3-month moving averages.
3. Percentage changes in the seasonally adjusted index of manufacturing production (3-month moving average over previous 3-month).

Treasury bonds purchased voluntarily by the banks and the public was raised from 3.4 per cent to 4.4 per cent in May and 5 per cent in August and September. The higher short-term interest rates have been allowed to affect the bond market. The average yield on bonds other than Treasury bonds rose from 6.5 per cent in May to 6.8 per cent in September, possibly reflecting a change in policy by the Bank of Italy which had previously kept long-term bond rates stable by open market operations. The rise was more pronounced for bonds of private companies—from 6.9 per cent in May to 7.6 per cent in September. Bank lending rates also seem to have increased recently.[1] However, in the first eight months of the year the banks were able to increase loans by over 5.3 per cent, compared with a rise of 3.0 per cent a year earlier. This was possible despite the fact that bank deposits rose somewhat less fast than in the previous year and there was a slight fall in the banks' recourse to the Bank of Italy. The repatriation of net foreign assets increased available funds, and the banks also reduced both their purchases of bonds and their liquid assets.

Prospects

The 1970 forecast is based on the assumption that disturbances will cease by the end of 1969 and that rather over half of the production lost in the strikes will be made good. Public finances are assumed to exert an expansionary impact. According to preliminary official estimates, the current saving of the central government may decline somewhat in 1970, partly reflecting the full implementation of the stimulative measures taken in 1968 and 1969; in particular, it has been assumed that the increase in pensions will become fully effective. The impact of general government (including public enterprises and state holdings) will probably be more important as total public fixed investment has been forecast to rise by an amount equivalent to about 0.5 per cent of GNP. It is also assumed that monetary conditions, although tighter than recently, will not represent a serious restraint on the growth of domestic demand. On this basis, the rise of real domestic demand should accelerate in 1970, with a further boost in the early months of the year when, for example, stocks are replenished. Including this catching-up effect, real GDP might rise by about 7½ per cent despite some weakening of the external surplus. At the end of the year the underlying growth rate for output may be roughly in line with—or above—a capacity growth rate.

Italian export markets are expected to grow much more slowly in the coming period and the increase in Italy's share of foreign markets may become

1. There are no official data on bank lending rates. According to information by the Morgan Guarantee Trust, rates charged to prime borrowers were 7.75 per cent in September, compared with 7.25 per cent in July and 6.50 per cent in May.

Balance of payments
ITALY

Value, million dollars
Estimates and forecasts

	1968	1969	1970	1968 II	1969 I	1969 II	1970 I	1970 II
SEASONALLY ADJUSTED								
Exports	10 095	11 750	13 700	5 279	5 839	5 900	6 800	6 900
Percent change[a]	(17.0)	(17.0)	(16½)	(17.7)	(27.8)	(–1.0)	(34)	(4)
Imports	9 044	11 250	13 800	4 799	5 491	5 750	6 800	7 000
Percent change[a]	(4.3)	(19.0)	(23)	(28.8)	(18.6)	(11.0)	(40)	(5½)
Trade balance	1 051	500	–100	480	348	150	0	–100
Services and transfers, net	1 593	1 950	1 900	777	977	950	1 000	900
Current balance	2 644	2 450	1 800	1 257	1 325	1 100	1 000	800
UNADJUSTED								
Current balance	2 644	2 450	1 800	1 574	1 159	1 300	800	1 000
Long-term capital[b]	–1 353			..	..			
Short-term capital and unrecorded	–630			..	..			
Balance on non-monetary transactions	661			639	–872			
Change in reserves (increase = +)	–268			90	–25			

a) Over previous period at annual rates, customs basis.
b) Excluding special transactions.

smaller than in the last two years, given stronger pressure on resources and costs at home. On balance, the effects of the devaluation of the French franc and the revaluation of the Deutschemark on trade may be quite small. The underlying growth of Italian exports may thus be about half that of 1969. Strike losses in 1969 and some recovery from them in 1970 could, however, mask this for some time.

Much of the expected budget stimulus will probably result from higher transfer payments. The government sector's total purchases of goods and services in real terms may rise at about the same rate as in 1969. Fixed investment will probably remain an important dynamic element. The rise of public investment (including that of state-owned enterprises) may be faster than in 1969, since direct government investment is expected to accelerate after the slowing down this year. There might be some catching up of business investment, lost recently, and this sector will still benefit in 1970 from the tax credit granted in the autumn of 1968. Higher rates of capacity utilisation should also have a favourable influence on investment decisions. According to the latest (September) business survey the flow of domestic orders to the capital goods industries has been rising in the last year; but it has levelled out somewhat since last May, probably due to seasonal factors. The trend of residential construction is expected to slow down appreciably in the course of the year partly because of the disappearance of the effects of administrative regulations which bunched starts in 1968 and partly, perhaps, because of the rapid rise of costs.[1] Stockbuilding will certainly need to be very substantial in early 1970 because of the recent reductions. Thereafter it may slow down significantly.

The rise of consumer expenditure may well accelerate further, mainly because of the continued rise of dependent employment, and the expected increase of average hourly earnings. Further sliding-scale adjustments of wages because of higher prices seem likely and 50 per cent of the remaining regional differences between wage rates will be abolished in October 1970. More important, settlements affecting some 4 million workers are now under discussion. Agreement has already been reached in the building industry, affecting about 1 million workers, for hourly wage rates to be increased by over 20 per cent

1. Much however will depend on whether the measures proposed by the government to subsidize residential construction (amounting to 1,700 billion lire in three years) and now being discussed in Parliament are approved and implemented quickly.

in a three-year period (from 3 to 6 per cent more at the local level) and for normal weekly working hours to be reduced from 42 to 40. Before the results of other settlements are known forecasts of wage trends can only be highly tentative. If the settlement of the construction industry were to set the pattern for other agreements, average hourly rates (including social security contributions) might rise by about 12-13 per cent between 1969 and 1970 and the wage bill by 14-15 per cent. Increased pension payments should provide an additional boost to personal incomes. Even if the rise of prices accelerates, private consumption in volume could increase by 7-8 per cent between 1969 and 1970.

Domestic demand may therefore rise much faster than in 1969, but partly because of the effects of the strikes. On the assumptions made, the rise in GDP in real terms might be as much as 7½ per cent in 1970 as a whole despite a lower external surplus. But this would be on a depressed base in 1969 and include a partial making good of production losses in the earlier year. Despite some absorption of unused resources in the two year period up to end-1970, there would remain a margin of slack. But given the change in the pattern of the expansion—a faster rise of domestic demand and a slower underlying growth of exports—individual sectors may be affected somewhat differently.

On the above assumptions concerning the rise of wages and output the trend of unit labour costs (for the whole economy) may rise by more than 7 per cent on average for the next year. On the basis of past relationships, and assuming a certain margin of slack remaining in 1970, this could entail a rise in the GDP deflator of some 4¾ per cent. In 1962-1963 when the pressure of resources was stronger and the wage bill rose by 20 per cent a year, unit labour costs were increasing at an annual rate of 12½ per cent, entailing a 7½ per cent rise in the GDP deflator.

The current external surplus is likely to lessen somewhat in 1970. The rise of imports will probably accelerate for the year as a whole, given the strong advance in aggregate demand, and particularly in the first part of the year when substantial stockbuilding is expected. Export markets are likely to slow down. Net invisible earnings, which seem to have recovered appreciably in 1969, may not change much next year. Nevertheless, the current account surplus could still amount to around $ 1.8 billion in the year as a whole, with an annual rate of say $ 1.6 billion in the second half, when little distortion from current events is assumed to remain.

TECHNICAL NOTES

The OECD *Economic Outlook* draws heavily on the statistical work of the Department of Economics and Statistics. The following notes describe briefly the statistical concepts and methods applied as well as the forecasting techniques used. Special emphasis is given to deviations from national (or other international) practices.

FORECASTING TECHNIQUES

Tables 1, 3, 7, 10 to 12, 14, 16, 17 and the tables on demand and output and the balance of payments of seven major countries are based on an internally consistent set of forecasts of national accounting aggregates for the OECD area. Relatively detailed forecasts are prepared for the major seven OECD countries (Canada, France, Germany, Italy, Japan, the United Kingdom and the United States), which account for more than 70 per cent of total OECD trade. For the other OECD countries only GDP and foreign trade forecasts are made. While account is taken of forecasts prepared in the countries concerned, both official and unofficial, the forecasts given here are entirely the responsibility of the Economics and Statistics Department. Some of the forecasting methods employed, particularly in the major countries, have been described in an OECD Report: *Techniques of Economic Forecasting*, Paris, 1965.

Forecasts are first prepared for what may be broadly called the exogenous elements of demand : public consumption, gross fixed investment and exports of goods and services. For public consumption and public investment as much use as possible is made of budgetary statements, although their availability and usefulness vary from country to country. With regard to private investment extensive use is made of the intention surveys which are carried out in most of the seven countries. Exports are initially forecast in the light of past trends, but as will be seen below, they are reconsidered as the general forecasts for each country and for all countries together take shape.

The forecast for these exogenous elements of demand, plus any information that may be obtained regarding stock changes, provides a first indication of the likely development of the pressure of demand. In order to get some indication of the possible growth of supplies, use is made of relationships describing the " capacity " rate of growth of the economy. At this stage an appropriation account for the household sector is constructed which takes into account the probable development of incomes as indicated by wage settlements and by the forecast change in the pressure of demand and provides an estimate of personal disposable income. Little is known about the short-term behaviour of the personal saving ratio and hence the forecast underlying consumers'expenditures usually assumes an unchanged ratio unless there are particular reasons to assume otherwise. The forecast for the exogenous elements of demand, together with that for personal disposable income, provides a basis for a first assessment of likely price developments. This in turn is used to forecast the likely development of personal consumption in real terms.

Thus, a first forecast of the change in final expenditure is obtained and on the basis of past cyclical relationships with imports, an estimate is also made of the likely import demand. In this respect a number of relationships have been developed linking import demand with domestic demand which have thrown some light on the cyclical variation in import propensities. Forecasts for merchandise imports and for imports of services are usually made in terms of customs and balance of payments statistics (see below) and then transposed in national accounting terms.

The subsequent stages of the forecasting procedure consist of reiterations, with a view to ensuring the international consistency of foreign trade forecasts of individual countries.

OECD trade forecasts are based on the projected import demand of individual countries, described above. The figures obtained for the seven major countries, together with direct import forecasts for the other OECD countries, provide the aggregate OECD import demand, which is broken down into:

i) demand for OECD exports;

ii) demand for imports from the rest of the world.

The forecast for OECD imports from the rest of the world is taken as the starting point for a forecast of OECD exports to the rest of the world, via an assessment of possible movements in other elements in the rest of the world's balance of payments with the OECD area, the financial position of the primary producing countries, and special factors affecting exports to the Sino-Soviet countries.

Exports to the rest of the world, in combination with *i)* above, yield the projected total of OECD exports[1], which is allocated among exporting countries on the basis of the projections shown in Table 14.

These projections distinguish between :

i) Potential exports—defined for each country as the exports which would take place in any given period if the country retained its share in OECD exports to each individual export market[2] ;

ii) Export performance—defined as a country's gain or loss in market shares. This has been found to be affected both by longer-run factors and by cyclical changes in relative pressures on capacity.

The export forecasts thus obtained are transposed into national accounting terms and incorporated in the forecasts of the seven major countries.

A similar but simpler process is employed in arriving at forecasts of invisible transactions. For each main category of invisibles—travel, transportation, investment income, Government services, other miscellaneous services, private and official transfers—forecasts are prepared for each country's imports (debits) and for the OECD's transactions with the rest of the world. The resulting total OECD exports (or credits) are then allocated to individual OECD countries.

The consistency check imposed by the foreign trade matrix and the invisibles forecast often contributes to the country forecasts themselves, since the inter-dependency of the OECD area is such that developments in one country or in a group of countries are as a rule reflected in developments elsewhere.

All forecasts are prepared on a half-yearly basis. In a number of cases this can be done on the basis of quarterly national accounts compiled in Member countries. In others, the half-yearly national accounts aggregates covering the past periods are prepared by the Secretariat on the basis of the short term economic indicators available and can only be considered as more or less rough estimates.

1. Allowing for inconsistent recording of intra-OECD trade, as discussed on pp. 96-97.

2. For the purpose of this calculation, the following markets are distinguished: each major OECD country, other OECD countries aggregated into three groups, the primary-producing countries aggregated into four groups and the Sino-Soviet area.

NATIONAL ACCOUNTS

The figures shown in the country tables on Demand and Output follow, in general, the *OECD Standardized System*[1] definitions which need not be summarized here. There are however, some important deviations from the *Standardized System :*

a) *France*

In the French system the main aggregate is " Gross Domestic Production " which has a narrower definition of production. It excludes the services provided by the General Government, financial institutions and domestic servants.

It follows from the French definition that " government consumption " excludes salaries paid to civil servants. On the other hand, expenditure on goods and services of so-called " private administrations ", which would come under private consumption in the *Standardized System,* are included with government consumption in the French system.

In 1964 the French definition of stocks was extended to include unfinished as well as new, finished, but unsold dwellings which are excluded from " fixed capital formation " and " residential construction ".

Exports include net services plus freight earned on imports, the latter being given c.i.f.

Finally, the activities are recorded on a territorial basis and thus, for instance, expenditure by foreign tourists is treated as part of French personal consumption, whereas in the *Standardized System* it is classified under exports.

The figures shown in this number of the *Economic Outlook* are based on the new series of French national accounts (see *Economic Outlook*, Nº 4, pp. 99-101), adjusted to the definitions of the *Standardized System.*

There are no official French quarterly national accounts, but the INSEE publishes quarterly data on private consumption on a national accounts basis.

b) *Germany*

Although the German official national accounts follow the *Standardized System*, the rates of change in constant prices shown in *Economic Outlook* differ significantly from those published officially. The discrepancies result from the use of a 1954 price base in the official calculations whereas the OECD figures are expressed at 1968 prices. In 1968 the rate of increase of GNP at 1968 prices is 7.0 per cent and at 1954 prices is 7.6 per cent. The 1969 rate of growth calculated at 1968 prices is more than a ½ per cent higher than the rate calculated with 1954 price weights.

The seasonal adjustments to the official half-yearly national accounts are made by the OECD Secretariat.

c) *Italy*

The definitions used are those of the *Standardized System.* Following improvements in the basic statistics, the annual national accounts published by the Istituto Centrale di Statistica (ISTAT) have been substantially revised for the period 1965-1967. Within the limits of the available data the Istituto intends to carry the revisions back to 1951.

The annual aggregates for 1967 and 1968 are drawn from the data published by the Institute.

Past half yearly developments are based on seasonally adjusted quarterly national accounts estimated by the Istituto Nazionale per lo Studio della Congiuntura (ISCO), adjusted to fit with the official annual totals.

d) *United Kingdom*

The quarterly national accounts for the United Kingdom are published in *Economic Trends* by the Central Statistical Office and follow the *Standardized System.*

However, since the published expenditure, output and income accounts show different quarter to quarter movements, a weighted average of the three series is used to produce a " compromise estimate " of GDP. Any differences between the compromise and expenditure estimates of GDP are allocated to the expenditure components at the forecasters' discretion. All GDP aggregates published in this issue are based on Secretariat compromise estimates.

e) *United States*

Government fixed investment expenditures (including those of government enterprises) are included in " public consumption " and no allowance is made for depreciation of government fixed capital. The investment figures therefore refer to the private sector only. Official quarterly national accounts are published in the *Survey of Current Business* of the Office of Business Economics of the U.S. Department of Commerce.

f) *Canada*

Government expenditure on fixed assets and changes in inventories of government commodity agencies are included in " public consumption " and excluded from " fixed investment " and " changes in stocks " respectively.

The quarterly figures appear regularly in the *Canadian Statistical Review* of the Dominion Bureau of Statistics.

The Canadian national accounting convention includes a separate entry for the " residual error of estimate ". This item is included in the Secretariat figures for GDP, which are therefore not the sum of the expenditure components. To avoid distorting the time-path, it has been assumed in the forecast that the residual error will remain unchanged from the first half of 1969 onwards.

g) *Japan*

" Public expenditure " includes expenditure by some public enterprises and " Gross fixed investment " includes work in progress on heavy equipment and on ships for the domestic market which are hence excluded from " changes in stocks ".

The quarterly national accounts are published in the *Annual Report on National Accounts* and *National Accounts Statistics Quarterly* of the Economic Planning Agency. However, data in constant prices only become available after a considerable delay. Hence the half-yearly figures shown for the most recent periods are estimates based on official quarterly figures at current prices.

MEASURES OF THE PRESSURE OF DEMAND

Chart A illustrates recent and forecast developments of certain aggregates in the seven major OECD countries, including a measure of the pressure of demand. This measure is derived from a comparison of the estimated growth rate of " potential GNP (GDP) " with the actual or forecast growth of output. The rate of growth of potential GNP (GDP) can be thought of as " the rate of growth of GNP at a given pressure of demand which results from the combined increase of the labour force and underlying productivity " (see *OECD Economic Growth 1960-70. A mid-decade review of prospects*, Paris 1966, page 101). The level of potential GNP may be estimated by reference to a " normal " rate of unemployment.

1. OEEC, *A Standardized System of National Accounts*, Paris, 1958.

The OECD Secretariat is carrying out research on potential rates of growth in member countries in connection with the preparation of the report of Working Party No. 2 of the OECD Economic Policy Committee on Policies for the Promotion of Economic Growth. Although still in a preliminary stage this work has been drawn on, for illustrative purposes, in preparing the chart.

National accounts data have been drawn, as far as possible, from *National Accounts of OECD countries 1958-67*, Paris, 1969, supplemented by national statistics, Secretariat estimates and forecasts. Country by country details of the estimates of potential GNP (GDP) growth rates and levels are given below.

a) *France*

The rates of growth of potential GDP are Secretariat estimates. The rate is assumed to accelerate gradually from 5 per cent p.a. in 1965 to 6 per cent p.a. in 1969 and is held at 6 per cent for 1970. The assumed level of potential output was set at close to 2 per cent above actual GDP in 1967 (see *OECD Economic Outlook*, No. 3, July 1968). An attempt has been made to work out a quarterly time-path in the first half of 1969 to illustrate the sudden further acceleration of domestic demand and output in the spring.

b) *Germany*

The potential growth rate of GNP up to 1967 has been taken as 4 per cent p.a. This rate is implied in German estimates of trend growth in the late 1960s (see *Vierteljahresbericht II*, 1968, Bundeswirtschaftsministerium). For the remainder of the period the Secretariat estimate is 5 per cent p.a. For the chart actual and potential GNP were assumed to coincide in 1966.

c) *Italy*

The 6 per cent p.a. growth rate of potential GDP is a Secretariat estimate. Actual GDP was assumed to be 1.5 per cent above potential in 1963.

d) *United Kingdom*

The potential growth rate is estimated to have fallen from slightly above 3 per cent p.a. up to 1967 to 2.9 per cent in the forecast period. This compares with an estimate of 2.9 per cent p.a. for the growth of productive potential between 1967 and 1972, used in the " basic case " presented in *The Task Ahead*, the United Kingdom Government's medium-term planning document. The level of actual GDP is assumed to have been equal to potential GDP at the beginning of 1967.

e) *United States*

Potential GNP is calculated by the Council of Economic Advisers (see *The Economic Report of the President, 1969*, p. 64) and shows rates of increase of 3¾ per cent p.a. up to the fourth quarter of 1965 and 4 per cent p.a. thereafter.

f) *Canada*

The potential growth rates of 5.1 per cent p.a. up to mid 1967 and 5½ per cent thereafter are Secretariat estimates. Potential GNP is assumed to have been slightly greater than actual GNP in the first quarter of 1965.

g) *Japan*

The levels and growth rates of potential GNP have been taken from a Japanese Economic Research Institute discussion paper by Shishido, Jinsenji and Kohno entitled *Capital Planning and Capacity Projection in Japan*. The approach is somewhat different from that used for other countries in that the estimates are derived from an aggregate production function.

The half-yearly figures for actual GNP have been adjusted to smooth what appear to be residual seasonal movements in stockbuilding by the government sector.

BALANCE OF PAYMENTS DATA

a) *Sources*

Annual balance of payments statistics in *Economic Outlook* are derived from OECD countries' annual submissions to the Organisation, on the basis of a reporting system common to OECD and the IMF. The concepts and definitions underlying this system are, with few exceptions, those described in the IMF *Balance of Payments Manual* (third edition, July 1961).

Up-to-date information and figures for periods of less than one year are derived from national sources and adjusted by the Department of Economics and Statistics to internationally comparable definitions. Seasonally adjusted series are taken from national sources for Canada, Italy, the United Kingdom, the United States and, for some data, Germany and Japan and estimated by the Department of Economics and Statistics for other countries.

b) *Presentation*

For analytical purposes, the *Economic Outlook* makes use of a uniform presentation of the balance of payments data of all OECD countries. The analytical groupings adopted are the following :

A) *Trade Balance.* This is defined as merchandise exports less imports f.o.b. frontier. It is recorded on a transactions basis, i.e. derived from customs records of merchandise trade, with valuation and coverage adjustments required :

i) to put the figures on to an f.o.b. frontier basis,

ii) to ensure that the data reflect as closely as possible the net transfer of ownership of goods to and from abroad by the residents of a country.

B) *Current Balance.* This is the sum of the trade balance, net services and private and official transfers.

C) *Balance on non-monetary transactions.* This covers all current and long-term capital transactions, as well as the short-term capital transactions of the non-monetary sector of the economy (including the balance of unrecorded transactions). It excludes, however, official transactions undertaken for specific balance of payments reasons : such " special transactions " relate, in particular, to the anticipation or postponement of public debt servicing, and changes in official long-term assets and liabilities, such as the extension of special credits to international lending institutions.

D) *Balance on official settlements.* This is the sum of the balance on non-monetary transactions and the net change in the external short-term position of commercial banks. It is financed by :

i) changes in official gold and currency assets ;

ii) changes in the net IMF position ;

iii) changes in official liabilities to foreign official monetary institutions, and in official short-term assets other than gold and currency ;

iv) special transactions, as described above.

c) *Relation to national concepts*

In a number of cases, the uniform concepts and definitions used by the Department of Economics and Statistics to ensure inter-country comparability differ from those most commonly found in national presentations of balance of payments statistics. The main deviations are listed below :

A) *Trade Balance.* While the trade balance concept appears in all national publications, its definition may differ from that adopted in *Economic Outlook.*

i) In Canada, the trade balance as usually defined excludes inland freight on both imports and exports, and gold production available for export.

ii) In France and Belgium trade as well as other components of the balance of payments are recorded on a settlements basis, i.e. based on foreign exchange rather than customs statistics. The same applies to Italy, although data on a transactions basis are also given in national publications.

iii) In Germany, the trade balance concept which appears most frequently in public discussion includes all freight on imports and excludes the coverage adjustments of customs data to a balance of payments basis.

B) *Current Balance.* Aggregates corresponding to the current balance concept appear in all national presentations, under various denominations. They are identical with the data appearing in *Economic Outlook* subject to the remarks made above about France, Italy and Belgium.

C) *Overall Balance.* Most national presentations emphasize some form of overall balance which either takes the form of a balance of monetary movements (akin to the balance on non-monetary transactions) or a balance on official reserve transactions (akin to the balance on official settlements). The concepts used in major OECD countries are related to those shown in *Economic Outlook* as follows :

i) The overall balance as defined under various denominations in France, Italy, Japan and the United Kingdom, corresponds fairly closely to the balance on " non-monetary transactions ", except insofar as special transactions are generally not shown below the line. Furthermore, the United Kingdom " balance of monetary movements " treats the recorded short-term capital transactions of the non-monetary sector of the economy as a financing item below the line.

ii) The United States " balance on liquidity basis " corresponds to a balance on non-monetary transactions *with the short-term claims of the banking sector moved above the line* (and without adjustment for special transactions). In addition, United States data have been adjusted by the Department of Economics and Statistics to include as financing items below the line certain obligations of the United States Government to foreign central banks in the form of special Treasury bonds, and purchases of U.S. Government Agency bonds by international institutions, as well as foreign holdings of certificates of deposit in United States commercial banks, which are included above the line in the calculation of the " liquidity balance ". In view of the complexity of these adjustments, a detailed reconciliation is shown in the table below.

iii) The overall balance as defined in Canada and Germany, and also the " balance on official reserve transactions " which appears in United States publications, approximate the concept of the " balance on official settlements ", except insofar as special transactions are included above the line. In addition, the figures appearing in German publications exclude changes in foreign holdings of German money market paper, as well as the greater part of the changes in Germany's net IMF position, both of which are treated as financing items in *Economic Outlook.*

d) *Inconsistencies in balance of payments recording*

A uniform accounting framework does not by itself ensure consistent recording of each transaction by the two participating countries. In fact, transactions of the same type among OECD countries do not sum to zero as theoretically they should. The sum of any particular balance for all OECD countries should therefore not be taken to be the balance of the OECD area with the rest of the world, and developments in this type of aggregate should be interpreted with due regard to the possibility that the net effect of inconsistent recording may vary over time.

The analysis done to date points to the following main sources of inconsistency in OECD countries' balance of payments recording :

A) On current account, inconsistencies arise in connection with the classification, coverage and valuation of transactions. In particular, the border-line between merchandise and service transactions tends to be blurred in the case of government purchases, while the distinction between services and transfers may be interpreted differently by the two partner countries in the case of workers' remittances ; a cross-classification problem also arises from official indemnification payments to private recipients. Discrepancies occur in the estimation of

UNITED STATES

Reconciliation betwen OECD " balance on non-monetary transactions " and U.S. " balance on liquidity basis "

	BALANCE ON NON-MONETARY TRANSACTIONS (OECD BASIS)	SOURCES[a]
Less:	Liquification of U.K. government dollar security portfolio	Secretariat estimates
Plus:	Debt prepayments received and sales of foreign obligations to foreigners	*SCB* Table 1, line 45, plus *SCB* Table 5, line C.2
	Waiver of UK debt obligations	*SCB* Text Table A2, line 13
	Long-term bank liabilities	*SCB* Table 1, line 53
	Short-term banking claims	*SCB* Table 1, line 38
	Non-convertible, non-marketable U.S. Treasury securities not associated with specific transactions	*SCB* Table 5, line C.3
	Special Treasury securities issued to foreign official agencies in connection with military contracts	*Federal Reserve Bulletin,* International statistics, Table 12
	Non guaranteed U.S. Government agency bonds held by international and regional institutions	*SCB* Text Table A2, line 8
Equals:	BALANCE ON LIQUIDITY BASIS	*SCB* Table 3, line 1

a) SCB refers to the US Department of Commerce *Survey of Current Business*, September, 1969 (Article on Balance of Payments).

freight on imports (which tends to exceed the corresponding receipts) and in the recording of foreign travel (where receipts tend to exceed payments). Further discrepancies result from the inclusion in some countries' data of re-invested earnings of foreign subsidiaries, which are not covered in most countries' statistics. Some, but by no means all, of these inconsistencies cancel out at the current balance level.

B) On capital account, asymmetries result in the first place from the inconsistent recording of current transactions (the net effect of which produces an offsetting entry under unrecorded transactions). Further asymmetries result from the principle of allocating changes in assets and liabilities according to the domestic sector involved, which implies that international transactions between two different sectors (e.g. banks on one side and non-banks on the other) will be reported under different headings by the two partner countries. Inconsistent recording of official settlements will also be reflected in the capital account.

C) On official settlements account, the sum of all OECD countries' balances will not reflect the change in the area's net official position vis-à-vis the rest of the world, due to :

i) changes in total official gold holdings resulting from the incorporation of newly mined gold or sales to private users ;

ii) the inclusion in official reserve assets of claims on commercial banks (either in the form of non-reserve currencies or of Euro-dollars) the counterpart of which is not reported as a liability to monetary authorities.

MONETARY DEVELOPMENTS

a) *Monetary aggregates*

Chart J and Table 26 : Except as noted below the Chart and Table show respectively levels at, or growth rates between, last days of the periods indicated, and are based on series published in *International Financial Statistics.* Series from this source have been seasonally adjusted for the OECD Secretariat by the Statistics Bureau of the International Monetary Fund.

For *money* and *money plus quasi-money* in the United States the data are derived from monthly averages of daily figures as published in the *Federal Reserve Bulletin.* The figures have been recently revised : see Federal Reserve *Statistical release H.6* of 25th September, 1969.

For France, data for all series are based on various publications of the Conseil National du Crédit, and INSEE, *Tendances de la Conjoncture, Graphiques Mensuels.*

Because of breaks in series for Sweden, growth rates in 1969 are for the period beginning January.

For the definitions of *money* and *quasi-money* see the sources quoted above. *Domestic credit* is Line 32 in *International Financial Statistics* : it consists essentially of the claims of the Central Bank and deposit banks on the rest of the economy (claims on the central government being recorded net). For the United Kingdom the concept employed here differs in some respects from the national concept discussed on page 81 of *OECD Economic Outlook*, No. 5, and shown in Table 29 of the present *Outlook.*

b) *Interest rates*

Charts H *and* I *and Tables 24 and 25:* The rates or yields shown, except the most recent, are generally those at or near ends of periods indicated. With the exceptions noted below, they are those on Government bonds and 3-months Treasury bills as published in OECD *Main Economic Indicators :* see the notes therein.

Other rates from the same source, and rates derived from various national sources, are :

Canada : Finance company paper and average of 10 industrial bonds—Bank of Canada *Statistical Summary.*

France : Call money on collateral of private bills.

Germany : 3-months interbank money—*Monthly Report of the Deutsche Bundesbank ;* 6 per cent Government bonds—*Blick durch die Wirtschaft.*

Italy : 12-months Treasury bills.

Japan : Call money ; Telephone and Telegraph bonds—Bank of Japan. *Economic Statistics Monthly.*

Switzerland : Short-term deposit rate (major banks, Zürich).

United Kingdom : Local authority deposits and Company debenture and loan stocks (20 years to maturity)—*Financial Statistics.*

United States : Treasury bills, Certificates of Deposit, and Government and Corporate (Aaa) bonds—*Federal Reserve Bulletin* and other publications and releases of the Federal Reserve System.

3-months Euro-dollar deposits in London : Various material prepared within the Federal Reserve System.

$ and DM denominated Eurobonds : Morgan Guaranty Trust Company, *World Financial Markets.*

INTERNATIONAL CAPITAL MOVEMENTS

Table 19 : United States—Selected Capital Account Items. Transactions in U.S. private non-monetary assets correspond to the *Survey of Current Business*, Table 1, line 32 less line 38. Transactions in foreign holdings of U.S. securities other than Treasury issues correspond to the *Survey of Current Business*, Table 1, line 52.

Table 20 : Sources and Uses of Funds in the Euro-dollar Market. Data for end-1968 are taken from the BIS 39th *Annual Report*, 1969, p. 149. Data for 1969 are mainly Secretariat estimates. The lower figure for total uses is taken from *World Financial Markets*, Morgan Guaranty Trust Company, adjusted to BIS definitions.

USE OF CURRENT NATIONAL STATISTICS

Unless otherwise stated, all the national statistics quoted in the *Economic Outlook* are taken from the *Main Economic Indicators* published monthly by the OECD (MEI). Starting in September 1967, supplements to MEI have been published describing in detail the sources and methods of these statistics. The following notes are therefore confined to some methodological points of special importance for the understanding of the text.

Merchandise trade

Except where otherwise indicated, merchandise import and export data are taken from OECD foreign trade statistics as published in MEI and the OECD Foreign Trade Bulletins[1]. Except for Canada, whose trade is recorded f.o.b. place of shipment, exports are recorded f.o.b. frontier and imports c.i.f. frontier. For the United Kingdom and Ireland, the export series used include re-exports. United States trade figures are taken from national publications; both import

1. The OECD publishes three sets of Foreign trade bulletins. *Series A*—overall trade by countries; *Series B*—trade by commodities, analysis by main trading areas; and *Series C*—trade by commodities, detailed analysis in the form of trade matrices.

and export data are f.o.b. frontier and relate to general trade; exports exclude Department of Defence shipments.

Seasonal adjustments are made by the Department of Economics and Statistics except for Canada, the United Kingdom and the United States[1], where national estimates are used.

Data for total OECD trade by areas differ from the aggregates published in MEI on account of:

i) revisions of back data to adjust for significant changes in coverage, such as the inclusion of trade in pearls and precious stones in United Kingdom statistics from 1964 onwards, and changes in the definition of United States " Special Category " exports, which are not allocated regionally;

ii) adjustments for inconsistent recording of intra-OECD trade from the import and export sides respectively, arising from differences in timing, coverage and valuation, and inconsistencies in the seasonal adjustment of individual series. These adjustments could only be applied to major aggregates of OECD trade; where relevant, they are signalled by a footnote.

Unemployment statistics

The figures are taken from the OECD Main Economic Indicators, which generally reproduces the most usually quoted national series, the figures being seasonally adjusted by the OECD Secretariat[2]. These series, however, vary considerably from one country to another insofar as methods of collection, coverage and definition are concerned.

The Italian unemployment figures are based on national *sample surveys*, carried out in the first months of each quarter. The figures for Germany, Netherlands, Norway, Sweden and the United Kingdom relate to *registered unemployed.* (In Sweden there is also a quarterly sample survey on employment and unemployment which usually shows a higher unemployment figure). For the United Kingdom, it should be noted that the figures relate to the whole country and include school-leavers and the temporarily stopped, in contrast to the commonly quoted figures relating to wholly unemployed in Great Britain only, seasonally adjusted by the Department of Employment and Productivity. There is usually a difference of about one-fifth between the two figures. The figures for Austria and France relate to *registered job applicants.* These figures depend very much on the proportion of unemployed who usually register. In France, this proportion was estimated to be about 60 per cent in March 1968, compared with slightly more than 50 per cent 6 years earlier.

In Belgium, Denmark and Ireland the figures relate to *insured unemployment* and do not include unemployed not entitled to unemployment benefits (a similar series is also available for France but it covers only a fraction of total unemployment).

In a number of countries, including Germany and France, sample surveys of employment are carried out at yearly or more infrequent intervals and their results are of some use for the correction and interpretation of the monthly unemployment figures.

Index of industrial production (Table 2, country tables and charts)

The figures shown include, as far as possible, mining, manufacturing and public utilities, but exclude construction. The exact coverage, the weighting system and the methods of calculation vary from country to country but the divergencies are somewhat less marked than in the case of the price and wage indices. With the exception of Austria and Germany, the indices are seasonally adjusted by national statistical offices, using different methods, derived from the U.S. Bureau of the Census Method II[3].

Seasonal adjustment

As noted above, some of the series used have been seasonally adjusted by the Department of Economics and Statistics, notably in the area of foreign trade but also in some cases for industrial production, unemployment, and retail sales. The method used is an OECD variant of U.S. Bureau of the Census Method II known as X-10 and programmed for processing by electronic computer. (Further details can be obtained from the OECD Statistics Division). Where unadjusted series published by countries do not take into account the effects of unequal length of month and the incidence of public holidays, a prior calendar adjustment is carried out to eliminate possible distortions in the final seasonally adjusted series. Prior adjustments are also made where major irregularities such as strikes might interfere with the determination of seasonal factors.

COST AND PRICE DEVELOPMENTS

In order to facilitate the interpretation of current cost and price trends, the OECD Secretariat has compiled from various sources short-term indicators on wage costs, consumer and producer prices. In spite of the efforts made to make such series reasonably comparable, there are still considerable divergencies in definitions and statistical methods and the figures can only be taken as indicators of broad orders of magnitude. The series or figures marked * are OECD Secretariat estimates. The others are derived from various national sources. The series marked s/a are seasonally adjusted.

Price indices (Table 4 and appendix tables below)

The coverage and methods of calculation of the *consumer price indices* vary a great deal from country to country. In some countries the weights used to calculate the index are revised fairly frequently on the basis of family expenditure surveys using large samples; and in such cases the index generally moves quite closely in line with the price deflator for private consumption. In some countries, however, the weighting system relates only to low income groups and/or is seriously out of date; and in such cases the weight given to food is generally high, and that given to services low, compared with the pattern of expenditure for private consumption as a whole. Coverage varies considerably and also the degree to which seasonal price changes are eliminated[4].

The lack of uniformity is even more marked when it comes to *wholesale price indices.* The components of this index are based on *net sector flows* in the United Kingdom, on commodity groupings by *degree of processing* in Canada, U.S.A., and France and on commodity groupings by *end-use* in Italy and Japan. Differences in coverage are particularly important with regard to the degree to which the index covers finished goods in addition to raw materials and semi-finished products. The number of items included varies from a few hundred to several thousand.

1. For the United States, data seasonally adjusted by the Department of Economics and Statistics on the basis of the OECD definition of trade are also published in MEI.

2. More detailed Labour force statistics on an annual basis, can be found in *Labour Force Statistics* 1956-66, OECD, Paris, 1968.

3. *Industrial Production,* a quarterly supplement to *Main Economic Indicators,* contains an internationally comparable selection of industrial output indices for individual industrial sectors.

4. A supplement included in *Main Economic Indicators* every three months shows recent consumer price developments in eight selected countries, analysed in terms of four standard sub-indices: food; all goods less food; rent; and all services less rent.

Wages (*Country Charts* and appendix tables below)

The wage indices are also not comparable from country to country, not only because of the wide variety of sources and methods of calculations, but also because of important differences in definitions (e.g. hourly rates, hourly earnings, monthly earnings, inclusion or exclusion of fringe benefits, etc.). Apparently, seasonal movements are important in some countries because of the tendency for wage settlements to bunch at the same period of the year. Seasonally adjusted data are used when available.

Appendix tables on costs and prices

Unit " wage " costs cover wages and salaries, excluding employers' social security contributions, wage related taxes and fringe benefits. Unit " labour " costs include all costs of employment to the employer. Differences from these definitions are given in the footnotes to the tables for individual countries.

FRANCE

	Per cent change		Index, 1967 = 100						
	1967	1968	1968 Q1	1968 Q2	1968 Q3	1968 Q4	1969 Q1	1969 Q2	1969 Q3
Manufacturing									
Hourly rates *a*	6.0	12.4	103.1	104.4	115.5	118.0	119.8	122.0	124.9
Production (s/a)	3.0	5.4	105.3	88.3	109.8	116.1	115.4	118.3	118.5
Unit wage costs (s/a)*b**	1.0	4.8	97.2	117.9	103.5	100.7*c*	103.9*c*	104.2	107
Prices									
Consumer prices	2.4	4.6	103.0	103.6	104.8	107.0	108.8	110.2	111.4
Wholesale prices, total	–0.8	1.5	100.5	99.6	101.1	104.8	107.2	108.8	109.6
Intermediate goods	–0.7	–1.9	97.6	96.2	97.9	100.9	104.5	106.4	108.5

a) Survey relating to the last complete week of preceding quarter ; annual figures are centred by averaging data from January of each year to January of following year.

b) A crude measure of unit wage costs (excluding salaries) has been derived using hourly wage rates, employment and hours worked, divided by the production index. The result has been adjusted for wage drift ; employment and hours worked are seasonally adjusted. The rise of unit wage costs in the 2nd quarter 1968 may have been over-estimated as the effects of the May-June events on earnings are not known.

c) The rise between 1968 Q4 and 1969 Q1 was more than offset by the complete abolition of the 5 per cent payroll tax, not included in the figures.

Source : INSEE, *Bulletin Mensuel de Statistiques.*

UNITED STATES

	Per cent change		Index, 1967 = 100						
	1967	1968	1968 Q1	1968 Q2	1968 Q3	1968 Q4	1969 Q1	1969 Q2	1969 Q3
Manufacturing (s/a)									
Wages and salaries per employee	3.7	7.0	104.3	106.0	107.6	109.7	110.7	112.5	114.4
Output per employee	–0.4	2.8	101.6	102.5	102.4	103.3	104.2	105.1	105.4
Unit labour costs	4.7	4.1	102.6	103.3	104.9	105.5	105.7	106.5	107.9
Ratio of prices to unit labour costs	–3.5	–1.4	99.1	99.1	98.0	98.0	99.1	99.2	98.8
Prices									
Consumer prices	2.8	4.2	102.4	103.5	104.8	106.1	107.2	109.2	110.7
Goods less food	2.5	3.7	102.1	103.1	104.0	105.4	106.1	107.7	108.5
Wholesale prices, total	0.2	2.5	101.6	102.3	102.7	103.2	104.8	106.1	106.9
Manufactured goods	1.2	2.9	101.8	102.5	103.4	103.8	104.8	105.9	106.8

Source : Survey of Current Business, Economic Indicators and *Business Conditions Digest.*

JAPAN

	Per cent change		Index, 1967 = 100						
	1967	1968	1968 Q1	1968 Q2	1968 Q3	1968 Q4	1969 Q1	1969 Q2	1969 Q3
Manufacturing (s/a)									
Monthly earnings per regular worker	13.6	15.7	108.3	113.1	115.9	120.9	122.2	131.3	137.2*a*
Production per regular worker	17.4	14.7	107.6	113.1	116.9	120.9	121.6	129.0	132.6*a*
Unit wage costs*	–3.2	0.9	100.7	100.0	99.1	100.0	100.5	101.8	103.5*a*
Prices									
Consumer prices	4.0	5.4	104.3	104.5	105.3	107.3	107.8	109.8	112.3
Wholesale prices, total	1.5	0.5	100.9	100.1	100.2	100.9	101.1	101.9	103.1
Producer goods *b*	2.2	–0.4	100.8	99.2	98.9	99.4	99.7	100.8	102.3
Investment goods *c*	0.7	0.8	100.5	100.9	101.1	100.8	101.0	101.0	101.3

a) July-August.

b) Including raw materials, fuels and energy, construction materials and semi-finished products.

c) Manufactured goods.

Source : Basic Data for Economic Analysis (Bank of Japan), *Economic Statistics Monthly* (Bank of Japan).

GERMANY

	Per cent change		Index, 1967 = 100						
	1967	1968	1968 Q1	1968 Q2	1968 Q3	1968 Q4	1969 Q1	1969 Q2	1969 Q3
Industry (s/a) *a*									
Wages and salaries per manhour	4.7	6.3	102.6	105.9	106.9	109.6	112.0	114.9	115.8*c*
Production per manhour	5.1	9.9	104.8	108.6	113.8	112.5	114.2	116.8	122.4*c*
Unit wage costs	–0.4	–3.6	97.4	97.4	93.8	97.0	97.9	98.5	95.0*c*
Prices b									
Consumer prices	1.5	1.8	101.5	101.7	101.6	102.4	103.9	104.3	104.4
Industrial producer prices	–0.9	–5.3	95.0	94.4	94.4	94.8	95.4	95.9	96.9

a) Excluding public utilities and building and civil engineering.

b) After the change-over to the value added tax system (TVA) as of January, 1968, industrial producer prices exclude indirect taxation. Hence, the price index fell by 4.8 per cent between the 4th quarter 1968 and the 1st quarter 1969. Consumer prices were slightly raised by the change-over to TVA.

c) July-August.

Source : Statistical Supplement of the Bundesbank and *Wirtschaft und Statistik.*

CANADA

	Per cent change		Index, 1967 = 100						
			1968				1969		
	1967	1968	Q1	Q2	Q3	Q4	Q1	Q2	Q3
Manufacturing (s/a)									
Wages and salaries	6.1	6.6	102.5	105.6	107.3	110.9	114.4	116.9	117.4 *a*
Output	0.4	5.1	101.5	104.6	105.2	108.6	110.5	111.0	110.6 *a*
Unit wage costs	5.7	1.4	101.0	101.0	102.0	102.1	103.5	105.3	106.1 *a*
(Corp. profits before taxes in the whole economy)	–2.4	17.1	106.1	112.7	118.7	130.8	130.5	130.9	..
Prices									
Consumer prices	3.5	4.2	102.7	103.6	104.7	105.8	106.6	108.6	109.9
Wholesale prices, total	1.8	2.1	101.2	101.7	102.2	103.2	105.6	107.2	107.2
Manufactured goods	2.0	2.7	101.3	102.0	103.0	104.4	106.5	108.0	107.3

a) July-August.
Source : Bank of Canada *Statistical Summary*.

ITALY

	Per cent change		Index, 1967 = 100						
			1968				1969		
	1967	1968	Q1	Q2	Q3	Q4	Q1	Q2	Q3
Manufacturing									
Hourly wage rates	5.2	3.6	102.5	103.3	104.0	104.6	106.1	110.8	113.3
Number of wage earners	3.5	1.7	100.2	100.8	102.7	103.3	103.3	104.8	105.2
Production (s/a)	8.6	6.2	103.6	105.0	106.2	109.4	112.3	113.9	..
Unit labour costs (s/a)	5.0	–1.8	99.0	98.0	98.0	98.2	98.5*		..
Prices									
Consumer prices	3.2	1.4	101.1	101.4	101.2	101.6	102.4	103.4	104.6
Wholesale prices :									
Investment goods	0	1.3	101.7	101.2	101.1	101.4	102.4	105.6	111.2
Consumer goods	–0.5	–0.2	100.1	99.8	99.2	100.3	101.2	102.7	104.2

Source : Figures represent unit labour costs up to and including 4th quarter 1968 published in the *Annual Report* 1968 of the Banca d'Italia. OECD Secretariat estimate for the first half of 1969 is based on hourly rates, number of wage earners and hours worked.

UNITED KINGDOM

	Per cent change		Index, 1967 = 100						
			1968				1969		
	1967	1968	Q1	Q2	Q3	Q4	Q1	Q2	Q3
Whole economy									
Hourly wage rates	4.0	6.8	105.4	106.0	107.1	109.0	111.0	111.5	112.4
Income from employment per head (s/a)*a*	5.3	7.8	105.6	106.1	108.6	110.7	112.9	..	..
Real GDP per employee (s/a)	3.1	4.6	103.6	103.7	104.9	106.0	105.2	..	..
Labour costs per unit of output (s/a)	2.5	3.7	102.2	102.6	104.5	105.4	106.6	108.3	..
Manufacturing									
Hourly wage rates	4.4	7.8	106.7	107.2	107.8	109.6	112.5	112.9	113.8
Wage and salary bill	0.4	7.5	105.1	106.8	107.7	110.1	113.5	116.0	116.4 *e*
Output (s/a)	–0.2	6.3	103.6	105.8	107.0	108.9	108.8	110.4	111.4 *e*
Output per employee (s/a)	2.7	7.3	104.7	106.9	108.0	109.9	109.4	110.8	112.1 *e*
Employment (s/a)	–2.8	–0.9	99.0	99.0	99.1	99.2	99.5	99.6	99.4 *e*
Unit wage costs*	0.6	1.1	101.4	100.9	100.7	101.1	104.3	105.1	104.5 *e*
Unit wage costs *b*	1.6	1.2	..	..	..	..	..	..	..
Unit labour costs *b*	–2.2	2.5	..	..	..	..	..	..	..
Consumer prices	2.5	4.7	102.3	104.7	105.3	106.5	108.7	110.4	110.5
Goods less food	1.8	5.6	102.5	105.8	106.4	107.7	109.0	109.9	110.2
Food	2.1	3.7	101.6	104.0	104.1	105.1	108.6	111.1	111.1
Wholesale prices									
Manufactured goods excl. food *c*	0.8	3.9	103.0	104.0	104.2	104.5	105.5	106.4	107.5
Raw materials excl. foods *d*	–1.6	11.2	113.4	110.2	110.1	111.1	112.8	114.6	116.5

a) National accounts definition.
b) As published by the *Employment and Productivity Gazette*.
c) Home market sales.
d) For use in manufacturing.
e) July-August.
* OECD Secretariat estimate has been calculated from average earnings of all employees plus employment effect divided by output.

Source : *Monthly Digest of Statistics* and *Employment and Productivity Gazette*.

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