OECD ECONOMIC OUTLOOK

3

JULY 1968

ORGANISATION FOR ECONOMIC CO-OPERATION AND DEVELOPMENT

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CONVENTIONAL SIGNS

$	US dollar	—	Irrelevant
c	US cent	.	Decimal point
£	Pound sterling	I, II	Calendar half-years
...	Data not available	Q, q	Calendar quarters
0	Nil or negligible	Billion	Thousand million

SUMMARY

The lack of confidence in monetary arrangements this year has primarily been due to simultaneous weakness in the balances of payments of both the United Kingdom and the United States. The situation has been further complicated by the repercussions of recent developments in France; when confidence is frail, speculation against one currency may further weaken another already under pressure. There are now, however, reasonable grounds for believing that the worst of the confidence crisis is over. The United Kingdom and the United States have now taken decisive action to check the excessive growth of domestic demand. The decision to suspend gold pool operations in March eliminated one source of weakness that had developed in the system. And, dramatic and unexpected as were events in France in May and June, the economic problems left in their wake should not be exaggerated. Though flurries of confidence may still occur, their frequency and importance should diminish if policies remain firmly directed to the re-establishment of internal and external equilibrium.

Both of the reserve currency countries have now, after differing periods of delay, taken action to restrain domestic demand—action on a scale very much in line with what expert opinion at home and abroad thought appropriate. It is still too early to judge the full effect—and its timing—of the British budget in March. But there should be little doubt that a major improvement in the British balance of payments will develop over the coming year. In the United States, the restrictive fiscal action eventually taken by Congress ($ 10 billion temporary tax increase and a $ 6 billion cut in the 1968/69 Federal expenditure programme) was even larger than originally envisaged, and should provide a period of about a year during which the excessive pressure of home demand cools off. This should lead to a better trend of costs and prices; and—together with last January's measures to improve the external capital account—should establish a progressively stronger balance of payments during the next 12 months or so.

FRANCE AFTER THE STRIKES

France's problems are of a different order. The strikes began in a situation in which demand pressures were relatively low. In contrast, therefore, to the experience of some neighbouring countries which earlier experienced wage explosions, the wage increases resulting from the new settlements are unlikely to lead to a general excess of demand. In most sectors, output should be able to respond rather fully to the effects of the wage increases on demand. The fact that there is significant underutilized capacity presents policy with a choice of either allowing cost increases to be reflected rapidly in price increases; or, alternatively, of

limiting the price increase so as to permit higher money incomes to work themselves out in the form of higher real demand. The second line of action would involve a fairly complex and coherent line of action on the part of the authorities, combining substantial temporary support to public and private enterprises with an active price policy and a relatively easy monetary policy.

The implications of such a policy are examined in the note on France (pp. 52 to 69). A feasible aim, it is suggested, might be to stimulate a rise in output of around 6½ per cent between the beginning and end of 1968. This would only be possible if the rise in the general price level could be limited to 5 per cent over the same period. It is estimated that to achieve these aims, a budget deficit giving an expansionary stimulus at the end of this year at a rate equivalent to 1½ per cent of GDP might be required.

The advantage of this line of policy would be: wage and salary earners would enjoy real gains; the employment situation would be improved; and part of the cost increases resulting from the wage settlements would be offset by faster productivity growth. If, on the other hand, price rises quickly offset the wage awards recently made, the risk of a price-wage spiral would be greater; unemployment could rise in the sectors exposed to international competition; and the damage to the balance of payments would be greater. In any case, a deterioration of the current external account seems likely. But the effect of higher imports required to support faster growth would seem to be less serious than that of a continuing rapid rise of costs and prices, which would inevitably cause permanent damage to France's competitive position. International credit facilities backed by substantial first-line reserves should be large enough to deal with adverse speculative capital movements till confidence is restored.

THE SLOWDOWN IN OUTPUT AND TRADE

The scale of fiscal action taken in the United Kingdom and the United States is very large. The deflationary impact of the United States fiscal package is probably, alone, equivalent to a reduction of demand in the OECD area by a full one per cent; and this is bound to have a major impact. The strong upsurge of output in the early months of this year is likely to become more moderate from now on. The effect on trade could also be rather marked: the underlying trend in OECD exports might come down from an annual rate of 15 per cent in the first half of the year to around 5 per cent in the second half of the year. The slowdown in export demand would be most marked for Canada and Japan, and would also affect many countries in Continental Europe.

OECD output and trade 1967-68

Estimates and forecasts

Per cent change from previous half-year, seasonally adjusted annual rates.

	1967 I	1967 II	1968 II	1968 II
Trend rates excluding effects of French strikes				
OECD real GNP [a]	2.6	4.6	5½	3
OECD imports [b]	4.0	5.7	13½	4
OECD exports [b]	7.3	0.8	15	4½

a) Because of the French strikes the level of OECD GNP was actually 1/2 a per cent lower in the first half of 1968 and is expected to be 1/2 a per cent higher in the second half.

b) Adjusted for temporary effects of U.K. dock strikes and French strikes.

The strikes in France had a significant impact on the timing of both exports and imports, but the longer lasting effects on trade—and demand in other countries—seem likely to be small. OECD exports, which seemed likely to rise by about 2 per cent in the second quarter, may as a result of the French strike have fallen by perhaps 1½ per cent; and this will probably be followed by a temporary surge in the third quarter. If there is now a higher rate of expansion in France this would accelerate the rise in French imports. But this acceleration could hardly add more than one third of a per cent to the rise of total OECD imports from beginning to end of the year.

Activity was rising quite strongly in the first half of the year in most Continental European countries. But it is not clear whether domestic demand has acquired enough momentum to sustain the pace of expansion in the face of the weaker trend in export demand which—whatever the uncertainty about timing—seems due for the next six to twelve months. This is the case, in particular, in Italy, where the rapid growth of domestic demand has weakened since mid-1967, and in Germany, where there are still some doubts about the continued strength of domestic demand in the latter part of 1968.

Looking ahead to next year, it seems likely that the authorities in both the reserve currency countries will be aiming to maintain a much more moderate growth of domestic demand well into 1969. Reasonably satisfactory growth of OECD output and trade would, nevertheless, be possible in 1969, if strong rates of domestic expansion are maintained in the surplus countries of Continental Europe.

PAYMENTS EQUILIBRIUM AFTER THE GOLD CRISIS

The implications of these trends for payments equilibrium in 1968 and 1969 are examined in a special section on pp. 44 to 51. It is suggested that the combined current account position of the reserve currency countries might improve by as much as $ 3½ billion (annual rate) between the two halves of this year. This would reverse the major part of the deterioration experienced over the last 18 months. A swing of this size would be mirrored in the trading position of other countries; there might be a swing of around $ 2½ billion for the EEC and of perhaps over $ ½ billion for Canada. An unusually sharp reversal of trade and payments trends, not yet apparent in the figures at present available, could therefore emerge rather rapidly in the coming months. These figures, however, assume that domestic demand is effectively moderated in the reserve currency countries and that sustained expansion continues elsewhere. These assumptions may not prove fully justified, and there must be some uncertainty about the scale and speed of the swing in payments positions. But there can be little doubt that changes in the right direction will shortly begin to be felt; this should contribute powerfully to a return of confidence in the international monetary system. Looking ahead to the second half of 1969, a necessary factor in further progress towards international payments equilibrium would seem to be the maintenance of a substantial level of long-term capital outflows from the European Economic Community. The longer-term problems of the pattern of international capital movements are discussed on pp. 34 to 43.

OTHER FEATURES

This issue also includes an analysis of productivity, wage cost and price developments in some Western European countries and in the United States (pp. 21 - 26) *and a detailed study on monetary developments with special emphasis on the United States and Germany* (pp. 26 - 34). *A review article highlights some aspects of the recently published* National Accounts of OECD countries, 1957-66.

10th July 1968.

GENERAL TRENDS IN OECD COUNTRIES

DEMAND AND OUTPUT

The Current Situation

After the setback experienced in the first half of 1967, OECD industrial production advanced strongly during the second half of the year and the early months of 1968. The sharp recovery in activity was widely spread, covering the United States, Germany, the United Kingdom, most of the smaller industrial countries in Europe and, up to the strikes in May, France.[1] The recovery in OECD output was accompanied by a strong rise in imports (see Chart A). More recently the previous steady rise seems to be beginning to tail off in Japan and, apparently, in Italy.

The recovery in international trade, though delayed by the Middle East crisis and strikes in the United States and the United Kingdom, was significantly stronger than foreseen a year ago.[2] This was partly because the expansion of domestic demand in the two reserve currency countries was greater than anticipated—or desirable—because of delays in policy action. In the six months up to March 1968 domestic demand in the United Kingdom and the United States expanded at an annual rate of about 6 per cent, contributing to a deterioration in the combined foreign balance of about $ 4 billion (in volume terms at annual rates) between the six months ending in September 1967 and the

1. The effect of the strikes in France and present prospects are discussed in detail on p. 20 and pp. 52 to 69.
2. See *OECD Economic Outlook*, No. 1, June 1967.

CHART A

O.E.C.D. INDUSTRIAL PRODUCTION AND IMPORTS IN THE 1966-68, 1960-62, 1957-59 CYCLES

3-month moving averages, monthly index numbers, mid-point of the extremes of each period = 100

(Semi-logarithmic scale)

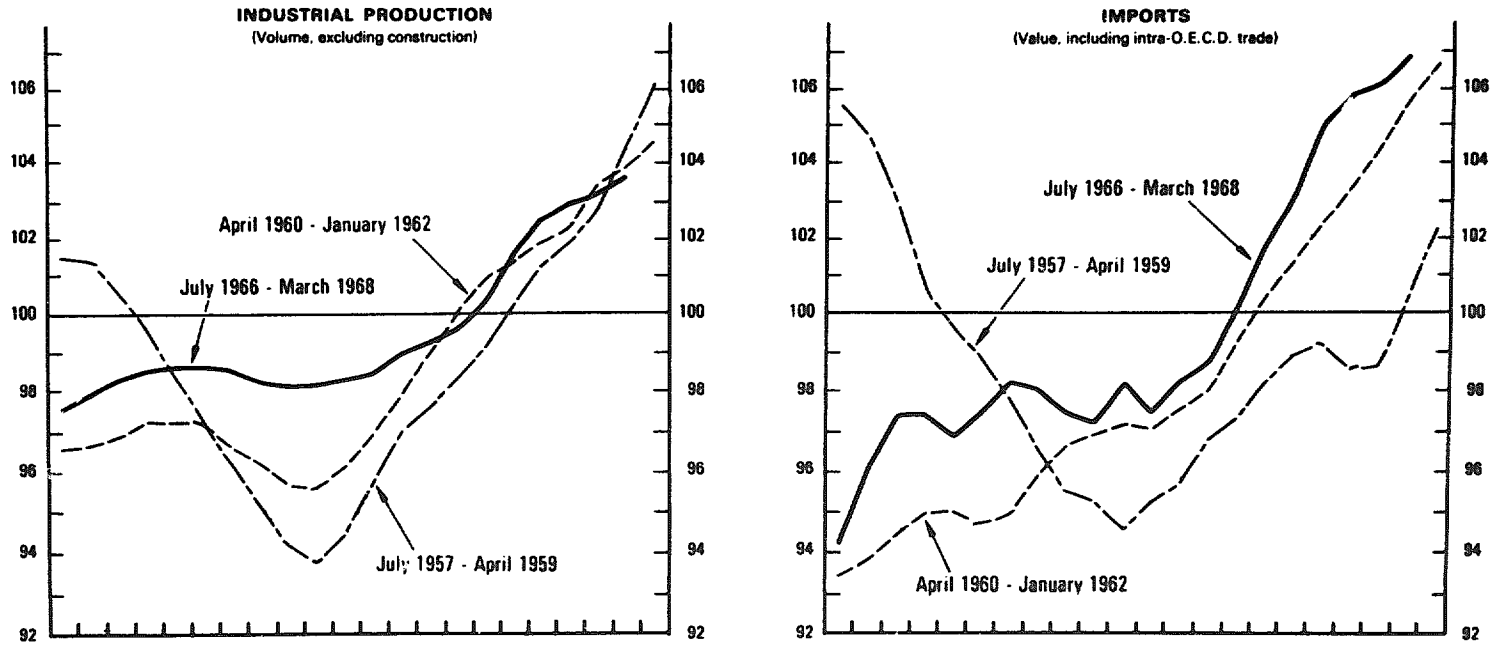


TABLE 1.

Real Gross Domestic Product

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

	Weight in 1966[b]	From previous year		From previous half-year[a]			
		1967	1968	1967 I	1967 II	1968 I	1968 II
United States (GNP)	52.2	2.6	4½	1.5	4.0	6	2¾
United Kingdom	7.2	1.4	3	2.1	2.1	4	2½
Canada (GNP)	3.7	2.8	3½	4.3	0.8	4¾	3½
Japan (GNP)	6.7	13.1	7½	12.7	13.9	7	2½
France [c]	7.0	4.4	3½	4.4	4.5	..[c]	..[c]
Germany (GNP)	8.3	-0.3	4½	-2.7	4.7	5	3½
Italy	4.3	5.9	5	7.3	3.0	7	3¼
Other Europe	10.6	3.3	4½	2.6	4.6	5½	3½
TOTAL OECD	100.0	3.3	4½	2.6	4.5	5½[d]	3[d]
of which:							
OECD excl. continental Europe	69.8	3.5	4¾	2.8	4.6	5¾	2¾

a) The figures for half years are the seasonally adjusted change from the immediately preceding half (e.g. 1967 I over 1966 II) expressed at a compound annual rate (e.g. an actual increase by 3 per cent between the two half years corresponds to a 6.1 per cent increase at annual rates).
b) Member countries' GDP for 1966 converted into dollars at current rates of exchange.
c) The half-yearly figures, distorted by the strikes, have no significance: see note on France below, which also sets out the policy assumptions on which the forecast for 1968 is based.
d) Adjusted for the distortions caused by the French strikes.

six months ending in March 1968. This provided a stimulus to other OECD countries equivalent to about ¾ per cent of their combined GNP. Over the same six-month period, German domestic demand rose at an annual rate of about 10 per cent, but the deterioration of the foreign balance, estimated at an annual rate of about $ 200 million, was much less striking.

The strength of the expansion also owed much to essentially temporary factors. In the United States there was a rebound from the automobile strike last autumn, a sharp and partly related fall in the savings ratio, and abnormally high demand for steel in anticipation of a possible strike this summer. In Germany, in addition to the impact of public spending under the contingency budgets in the closing months of last year, the placing of orders for investment goods was advanced to take advantage of the temporary depreciation allowances and in anticipation of tax changes. In the United Kingdom there was a temporary surge in consumer buying after the devaluation in anticipation of price increases and a severe budget.

Whereas in the United States and in Germany the recovery was large enough to lead to a substantial decline in unemployment, in most other countries the employment situation did not improve significantly, and indeed tended to deteriorate until the early summer of 1968 (Chart B).

Outlook for Individual Countries

In the UNITED STATES, after the revival of inventory accumulation in the second half of last year, output in the first half of 1968 was supported by an upsurge of domestic demand. The main factor was a strong rise in consumer spending, but there was also a pick-up in fixed investment and a renewed rise in military expenditure. The impact on domestic resources was cushioned somewhat by a decline in the rate of inventory accumulation and a further sharp deterioration in the foreign balance. The enactment of the fiscal package and the effects of recent monetary restraint should now gradually reduce the present overheating during the second half of 1968. Given a continuation of present policies of restraint, a major improvement in the current balance is to be expected over the next 18-24 months. This, however, will take time; and though the second half of 1968 should show a striking swing, this is likely to leave a good way to go for the attainment of lasting external equilibrium. The cost and price performance, which has been poor by the relatively high standards of the United States, may also improve slowly, but here again a return to satisfactory conditions may take some time before it is fully established.

The appropriate pattern and timing of the international adjustment process raise the question of the rate of expansion at which the Administration

should aim next year. Previous experience suggests that the "cooling-off" period of slow expansion will need to be continued for at least a year—i.e. until mid-1969 or later—if the external and internal effects of earlier over-rapid expansion are to be overcome. Experience in other countries suggests that slower than normal growth could be sustained for some time without generating an actual recession.

Domestic demand in the UNITED KINGDOM picked up strongly from the middle of 1967, following the easing of hire purchase controls and the rise in earnings after the period of severe wage restraint. Much of this demand, however, was taken up by the foreign balance and stocks and output rose only slowly with some small decline in unemployment. After devaluation, and in anticipation of price increases and a severe budget, private consumption in the first quarter apparently rose at an annual rate of well over 10 per cent, implying a substantial fall in the savings ratio. The foreign balance improved as the effects of the dock strikes were reversed and output rose strongly.

After the budget in March real consumption has fallen to more normal levels: the savings ratio seems to have recovered significantly and the sharp rise in price has reduced purchasing power. With a levelling off of government expenditure total domestic demand should now decline somewhat, despite the expected recovery in business investment.

Now that devaluation has been followed by strong measures to restrain home demand, the balance of

CHART B

UNEMPLOYMENT in selected Western European countries

Adjusted for seasonal variations — Semi-logarithmic scale

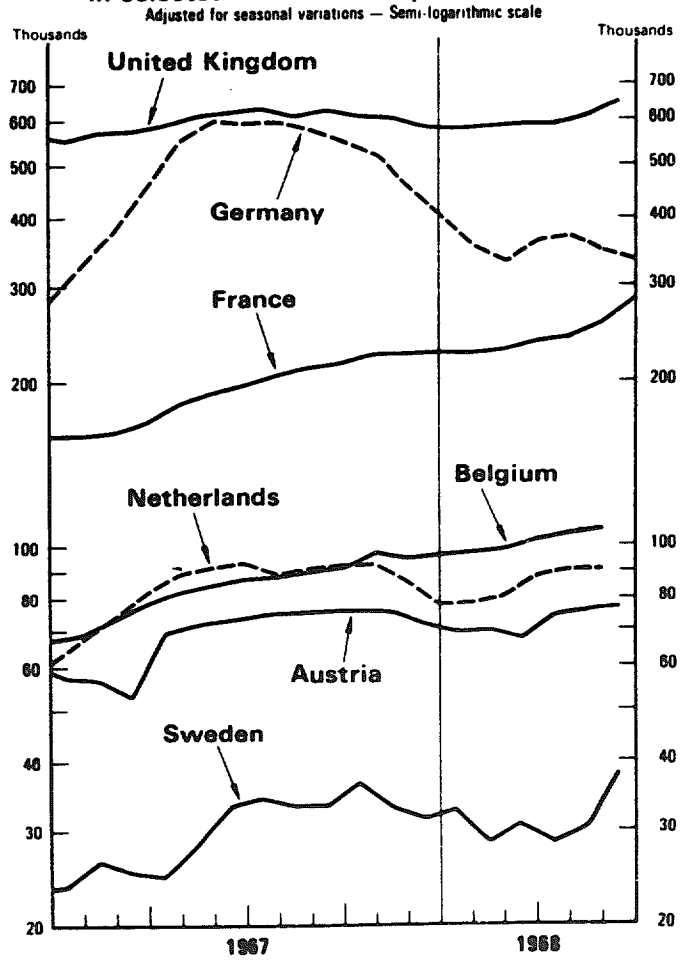


TABLE 2.

Changes in Final Domestic Demand, Total Domestic Demand and Gross Domestic Product in selected countries

Estimates and forecasts, percentages at annual rates seasonally adjusted

	From previous half-year			
	1967 I	1967 II	1968 I	1968 II
United States				
FDD	4.6	3.5	6½	2¼
DD	1.3	4,3	6½	2¼
GNP	1.5	4.0	6	2¾
United Kingdom				
FDD	3.4	5,9	2	−½
DD	3.8	5.6	2	−½
GDP	2.1	2.1	4	2½
Canada				
FDD	2.5	−0.6	4¼	4½
DD	0.9	0.0	5	5
GNP	4.3	0.8	4¾	3½
Japan				
FDD	10.0	13.7	9	4½
DD	14.4	16.1	4½	2
GNP	12.7	13.9	7	2½
Germany [a]				
FDD	−2.5	2.8	1½	5½
DD	−5.6	6.2	5¼	3½
GNP	−2.7	4.7	5	3½
Italy				
FDD	7.0	4.3	5	6
DD	7.4	4.5	4	6½
GDP	7.3	3.0	7	3¼

FDD = Final domestic demand (excluding stocks).
DD = Domestic demand (including stocks).
a) The half-yearly changes are considerably distorted by an accidental shift of final domestic demand (mainly investment) from the first quarter of 1968 into the fourth quarter of 1967. The average of these two quarters gives a better indication of the underlying trend.

	1967 I to 1967 Q4 *plus* 1968 Q1	1967 Q4 *plus* 1968 Q1 to 1968 II
FDD	2½	3¾
DD	6¾	3¼
GNP	5¾	3

payments should improve substantially; but it will remain important that any new pressures of home demand, reducing the incentive to export and to substitute for imports, should be avoided. Both here, and in the field of costs, prices and competitive position, much will depend on the vigour with which policies to moderate increases in prices and money incomes are implemented. But granted the continuation of present policies there are now—as for the United States—grounds for optimism concerning longer run prospects.

In GERMANY the upturn which began last summer has continued. Some demand which might have been effective in 1968, was shifted forward into 1967 as an anticipatory effect of various tax changes already mentioned; in consequence, after a remarkable jump in the fourth quarter, GNP appears to have remained roughly unchanged in the first quarter of this year but to have expanded strongly in the second. Business fixed investment should continue to be stimulated by technological developments and facilitated by the rise in profits and the prevailing easy monetary conditions.

However, it is not yet certain that the present expansion has got on to a self-sustaining basis. Investment demand is still running below the 1966 levels and may not be strong enough to offset slackening demand for exports. Consumers' demand, though fairly strong in recent months, is unlikely to accelerate because of the comparatively slow rise in money wages and the adverse impact of fiscal measures in the 1968 budget. The level of stock accumulation is likely to be considerably reduced in the second half of 1968, resulting in slower growth of output despite an accelerated rise in final domestic demand.

If the growth of overall demand in the second half of 1968 were to prove insufficient, the lack of balance now apparent between investment and consumption could lead to a more pronounced slowdown in 1969. This situation would make further stimulative measures desirable—probably in the form of fiscal action—to ensure that progress towards a more satisfactory rate of capacity utilisation is maintained. Continued easy money conditions would both support the recovery of internal demand and encourage the net outflow of long-term capital which will be necessary to finance the current external surplus which, although falling, is likely to remain large.

In ITALY, the slowdown in expansion in the second half of 1967 was to a large extent due to an adverse swing in the foreign balance. In the first half of 1968 a considerable reduction in the rate of stock-building has further slackened the expansion of domestic demand, but this was more than offset by the strong expansionary impact of the foreign balance. In the second half of 1968 domestic demand is likely to accelerate but the growth of exports should be markedly lower and expansion in the rest of the year now appears likely to be significantly slower than appeared likely earlier. If such a trend should develop the situation might well call for selective expansionary action. The current surplus of the balance of payments was running at a very high level in the first half of this year, and may remain substantial.

The SMALLER EUROPEAN COUNTRIES benefited significantly from the surge in activity in the major

TABLE 3.

Industrial production and exports in some OECD countries

Index numbers 1966 = 100

	Industrial production				Exports			
	1967			1968	1967			1968
	I	Q3	Q4	Q1	I	Q3	Q4	Q1
Austria	100.2	99.7	100.7	102.7	105.7	109.3	110.0	112.9
Belgium-Luxembourg	101.4	99.1	102.4	106.0	102.1	97.0	111.8	113.4
Netherlands	102.8	105.7	109.8	113.8	106.7	108.5	110.8	119.0
Norway	103.3	102.5	106.6	107.4	109.2	109.2	118.5	116.9
Sweden	102.4	103.2	105.6	105.6	109.1	101.7	105.9	116.6
Switzerland	100.4	100.0	102.6	105.3	105.3	104.4	111.7	114.6
TOTAL	101.9	102.1	105.2	107.9	105.8	103.6	110.8	115.8

countries. Exports have generally been buoyant and industrial production has risen strongly (see Table 3). In most of these countries, however, the revival of domestic demand has only been moderate and unemployment remains high in comparison to earlier years.

Four of the countries in this group—Denmark, Iceland, Ireland and Spain—devalued last autumn and will have to pursue cautious demand management policies this year. To a lesser extent, the same is true for Norway and Sweden where domestic demand is expanding quite strongly. But in the other countries, notably Belgium, Switzerland and Austria, it is doubtful whether domestic demand will be sufficiently buoyant to ensure satisfactory rates of expansion if, as expected, export demand slows down quite sharply.

In JAPAN the prolonged, rapid expansion has begun to slow down under the impact of the restrictive monetary policy pursued since the middle of last year. So far the main impact seems to have been on inventories, but there has also been some downward revision of investment plans. Together with a sharp surge in exports, notably to the United States, this has produced a dramatic improvement in the current balance which has moved back into surplus. Industrial activity may remain rather flat throughout the remainder of this year and, although the external climate may become less favourable, the current balance should continue to improve, albeit more slowly. The need to import capital in the interests of the overall balance of payments should therefore diminish, despite a probable acceleration of the outflow of Japanese capital. If the recent tendency towards a rapid improvement of the balance of payments is confirmed in the coming months some relaxation of monetary restraint may be possible, thus lessening any risk of a recession generated by severe pressure on fixed investment.

The renewed expansion in CANADA has been less marked than in the United States, partly because the inventory adjustment was more moderate, and partly because of the absence of certain special factors at work south of the border. Despite the continued worsening of the cost/price situation, the trade balance has improved strongly in response to heavier demand from the United States. Influenced by recent fiscal measures and trends in the United States there may be some weakening in expansion of output in the second half of the year. This implies that growth for the year will be at rather less than the capacity rate, with some increase in unemployment but some further progress towards the restoration of a better cost/price position.

Prospects for the Second Half of 1968 and 1969

Adjusted for the disturbances caused by the French strikes, OECD output seems to have risen at an annual rate of 5½ per cent in the first half of 1968 (against 4½ per cent in the second half of 1967). However, as a result of policy measures in the deficit countries, the underlying rate of growth is likely to slow down to around 3 per cent in the second half of 1968. In the United States, domestic demand is expected to increase by only 2¼ per cent (against 6½ per cent in the first half of 1968) and this weak trend is likely to continue into 1969. In the United Kingdom, an actual decline in domestic demand is anticipated in the second half, followed by very moderate growth in early 1969. As a result, the combined current account position of the reserve currency countries might improve by as much as $ 3½ billion (annual rate) between the two halves of the year, corresponding to a direct deflationary impact on other OECD countries equivalent to more than ½ per cent of their GDP. Moreover, domestic demand is also likely to decelerate in Japan.

The French strikes are likely to reduce OECD output by less than ¼ per cent in 1968, but have considerably distorted the half-yearly time-path. On account of this, the level of OECD GDP was ½ per cent less in the first half year and is likely to be ½ per cent more in the second half.

The prospects for most continental European countries into 1969 depend essentially on how successful they are in absorbing the substantial deterioration in their foreign balance. Most will be helped by the momentum built up during the rapid expansion since last autumn, and there is no reason why domestic demand rather than exports should not now take over the leading role. In France this would require policies along the lines discussed below, and in some other countries additional expansionary measures may prove necessary in 1969, if not before.

TRADE AND CURRENT INVISIBLES

Parallelling the trends in demand and output discussed in the previous section, OECD trade is expected to slow down markedly through the remainder of 1968. The United States and the United Kingdom between them account for about one-third of OECD trade; and if domestic demand in these two countries evolves along the lines discussed above, the underlying growth of total OECD exports may fall from an annual rate of 15 per cent in the first half of the year to only around 5 per cent in the second half (Table 4). The slowdown in export demand is likely to be most felt in Canada, Japan and some continental European countries (Table 10.II.).

The strikes in France have strongly disturbed OECD trade in May and June and the after-effects will continue to be felt for several months. A tentative estimate suggests that total OECD exports in the second quarter may have been 3½ per cent lower than they would otherwise have been because of the French strikes, but that most of this loss will be made up either by France or by other countries in the third quarter. Trade has also been disturbed by dock strikes in the United Kingdom last autumn and in the United States in March. A note at the end of this section gives some estimates, necessarily rough, of the impact of these and other special factors. These estimates suggest that while the underlying growth in OECD exports between the second and fourth quarters of this year is likely to be distinctly weak, the actual figures for recorded exports may show a strong surge in the third quarter followed by a decline in the fourth (Table 5).

The discussion in the remainder of this section concentrates primarily on underlying trends in imports and exports, and the figures given are adjusted to exclude the estimated temporary disturbances caused by the United Kingdom dock strike and the French strikes. In the following sections, however —that is in the section on balance of payments equilibrium after the gold crisis, and in the balance of payments tables shown for individual countries— the figures include estimates of the impact of these disturbances. [1]

OECD Imports

The most rapid import increases through mid-1968 have occurred in the United States and Canada, but Germany and—prior to the strikes—France were also contributing strongly to the total rise (Chart C). United Kingdom imports, although flattening out in the second quarter, remained at a disappointingly high level in April and May. By contrast, in Italy and Japan imports fell in the first quarter and only partially recovered in the second.

1. In general the effect of these disturbances is much greater on *levels* of imports and exports than on *trade balances*. The assumptions made concerning France are described in some detail on pp. 57 to 59.

TABLE 4.
Foreign trade of the OECD area [a]

Values, percentage changes seasonally adjusted, at annual rates
Estimates and forecasts

	1967 $ billion	From previous year 1966	1967[c]	1968[c,d]	From previous half-year 1966 II	1967 I	1967[c] II	1968[c,d] I	1968[d] II
TOTAL [b]									
Imports	145.7	11.1	5.4	9	8.4	4.0	5.7	13½	4
Exports	140.0	10.9	5.9	9	9.6	7.3	0.8	15	4½
INTRA-OECD	97.2	12.0	6.2	10	7.3	7.1	4.7	15½	4
EXTRA-OECD									
Imports	44.1	8.7	3.6	7	9.6	−2.2	8.8	7½	4
Exports	41.6	8.4	5.2	6½	16.9	6.9	−7.3	13	6½

a) Adjusted for discrepancy in recording of intra-OECD trade.
b) Including trade with unspecified origins/destinations.
c) Adjusted for the effects of the United Kingdom dock strike.
d) Adjusted for the effects of the French strikes.

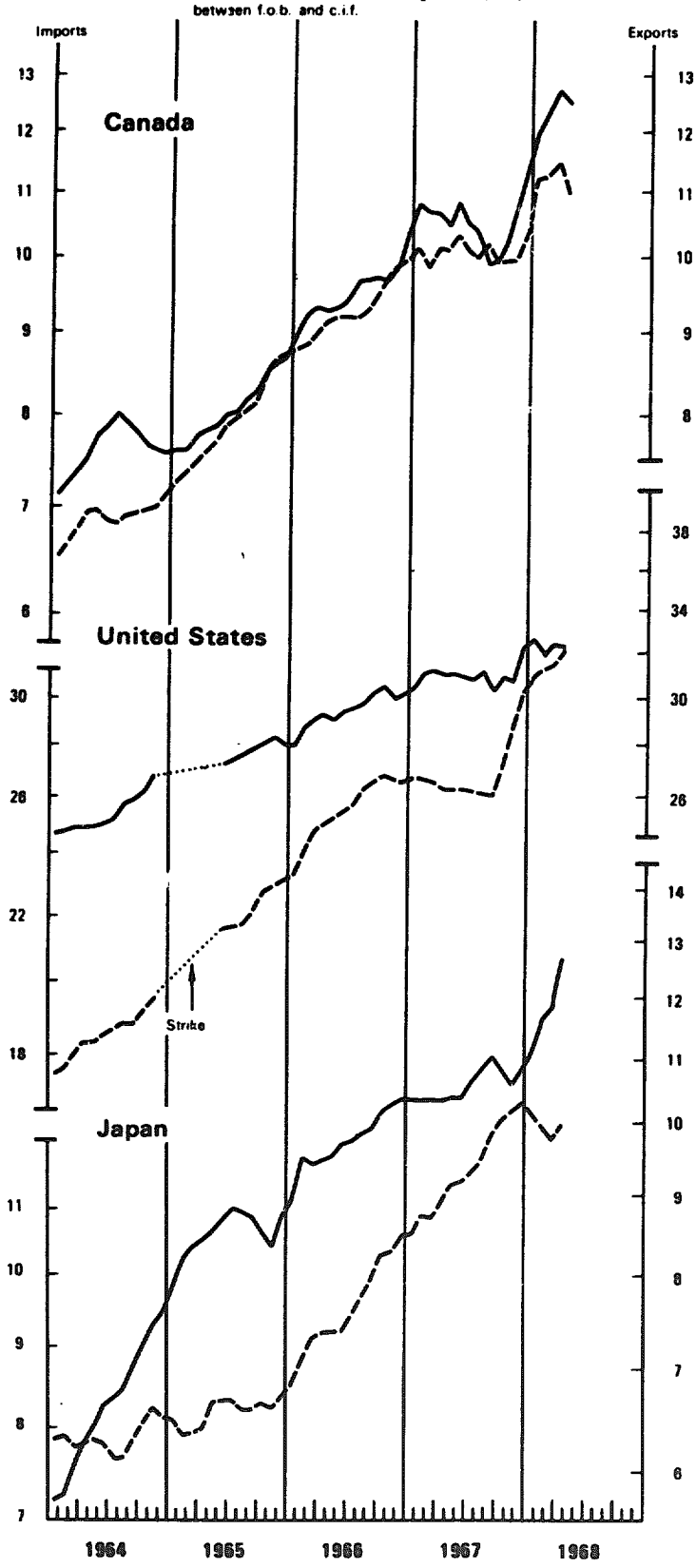
CHART C

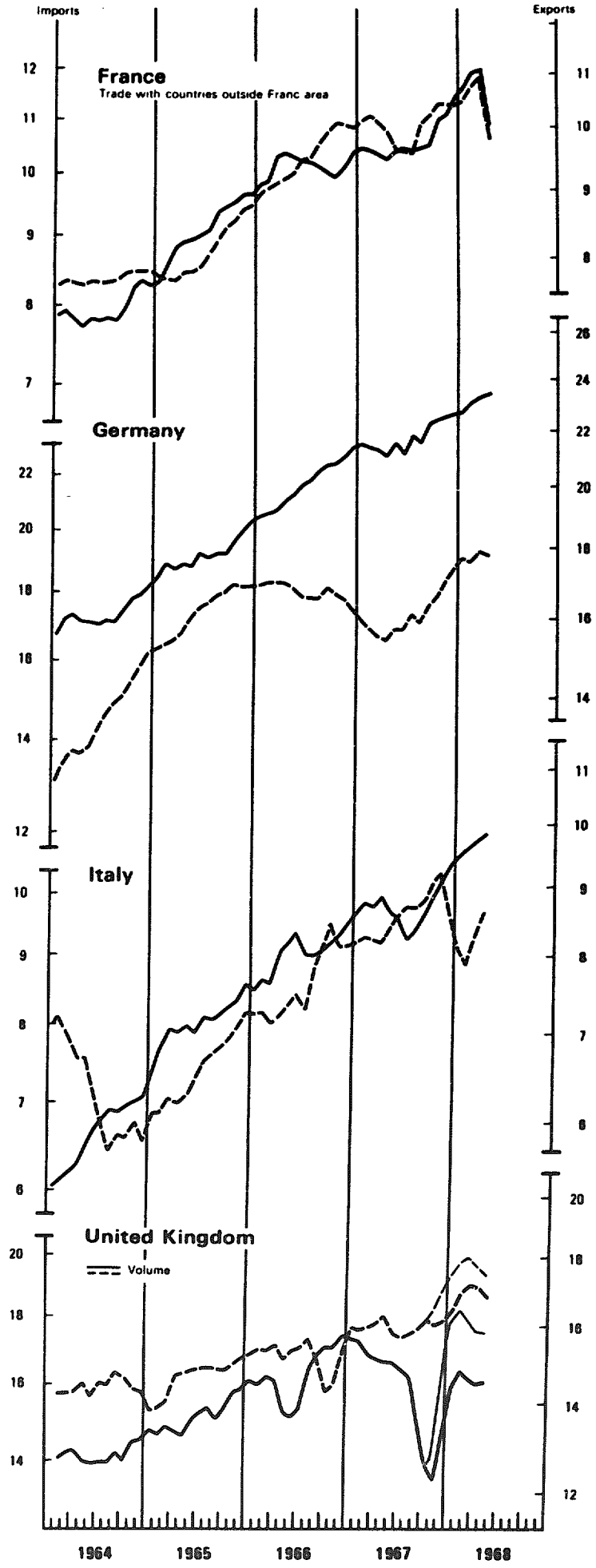
TOTAL TRADE OF MAJOR O.E.C.D. COUNTRIES

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.





In the case of Italy, the sharpness of the fall in the first quarter may be partly explained by statistical factors, but it no doubt also reflects the present conjunctural weakness in Italian domestic demand.

In all, in the first half of this year import demand has probably risen by about 14 per cent (annual rate) after adjusting for the effects of strikes. The extent to which the underlying growth rate may fall in the second half of the year depends very largely on the timing of the impact of policy measures taken in the United Kingdom and, more recently, in the United States. In the United Kingdom, the combined effects of the devaluation and of the strong fiscal action taken in March seem to have been delayed by speculative forces, but should begin to be felt from now on, causing a significant fall in imports. In the United States, the effects of the tax rise, together with the cessation of exceptional copper and steel purchases, may cause a sharp drop in imports later in the year. Against this, some acceleration in the import demand of several of the smaller continental European OECD countries may be expected, Italian imports may recover somewhat from their very low first half year levels, and by the fourth quarter the underlying trend of French imports may be rising fast.

Trade with non OECD countries

When OECD domestic demand picked up in the second half of 1967, imports from non-OECD countries responded much more quickly than intra-OECD trade. They had probably passed their peak rate of expansion by early 1968, although extraordinary copper imports by the United States kept the growth rate quite high in the first half. The second half of this year is likely to be weaker.

As in the past, volume fluctuations in OECD imports from the rest of the world have been amplified by movements in the prices of primary products. After falling from the middle of 1966, commodity prices picked up sharply in the fourth quarter of 1967 and rose further in the first months of this year. To a large extent this rise was short-lived as non-ferrous metal prices were artificially inflated by the effects of the US copper strike. More recently, the main price indices have fallen back and this tendency, so far entirely the result of a downturn in copper prices, may continue in the second half of the year as a result of slower growth of industrial output and the existence of relatively large stocks of most commodities.

TABLE 5.
Quarterly trend in OECD exports
Index numbers, seasonally adjusted, estimates and forecasts. 1967 = 100

	Exports	Adjusted exports[a]
1967		
Q1	100.2	99.9
Q2	100.2	100.0
Q3	99.3	99.1
Q4	100.3	101.0
1968		
Q1	107.1	106.8
Q2	105½	109
Q3	113	110
Q4	111	110½
Year	109	109

a) Adjusted for the effects of the United Kingdom dock strike and of the French strikes—see also note at end of this section.

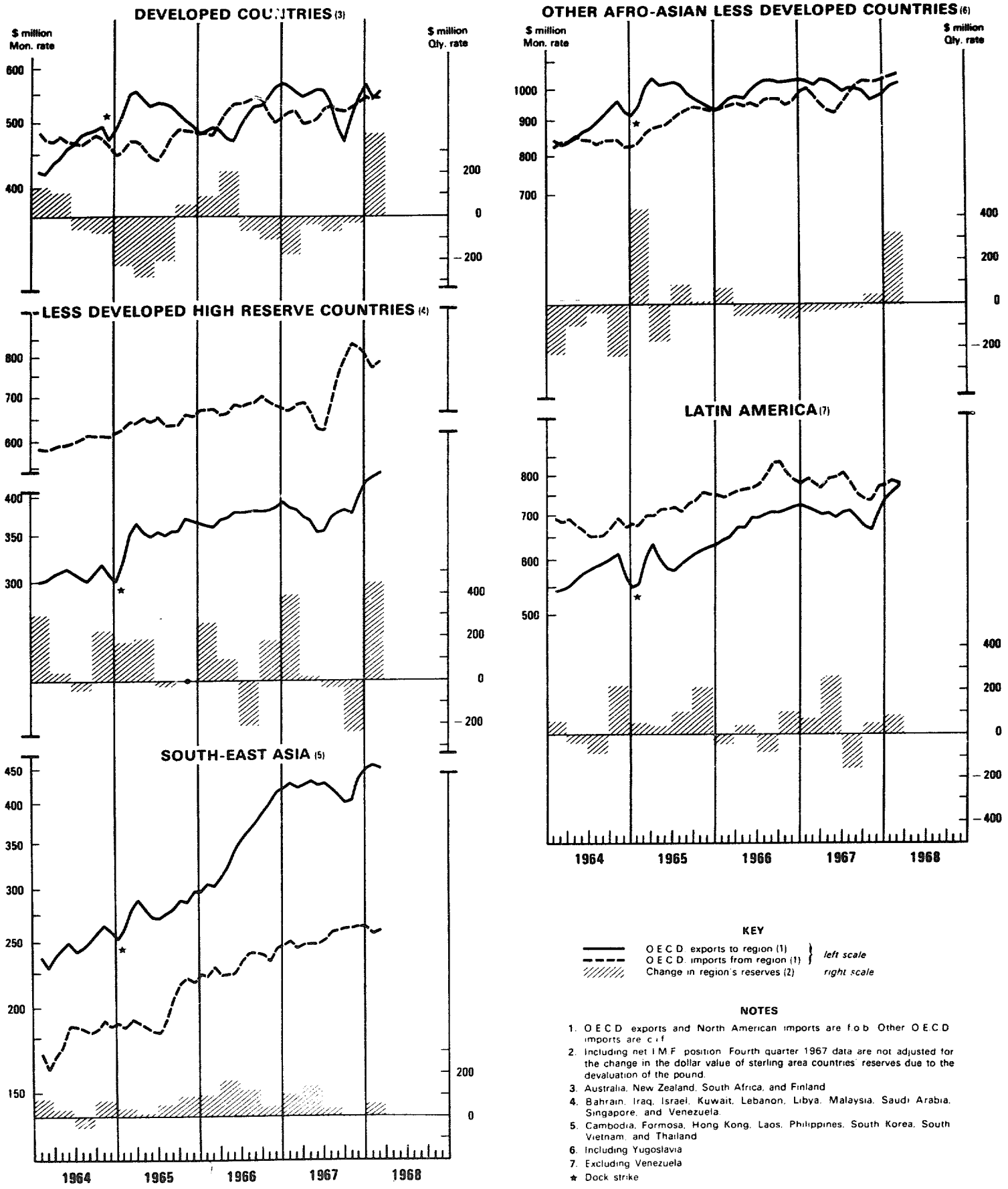
The pick-up of imports from the outside world in the second half of 1967 was accompanied by a sharp fall in exports to non-OECD countries, affecting almost all markets. Exports to the Sino-Soviet Area, after several years of steady growth, declined by 5 per cent between the two halves of 1967. Of the developed primary producers only Australia provided a growing market for OECD exports, substantial falls occurring in South Africa, New Zealand and Finland. Exports to Brazil grew strongly, but elsewhere in Latin America the picture was stagnant. Exports to South-East Asia, which had grown very rapidly over the last three years, fell by 4 per cent. The other less-developed Afro-Asian countries as a group were also weak, with India and Nigeria showing especially marked decreases in demand for OECD exports (Chart D).

The speed with which the outside world reduced its imports from OECD countries is surprising. The previous half-year had seen a very large trade imbalance in the OECD's favour (Table 6) which would normally have been expected to have been cut-back after a time in view of generally weak reserve position of many outside countries (Table 7). But, given the extent to which the OECD trade surplus had resulted from rising military expenditure in South-East Asia, its subsequent contraction might have been expected to be smaller. Although

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, and Finland.
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.

★ Dock strike

TABLE 6.
OECD Trade balance with the rest of the world [a]
$ billion, seasonally adjusted, annual rates
Estimates and forecasts

	Trade balance	Adjusted trade balance [b]
1966	2.6	2.2
1966 I	2.0	1.8
1966 II	3.3	2.7
1967 [c]	3.4	2.6
1967 I	5.0	4.2
1967 II	1.8	0.9
1968 [c,d]	3.4	2.2
1968 I [c,d]	3.0	1.8
1968 II [d]	3.8	2.6

a) Balance of payments basis.
b) Excluding the exceptional trade balance recorded with South-East Asia.
c) Adjusted for the effects of the United Kingdom dock strike.
d) Adjusted for the effects of the French strikes.

TABLE 7.
Changes in reserves [a] of primary producers
$ million

	1966 I	1966 II	1967 I	1967 II [b]	1968 Q1
Developed countries [c]	320	-170	-220	-90	380
Less developed high reserve countries [d]	370	-20	420	-270	450
Other less developed countries	290	105	535	-40	470
TOTAL	980	-85	735	-400	1,300
Memorandum Item:					
Other less developed countries excluding South-East Asia [e]	20	-75	275	-80	410

a) Including net IMF position.
b) Contrary to Table 30, the data shown here are not adjusted for the change in the dollar value of sterling area countries' reserves due to the devaluation of the pound.
c) Australia, New Zealand, South Africa and Finland.
d) Iraq, Israel, Kuwait, Lebanon, Libya, Malaysia, Saudi Arabia and Venezuela.
e) South-East Asia includes Formosa, South Korea, Philippines, Thailand and South Vietnam.

it is difficult to find any specific explanation, developments in the early months of 1968 in fact suggest that the contraction was probably to a considerable extent accidental, and may have been more than made up by the middle of the year.

The contrasting fluctuations between mid-1967 and mid-1968 have probably left OECD exports to the rest of the world at a level which may be considered fairly normal in relation to general demand conditions. They could thus be expected to grow regularly for the rest of the year, given the rise over the last twelve months in OECD demand from the primary producers. Exports to Latin America may be further boosted by higher United States direct investment in that area. Demand from countries in South-East Asia is increasing sharply and, given the high level of reserves accumulated by these countries in the past two years, their import growth should not be arrested by financial constraints. Among developed primary producers, on the other hand, only Australia seems to offer scope for a significant increase in OECD exports (although the balance of payments position may induce restrictive action later in the year), while demand from New Zealand and Finland (following their devaluations) and South Africa (where only a slight relaxation of present stringent policies is probable) seems unlikely to grow significantly. Exports to the Sino-Soviet Area may return to their medium-term trend of strong growth.

In total, OECD exports to the rest of the world may increase at an underlying annual rate of the order of 7 per cent in the second half of this year, following a 13 per cent rise in the first.

Total OECD Exports

As already noted, the underlying growth of total OECD exports may fall from an annual rate of 15 per cent to only around 5 per cent between the two halves of 1968. This slowdown (equivalent to about $ 13½ billion worth of exports at an annual rate, or nearly one per cent of the OECD's GNP) would very largely be accounted for by North America and the United Kingdom, their imports from OECD countries rising in the first half of this year by nearly $ 10 billion and falling by perhaps $ 2 billion in the second (Table 8). Growth of exports to non-OECD countries, which was exceptionally high in the first half of the year, should also moderate in the second.

The extent to which EEC countries will contribute to the maintenance of a minimum growth of import demand in the OECD area depends in part on how

the conjunctural situation develops in Italy. If, as assumed here, Italian domestic demand picks up in the second half of this year from its present hesitant state, the consequent rise in import demand may offset the somewhat slower growth expected in Germany. The underlying trend of French import demand should also pick up rather rapidly with rising incomes.

With demand from several major OECD markets slowing down or actually falling, average market growth should slow down sharply for most of the main exporting OECD countries (Table 9). Canada and Japan are the two countries whose markets would decelerate most sharply—reflecting their heavy dependence on the US market. The slowdown in the export markets of the United States and the United Kingdom, on the other hand, should be less marked than the OECD average, because they will not be affected by the slowdown in their own import demand. The market slowdown may also be rather smaller than the average for EEC countries, which should benefit from sustained intra-EEC import demand.

TABLE 9.
Growth of export markets [a] for OECD countries
Per cent changes [b]: Estimates and forecasts

	1966 II to 1967 II	1967 II to 1968 I	1968 I to 1968 II
United Kingdom	2½	7	2½
United States	3¾	6	1½
France	4¾	6	3½
Germany	2½	6	3
Italy	3½	7½	3
Other EEC	4½	7	3½
Canada	8½	13	-1½
Japan	3	10½	1
Other OECD North	5½	6½	1½
Other OECD South	5½	8	2½
TOTAL OECD [c]	4	7¼	2¼

a) The growth which would have occurred in a country's exports if it had exactly maintained its share in total OECD exports to each market.
b) Actual rates.
c) Adjusted for estimated effects of the United Kingdom dock strike at the end of 1967 and of the French strikes at mid-1968.

TABLE 8.
OECD Exports: Growth of various markets [a]
$ billion
Estimates and forecasts

Market	OECD exports to market in 1965-1966	Changes at annual rates seasonally adjusted: Average 1959-60 to 1965-66	1966 II to 1967 II [b]	1967 II to 1968 I [b]	1968 I to 1968 II [b]
United Kingdom	7.8	0.41	1.07	1.0	-1.1
United States	14.7	1.02	1.31	6.6	-0.8
TOTAL RESERVE CURRENCY COUNTRIES	22.5	1.43	2.38	7.6	-1.9
France	7.1	0.68	0.30	1.1	1.3
Germany	12.1	1.02	-0.03	2.3	1.5
Italy	4.8	0.35	0.68	0.3	1.4
TOTAL EEC	36.4	3.08	1.36	5.1	5.3
Canada	7.6	0.46	0.31	1.9	0
Japan	3.2	0.25	0.96	0	0.4
Other OECD	18.1	1.37	0.59	0.4	0.8
Non OECD	38.4	2.00	-0.20	5.4	2.4
TOTAL OECD [c] EXPORTS	127.0	8.62	5.60	20.4	7.0

a) Markets are here defined as the sum total of OECD exports to each country or group of countries.
b) Adjusted for the estimated effects of the United Kingdom dock strike at the end of 1967, and of the French strikes at mid-1968.
c) Details do not add to totals because of the inclusion of exports to unspecified destinations. The rates of growth of total OECD exports implied by these absolute figures are those shown (at annual rates) in Table 4.

TABLE 10.
Growth of markets and growth of exports
Percentages: Estimates and forecasts

I. UNITED KINGDOM

	1966 II to 1967 I	1967 I to 1967 II	1967 II to 1968 I	1968 I to 1968 II
Growth of markets [a]	3	0	7	2½
Export volumes [b]	-½	-6½	7	5
Dollar export unit values [c]	1	-1	-6	1
Dollar export values [b]	½	-7½	1	6
Plus : Dock strike and French effects	0	-4½	8	-1½
Dollar export values, unadjusted	½	-12	9	4½

II. OTHER COUNTRIES

	1966 II to 1967 II		1967 II to 1968 I		1968 I to 1968 II	
	Markets [a]	Exports	Markets [a]	Exports	Markets [a]	Exports
United States	3¾	3½	6	6½	1½	4
France	4¾	5¼	6	10	3½	1
Other EEC	3¾	6	6½	8	3½	1
Canada	8½	6	13	17	-1½	-2
Japan	3	6	10½	12½	1	4½
Other OECD Europe [d]	5½	7	6½	5	1¾	1
TOTAL ABOVE	4¼	5½	7¼	8½	2	1¾

a) The growth which would have occurred in a country's exports if it had exactly maintained its share in total OECD exports to each market. The figures are adjusted for the estimated effects of the UK dock strike and of the French strikes.

b) Adjusted for effects of dock strike and French strikes.

c) Export unit values in terms of foreign currencies are estimated here to fall by about 6 percentage points between the second half of 1967 and the first half of 1968. These are, however, average levels, with the second half of last year already affected by a sharp fall in December after the devaluation. The fall from pre-devaluation levels would be about 9 per cent.

d) Excluding United Kingdom.

The growth of markets may not, however, provide a very good guide to likely export trends for individual countries in the second half of the year, because there may be quite significant shifts in competitive performance. The United Kingdom, Japan and the United States may well increase their market shares; all three should be benefiting from easing demand pressures, the effects of the sterling devaluation should be working through, and United States exports may be boosted by special factors. Conversely, most other countries (except those that also devalued) may see a loss of market shares.

Even discounting the dock strike, the United Kingdom had a very poor export performance last year, particularly in the second half (Table 10 I). In the first half of this year, however, the *volume* of exports seems to have been rising about as fast as the growth of the United Kingdom's markets (again discounting the effects of the dock strike). In value terms there has nevertheless been a further loss of shares because export prices have been reduced on average by around 9 per cent since the devaluation. In the second half of the year it is expected that these price reductions will lead to a substantial gain in market shares in both volume and value terms. The magnitude of this gain in shares remains uncertain; it has been put here at about 3 per cent of United Kingdom exports, the equivalent of nearly ½ per cent of other OECD countries' exports.

Japan's export performance, which was unusually poor in the first half of last year, has already improved noticeably, and this trend seems likely to continue during the present cooling-off period (Table 10 II). United States export performance should benefit from exceptionally high aircraft deliveries in 1968, particularly in the second half of the year. Taking these various factors into account, it seems possible that—contrary to the rather persistent longer-run trend—the share of EEC countries in OECD exports may be reduced in the second half of the year.[1] Added to the expected slower growth of markets, this might mean a rise in exports at an annual rate of 2 per cent in the second half of the year, compared with an estimated 16 per cent in the first half.

French export performance, as shown in Table 10, is expected to develop roughly along the lines suggested for other EEC countries. This is based on the assumption, confirmed by empirical evidence on other countries, that changes in costs and prices take time to have much effect. However, the actual development of French exports will, of course, be much affected by the strikes, with a substantial once-and-for-all loss due to temporary interruption of deliveries. Thus, for 1968 as a whole, French exports may show a rise of only 7 per cent over 1967—with little change from the first to the fourth

1. Other European OECD countries are not expected, to lose much *as a group*, because some of them have devalued. Those countries in this group which did not devalue will, however, be facing stronger competition.

quarter of 1968—compared with the rise of around 11 per cent which seemed likely before the strikes.

As already noted, there are many uncertainties surrounding these export forecasts for the remainder of the year. It should be borne in mind, however, that the forecasts for the United Kingdom and the United States constitute a minimum step towards the achievement of balance of payments equilibrium in both countries. Policies in these countries, as well as in Japan, are designed to achieve that target. If the assumptions outlined above proved wrong because of higher import growth or less good export performance in deficit countries, the exports of surplus countries (particularly of EEC countries) could be higher, but the achievement of better equilibrium would be delayed.

Current Invisibles

Changes in the invisible balances of individual OECD countries are expected to be larger than usual in 1968. The United States deficit on services and transfers might improve by some $ 0.7 billion. The strongest contribution should come from higher repatriation of investment income induced by the balance of payments programme. The adverse impact on the tourist account from the Montreal exhibition will not be repeated, and there may be gains from the proposed tax on air tickets and reduced customs concessions for US tourists. Military spending will probably increase, but perhaps only moderately; transfers abroad should fall from the high 1967 levels which resulted from the Middle-Eastern conflict. The Canadian deficit on invisibles may rise by $ ½ billion, reflecting the end of the Montreal exhibition and the trend increase in investment income payments.

A substantial improvement, largely due to the effects of the devaluation, is expected in the United Kingdom invisible account. The devaluation will almost certainly affect adversely the terms of trade of invisible services, although in some sectors—in particular shipping—this will be reduced to the extent that United Kingdom prices in terms of foreign currency are governed largely by developments in world markets. On the other hand, the experience of other countries suggests that the effects of the devaluation on the number of tourists visiting the United Kingdom and their expenditure could substantially outweigh this disadvantage; at the same time, the restrictions on travel expenditure abroad and the higher cost of foreign travel for United Kingdom residents should continue to act as a brake on travel debits. Some small increase is possible in net government expenditure abroad, including grants; but this should be more than offset by a substantial fall in investment income payments in terms of foreign currencies.

A deterioration of the order of $ ¼ billion is expected in the invisible account of France. A large part of this would be due to the effects of the May-June disturbances on foreign travel, not only during that period but also—to a smaller extent—for the rest of the season. Part of the French loss could benefit Italy (through a diversion of foreign travel which would have otherwise gone to France) and to a lesser extent other EEC countries (both through higher receipts and lower expenditures). The rise in economic activity in Germany should lead to increasing travel payments and higher emigrants' remittances. Italy should no doubt benefit from this but seems to be suffering rather heavily from the prolonged closure of the Suez Canal. Two further factors which may affect the EEC countries' travel account are the devaluations in neighbouring countries, which may produce some shift from intra-

TABLEAU 11.
Current invisibles
$ billion. Estimates and forecasts

	1966	1967	1968
United Kingdom	0.32	0.38	0.80
United States	-1.48	-1.78	-1.10
TOTAL RESERVE CURRENCY COUNTRIES	-1.16	-1.41	-0.30
France [a]	0.07	-0.20	0.45
Germany	2.88	2.89	3.00
Italy	1.78	1.64	1.60
Other EEC	0.42	0.54	0.60
TOTAL EEC	0.61	-0.91	-1.25
Canada	1.65	1.24	1.80
Japan	1.02	1.35	1.45
Other OECD North	1.59	1.58	1.50
Other OECD South	2.16	2.10	2.45
TOTAL OECD	0.68	1.22	-0.85

a) Transactions with non-franc countries.

EEC travel to travel in those countries, and the restrictions on foreign travel imposed in the United States and the United Kingdom. In total the invisibles balance of the EEC might deteriorate by around $ 350 million.

Much of the increased invisible deficit of EEC countries may have its counterpart in other Mediterranean OECD countries—higher emigrants' remittances as well as increased travel receipts.

For the OECD area as a whole the invisible deficit could decrease somewhat, resuming the falling long-term trend which was temporarily reversed in 1967 because of the sharp rise in US military expenditure and the impact of the Middle East crisis.

A NOTE ON THE IMPACT OF SPECIAL FACTORS ON OECD TRADE, 1967 II - 1968 II

Most of the tables shown above employ figures adjusted for the estimated effects of the United Kingdom dock strike in the autumn of 1967 and the French strikes of May-June 1968, two special factors that have had considerable distorting effects on the development of OECD trade in 1967 and 1968. The estimated effects of these factors are shown in Table 12, which also gives estimates of the impact of abnormal United States copper and steel purchases in 1968. This latter factor has not, however, been adjusted for in preceding tables.

Estimates of this kind are subject to a considerable margin of error, and the figures shown in Table 12 should only be taken as rough orders of magnitude. A number of other incidental developments affecting OECD trade (some of them originating in other countries) have not been entered in the table either because they are too difficult to quantify or because they are not thought to have had an important distorting effect.

TABLE 12.
Main special factors affecting OECD trade,[a] 1967 II to 1968 II
$ billion, annual rates, estimates and forecasts

	1967 II		1968 I		1968 II	
	Effect on		Effect on		Effect on	
	country itself	other OECD countries	country itself	other OECD countries	country itself	other OECD countries
Effect of dock strike on U.K. exports	-0.7 X	-0.3 M	+0.4 X	+0.1 M		
Effect of French strikes on French imports			-1.4 M	-1.0 X	+0.8 M	+0.4 X
Effect of French strikes on French exports			-2.1 X	-1.4 M	+1.0 X	+1.1 M +0.5 X
Abnormal U.S. copper and steel imports			+1.6 M	+1.1 X	+0.1 M	+0.1 X
Total effect on OECD imports[b]	-0.3 M		-1.2 M		+1.9 M	
Total effect on OECD exports[b]	-0.7 X		-1.6 X		+2.0 X	

a) M indicates an estimated effect on imports and X an effect on exports. In 1968 II the effect of the strikes on French exports has repercussions on both the imports and exports of other OECD countries as it is assumed that part of the French export loss in the first half of the year is made good by France and part by other OECD exporting countries. For any given period and any given line in the table, the effect on non-OECD countries is the difference between the figures entered in the first and second columns.

b) These totals differ from the adjustments incorporated in Tables 4 to 10. The latter allow for the United Kingdom and French strikes but not for extraordinary United States copper and steel imports.

For the United Kingdom dock strike no estimate is included for the impact on United Kingdom imports because most of it would have been compensated within the second half of 1967 itself (although it is now believed that some delayed imports from the sterling area may have only arrived in the first months of 1968). The shortfall in United Kingdom exports resulting from the dock strike in the second half of 1967 is estimated at some $700 million (at an annual rate), of which only $400 may have been offset in the first half of this year (the rest being a once-and-for-all loss). The largest part of the swing of $1.1 billion (but not of the permanent loss) is thought to have occurred in trade with non-OECD countries; but there may also have been an associated swing of some $0.4 billion (at annual rate) in other OECD countries' imports between the second half of 1967 and the first half of 1968.

The French strikes held up both imports and exports in the first half of 1968, with, it is here assumed, the greater disruption on the export side. These shortfalls would have had most of their counterpart in the exports and imports of other OECD countries. In the second half it has been assumed that the first half losses will not be entirely made up in either French exports or French imports. On imports, it is supposed that requirements for the year will have been reduced, since not all the lost output will be caught up. On exports it is assumed that France suffers a once-and-for-all loss amounting to half the second quarter's shortfall. It is assumed that the demand left unsatisfied by French exports will be partly met by exports of other OECD countries, and partly by domestic production in the markets concerned. In total, the swings between the first and second halves of the year resulting from the French disturbances come to $4.7 billion for OECD imports. $5.0 billion for OECD exports, and $3.9 billion for intra—OECD trade (at annual rates).

The most important special factors assumed to affect United States trade in the period reviewed fall almost exclusively in the first half of this year. Imports in this period may be swollen to the tune of some $1.6 billion (at an annual rate), the combined effect of abnormally high copper imports following the copper mining strike, and of anticipatory steel imports hedging against a possible steel workers' strike when the present collective labour contracts expire in August. Extraordinary steel imports are expected to continue well into the third quarter, but the low figure ($0.1 billion) shown for the second half of 1968 is based on the assumption that the strike finally does not occur, and

that third quarter imports are almost completely offset by destocking of imported steel in the fourth quarter [1].

There are other special factors which affect United States imports and exports in the period under consideration. The dock strike in New York in March 1968 displaced about $200 million of United States exports from the first to the second quarter. This disturbance worked itself out in the first half and is therefore not shown here (but the figures in Table 5, showing quarterly developments, are adjusted for it). Automobile imports and exports under the Ottawa agreement between the United States and Canada are expected to rise considerably. This has been a feature of North-American trade over the past three years, although in the first quarter of 1968 some bunching may have occurred as a result of the United States automobile strike. United States exports may also be negatively affected in 1968 by the copper strike (but the figures involved are small); and positively by a sharp rise in aircraft deliveries.

1. The destocking allowed for is less than the "extraordinary" imports built in for the first three-quarters of the year, past experience suggesting that such compensatory movements are rather limited in extent.

COSTS AND PRICES

In last December's issue of *Economic Outlook* the question was raised as to whether the problems of excessive unemployment and under-utilised capacity in the United States, and excessive inflationary pressures in Europe, which characterised the first half of the 1960s, were in danger of being overcorrected in the second half of the decade. [1]

In the meantime, inflationary forces have continued to gather momentum in the United States. Decisive fiscal action has now, however, been taken by Congress and it seems reasonable to expect a return to satisfactory cost and price performance over the next two years, so long as fiscal restraint is backed by cautious general demand management and, insofar as possible, by an active price and incomes policy. On the European side, the further evidence of continuing good productivity performance discussed below tends to strengthen the suggestion made last December that renewed expansion in Europe on the scale then envisaged might not prove sufficient to ensure full employment over the longer run. Recent events in France illustrate the difficulties inherent in finding the right balance between expansion and price stability; they could also herald a period of more rapid wage increases in Europe.

While the primary aim of the authorities in each country must be to find the balance of priorities appropriate to its own social and economic objectives, the open nature of Western economies inevitably provides a continuing external constraint. It is easy, however, to draw over-hasty conclusions about the impact of short-term movements of a country's costs and prices relative to those in other countries on its overall external position. To a significant extent such movements may only reflect the cyclical position of the country concerned relative to other countries; notably, in the present case, the differences in cyclical timing between North America and Europe, and to a lesser extent within Europe. Furthermore, only part of a country's output enters into international trade and its competitive position also depends on technological progress, developments in tariff policy, trade discrimination, agricultural protection, and many other factors. It is normally only over the longer run that cumulative changes in relative costs and prices have a significant impact on a country's competitive position, raising difficult policy problems for foth deficit and surplus countries. [2]

United States

After an average annual increase of 1.4 per cent between 1961 and 1965, the rise in the implicit GNP price deflator in the United States has accelerated, reaching an annual rate of 3.7 per cent between the fourth quarter of 1967 and the first quarter of this year. The latest surge in the deflator reflects a rapid increase in consumer prices and, in the last few months, a sharp upward movement of wholesale prices. Price movements in the United States seem to be rather sensitive to changes in demand pressures. During the temporary check to expansion in the first half of 1967 there was a noticeable slowdown in the price rise (reinforced by partly autonomous factors influencing food prices), but this trend was quickly reversed when the rate of expansion began to pick up again from the middle of last year onwards.

1. "Expansion Versus Price Stability", *Economic Outlook*, No. 2, pp. 12-20, Paris, December 1967.

2. Cf. paragraph 46 of *The Balance of Payments Adjustment Process*. A report by Working Party No. 3 of the Economic Policy Committee of OECD, Paris, August 1966.

In contrast, the underlying rate of wage changes (leaving aside fluctuations arising from changes in overtime, etc.) appears to respond much more slowly, and was hardly affected by the temporary easing of demand pressures in the early part of 1967. To a considerable extent this is attributable to the nature of wage contracts in the United States, which typically cover periods of two or three years, with guaranteed wage increases during the period of the contract. The actual change in wage rates—resulting from current and previous collective agreements—has risen quite slowly, from 3.4 per cent in 1965 to 3.6 per cent in 1966 and 4.4 per cent in 1967 (see Table 13). Wage increases agreed under new collective agreements, however, have accelerated more sharply, averaging 5.7 per cent in 1967 compared with an average of 3 per cent over the period 1960-64. Following the Ford settlement late last year and the copper settlement early this year, the average level of new settlements in the first quarter rose to 7.4 per cent for the first year of the contract (an average of 5.8 per cent over the contract period).

The experience of the late 1950s suggests that the high level of new settlements both this year and last will have a continuing impact on wage increases. With some easing of demand pressures in 1956 and quite a sharp recession from mid-1957 to mid-1958, the level of new settlements came down from 5½ to 4 per cent, but with the impact of earlier settlements continuing to come through, the actual change of wage rates remained high until 1959. This experience seems likely to be repeated over the period 1968-70. It is estimated that collective bargains made up to the end of 1967 would in themselves already imply a median increase of 3 per cent in wage rates in 1968. If new settlements in 1968 were to average 7 per cent, then actual wage rates would rise by about 6 per cent over the 1967 level. In practice the increase in rates may be rather more than this because of automatic increases resulting from the operation of cost-of-living escalation clauses.

Unit labour costs rose rapidly in the first half of 1967, reflecting a sharp slowdown in the growth of productivity as well as rising wage rates. The upward trend has continued more slowly during the renewed expansionary phase because the rapid rise in average hourly compensation (partly attributable to higher non-wage payments) has been accompanied by an improvement in output per man-hour (see Table 14). In April 1968 unit labour cost exceeded the virtually stable 1958-65 level by more than 10 per cent.

It seems clear that, given the relatively high sensitivity of prices to changes in demand pressures in the United States, a "cooling-off" period would

TABLE 13.
United States: Wage settlements and prices 1955-1968
Percentage changes

	Settlements that year[a]	All settlements[b]	GNP price deflator
1955	5.4[c]	5.0[c]	1.5
1965	5.4[c]	5.4[c]	3.4
1957	4.9[c]	6.2[c]	3.7
1958	3.9	6.1[c]	2.7
1959	3.9	3.5	1.6
1960-64 (average)	3.0	2.9	1.3
1965	3.8	3.4	1.9
1966	4.8	3.6	2.7
1967	5.7	4.4	3.0
1968[d]	7	6	4

a) Average first-year change in wage rates under major collective bargains negociated in that year.
b) Average change in wage rates under major collective bargains, including those made in previous years.
c) Estimate.
d) Hypothetical.

TABLE 14.
United States: Cost and price indicators since 1961
Annual percentage changes

	1961 to 1965	1965 to 1966	1966 to 1967	Oct. 66-Mar. 67 to Oct. 67-Mar. 68
Total (private economy)				
Average hourly compensation[a]	4.4	6.9	6.2	..
Output per man-hour	3.8	3.1	1.4	..
Unit labour cost	0.5	3.7	4.8	..
Manufacturing				
Average hourly compensation[a]	3.6	4.9	6.1	6.8[b]
Output per man-hour	4.6	2.2	0.4	2.5[b]
Unit labour cost	-1.0	2.7	5.7	4.3[b]
Private sector price deflator	1.2	2.5	2.8	3.2

a) Wages and salaries of all employees and supplements to wages and salaries such as employer contributions for social insurance and for private pension, health, unemployment, and welfare funds, compensation for injuries, pay of the military reserve, etc. Also includes an estimate of wages, salaries, and supplemental payment part of the income of the self-employed.
b) Provisional estimates.

moderate price increases fairly quickly. However, it will take some time to bring the rate of wage increase down to a more sustainable level, depending in part on how far the Administration finds itself able to bring pressure to bear on the parties concerned in key collective bargains. The current negotiations in the steel industry—which unfortunately are taking place at a time of high demand pressure and rapidly rising consumer prices—will be of considerable importance in this respect.

Western Europe

For most European countries the rise in prices has slowed or remained moderate during the period of renewed expansion since the middle of last year. The main exceptions are the United Kingdom, Denmark and Spain where the price level has been raised by the effects of devaluation. Consumer prices in France and Germany have been pushed up by changes in indirect taxation and increases in public utility tariffs, controlled rents and other charges.

Productivity

In many European countries the cyclical slowdown experienced over the last two or three years was accompanied by unusually good productivity performance, which some observers have attributed to a " shake-out " effect after a period of overfull employment. There is now evidence that in several countries this good performance has continued at least through the early phase of renewed expansion. In some cases there has thus been a tendency for average productivity gains over the latest cycle to exceed those recorded in the early 1960s. [1]

1. Ideally labour productivity should refer to the economy as a whole, relating changes in the total number of hours worked in a country to its GDP growth. In practice such an approach is not only statistically very difficult but also raises problems in an economy in which structural changes are taking place, either through the transformation of traditional sectors (notably agriculture), or a movement toward new sectors and products (especially services). A short-term analysis of changes in productivity is more meaningful if confined to industry and, more particularly, manufacturing. This limited approach has the advantage of permitting the calculation of changes in unit wage cost in a sector which is of predominant importance in international trade. Nevertheless, the figures given below should be used with caution: they are not comparable internationally and provide only some guidance as to changes over time within each country.

TABLE 15.
Italy: Output, productivity and unit wage cost in manufacturing
Percentage change over corresponding period of previous year

	1964 Q1	1965 Q1	1966 Q1	1966	1967
Output	8.5	-2.0	11.2	9.9[a]	8.4[a]
Hours worked by workers	2.6	-11.3	4.3	0.6[b]	3.7[b]
Output per man-hour	5.7	10.4	6.7	9.2[c]	4.5[c]
Hourly earnings	13.2	9.0	3.7	..	..
Unit wage cost	7.2	-1.3	-2.8	-2.7[d]	4.6[d,e]

Source: Banca d'Italia, « Assemblea generale ordinaria dei partecipanti », bozze di stampa, 1966 and 1967.
a) Gross output at factor cost.
b) Employment.
c) Output per man-hour.
d) Unit labour cost.
e) The sharp increase in unit labour cost is partly due to the discontinuation of the budgetisation of employers' social security contributions.

TABLE 16.
France: Output and productivity in industry [a]
Percentage change over corresponding period of previous year

	1965 Q1	1966 Q1	1967 Q1	1968 Q1
Output	-0.8	6.9	3.4	5.7
Hours worked by all workers	-3.1	0.7	-0.1	-5.0
Output per man-hour	2.3	6.2	3.5	11.2

Source: INSEE, *Bulletin mensuel de statistique.*
a) Excluding construction.

In *Italy*, after an initial fall in early 1964, output per man-hour in manufacturing increased by more than 10 per cent between mid-1964 and mid-1965 and has been on a fairly steady trend of about 6 per cent since. Over the full cycle, from 1963 to 1967, output increased by 30 per cent whilst the number of wage earners in industry declined by 2 per cent, and the latest figures do not suggest any acceleration in the growth of employment. Thus the average productivity growth reached 7 per cent—slightly more than in the 1960-63 period when the economy expanded rapidly.

In *France* there have been two periods of restricted growth (mid-1964-mid-1965 and late 1966—mid-1967), but no actual recession. In the first period the reduction in industrial employment was relatively

small and the rise in productivity appeared to slow. However, from the middle of 1965 onwards the increase in productivity accelerated as output picked up and employment continued to decline until the first half of 1966. During the second slowdown the decline in employment was more marked and productivity continued to progress strongly, whilst a further acceleration occurred during the recent recovery. Taking the whole period from the early 1964 peak until early 1968 it is estimated that output per man-hour in industry increased at an average rate of 5½ per cent against 4½ per cent in the early 1960s, with particularly large gains since mid-1967.

In *Germany*, the rate of increase of industrial productivity was very high in the early 1960s, but it slackened significantly towards the end of the boom in 1965 and 1966 (see Chart E). The sharp decline in employment, accompanied by a fall in the number of hours worked, produced a considerable acceleration in productivity growth by the second quarter of 1967. There was a further acceleration during the first phase of the recovery, with an increase in productivity through 1967 which appears to have been of the order of 10 per cent, even if some allowance is made for the exceptionally high level of output recorded in December. The productivity performance of the last two years has been impressive, but it seems unlikely that this pace can be maintained.

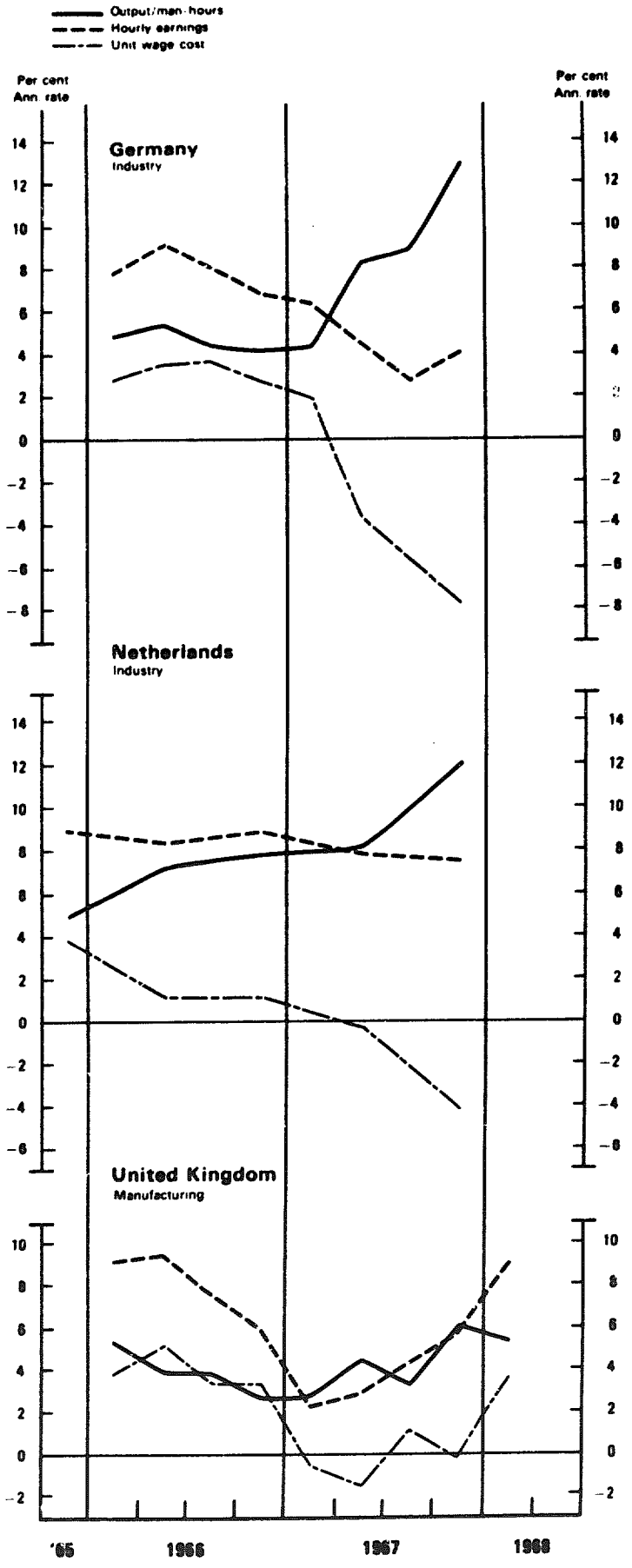
In the *Netherlands*, productivity growth started to accelerate in 1965, when industrial employment remained flat, and the movement gained momentum in 1966 and 1967 with a gradual decline in the total number of hours worked. By the end of 1967 productivity appeared to be about 12 per cent above the level of a year earlier, whilst the gain over the three years averaged more than 8 per cent per annum against less than 5 per cent in the early 1960s.

The acceleration occurred more recently and with less strength in the *United Kingdom*. The slow growth in output in 1965 and 1966 brought down the growth of productivity in manufacturing below the average of the early 1960s, but an improvement became apparent in the first half of 1967. The rise in output between the cyclical trough of the second quarter of 1967 and the first months of 1968 was accomplished without any increase in employment, and in the last two quarters the productivity gain over the preceding twelve months averaged over 5½ per cent.

CHART E

PRODUCTIVITY, EARNINGS, AND UNIT WAGE COST, 1965 - 1968

rates of change over corresponding period of previous year



It is probably too early to assess how much of the recent good productivity performance in Europe is purely a cyclical phenomenon. It seems probable, however, that there has been some permanent improvement in the underlying trend, which could be related to the wave of mergers, widespread rationalisation, strong international competition, and generally high levels of investment in manufacturing industry.

Wages

On the whole the 1966-67 slowdown in industrial activity in Europe did not have a very marked effect on the rise in hourly wage rates (Chart F). The major exceptions were Germany, and to a lesser extent the Netherlands. Hourly earnings were more affected by the recession as the incidence of overtime decreased, particularly in Germany and the United Kingdom. However, they are likely to increase fairly quickly in the recovery phase.

In France, up to the recent events, wage rates had risen at a trend rate of about 6 per cent over the past three years as against 7 per cent in the early 1960s. In Italy, the slowdown was more marked in late 1965 and early 1966 as well as towards the end of 1967, but the average for the 1963-67 period was of the order of 6 per cent. In the United Kingdom, the wage freeze held back increases in wage rates between mid-1966 and mid-1967 but by the early months of 1968 they were back on a trend of 6-7 per cent annual growth. In the Netherlands, however, the rise in wage rates slowed down to 6-7 per cent in 1967 from the very rapid increase in the three preceding years. And in Germany, the recession brought down the increase of wage rates from 7 per cent in 1964-66 to 2 per cent over the twelve months to January 1968.

Unit Labour Cost [1]

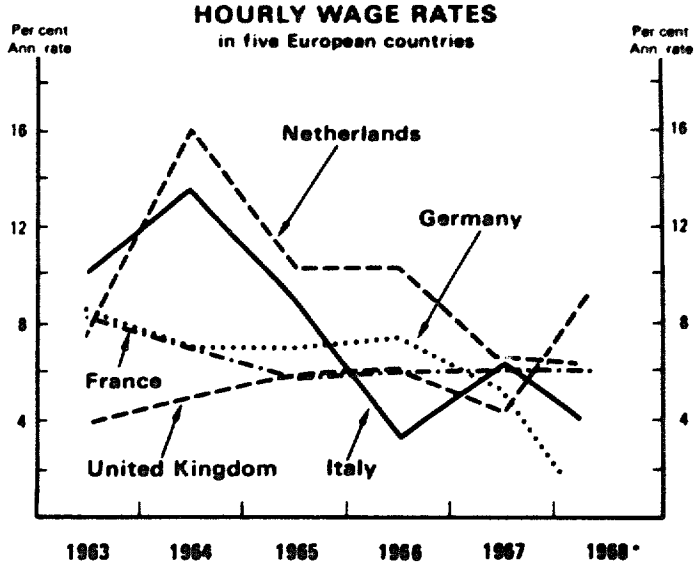
As a result of these developments in labour productivity and wages, the trend in unit labour cost [2] in the countries discussed here has generally improved significantly compared with the early 1960s (Chart E).

In *Italy*, unit wage cost declined by more than 2 per cent per annum between mid-1964 and mid-1966 (compared with an average increase of more than 5½ per cent between mid-1960 and mid-1964).

CHART F

HOURLY WAGE RATES

in five European countries



* Latest month
France, April 1968. Netherlands, March 1968.
Germany, January 1968. United Kingdom, April 1968
Italy, March 1968.

In 1967 the relatively small rise in output per man seems to have resulted in an increase in unit wage cost. Unit labour cost increased fairly sharply as a result of the discontinuation of the bugetisation of part of employers' social security contribuitons (Table 15).

French earning statistics do not give a breakdown of the wage bill by industry but the global statistics suggest that the rise in unit wage cost has slowed down gradually since 1963. They were practically stable in 1967 as compared with 1966, and appear to have declined somewhat between the early months of 1967 and 1968 (see Table 16).

The swing has been much more marked in the *Netherlands*, where after an average rise of 6 per cent in 1960-65, unit wage cost increased more slowly in 1966 and declined by nearly 4 per cent through 1967.

1. The term unit labour cost reflects the cost of labour for employers; it includes social security and other charges paid by the latter. The term unit wage cost refers only to wage payments.

2. It should be noted that movements in the index of unit labour (or wage) cost are not necessarily indicative of changes in the international competitive position of a given country. Inter-country differences in the absolute level of unit labour cost are extremely difficult to measure; the index does not show industry to industry variations, and, in any case, labour cost is only one of a number of influences on pricing and marketing decisions. In spite of these shortcomings, it seems that over the longer run the trend of unit wage cost is an important factor both in internal cost developments and in international competitiveness.

The most extreme change occurred, however, in *Germany*, with a fall of almost 8 per cent in unit wage cost through 1967, corresponding to a 1 per cent decrease year over year, contrasting with an average rise of about 3½ per cent in the 1960-66 period.

Unit wage cost in the *United Kingdom* declined during the period of the wage freeze, but this trend has subsequently been reversed. Thus, at the beginning of 1968, unit wage costs in sterling appear to have been about 3 per cent higher than two years earlier. In terms of foreign currencies, however, labour cost has been lowered by the devaluation, and at the beginning of 1968 it was almost back to the 1960 level.

MONETARY DEVELOPMENTS

Since the middle of last year the appropriate role for monetary policy in most countries has been unusually unequivocal, with little or no conflict between internal and external policy requirements. The deficit countries have generally been following restrictive monetary policies, while the emphasis in the surplus countries has been on the expansionary side. Recent events in France have, however, posed something of a dilemma for the monetary authorities.

The contribution of monetary policy to the achievement of external aims relating to international capital movements is discussed in a subsequent section. The following paragraphs consider how far monetary policy has contributed to the domestic objectives of restricting demand in the United States, the United Kingdom, Canada and Japan and to facilitating expansion in Germany, Italy and France. Particular attention is given to the two key countries in the 1968 policy context, namely, the United States and Germany, which, in different directions, are pursuing aggressive monetary policies. To some extent, monetary policy in both countries, and more particularly in the United States, has been required to carry too much of the burden of countercyclical policy.

UNITED STATES

Credit market prospects for 1968

The effect of monetary restraint on the volume of demand has been limited by last year's liquidity build-up in both the banking and non-bank sector. Moreover, in a situation in which the main demand pressures are coming from the public sector and consumption, monetary policy's influence on demand has been confined, primarily, to the effect that higher interest rates have on spending decisions. The prospects for 1968 as a whole are that business borrowing will be lower than last year, mainly because firms are in a very good position to meet their capital requirements given their existing liquidity position and higher profits. Household borrowing, as in 1966, will be reduced; consumer credit is likely to fall somewhat, and mortgages will certainly fall from the high rate reached in late 1967. Present indications are that even with the tax increase and expenditure cuts, Federal government financing requirements, though tending to decline, will not be much less in calendar 1968 than last year; credit market borrowing by State and local authorities may also show only a small decline.[1] Overall, on present expectations credit market borrowing by the private sector might fall by about $ 5 billion, and with the tax increase there should be a decline in total credit market borrowing from the unusually high figure of $ 83 billion recorded last year of roughly the same order of magnitude (see Table 17).

The Banking Sector

With a more expansionary monetary policy last year the banks proceeded to rebuild their liquidity, acquiring more than $ 18 billion of securities after the $ 1 billion decline in 1966 (see Table 18), thus

1. It may be noted that expenditure by State and local authorities was not markedly affected by the 1966 credit squeeze. See *OECD Economic Outlook*, No. 1, July 1967, page 19.

placing themselves in a strong position to cope with future tightness. A shift towards greater restraint was signalled last November by a rise in the Federal Reserve discount rate to 4½ per cent and by an increase in required reserves of about $ 550 million, effective in January 1968. The sharp fall in the gold stock and other market factors reducing bank liquidity were not fully offset by open market operations and free reserves declined by $ 700 million between November and May, bringing them nearly down to the position in the 1966 credit squeeze (see Table 19 and Chart G).

The decline in interest rates in late 1967 and early 1968 was temporary and resisted by the monetary authorities; the discount rate was raised in two steps to 5½ per cent on 18th April, and by mid-June all long-term interest rates were close to their previous peaks. The tighter policy has also been reflected in a slower growth of money supply from an annual rate of 7 per cent in the January-November period to a little over 4 per cent since then.

The banks are still in a good position, however, after last year's liquidity build-up, to satisfy business credit demand—which, unlike 1966, is moderate; even if monetary policy continues to be relatively tight through the remainder of the year, the banks will be able to satisfy loan demand by mobilising their reserves of secondary liquidity—i.e. by borrowing abroad and adjusting their portfolio purchases.

TABLE 17.
United States: Credit market borrowing[a] by non-financial sectors
$ billion, seasonally adjusted, annual rates

	1965	1966	1967	1966 II	1967 I	1967 II	1968 Q1[b]
Federal government	3.6	6.3	12.7	3.9	-6.6	31.9	31.2
State and local governments	7.8	6.8	10.5	6.5	11.1	9.7	9.3
Business	29.6	33.5	37.2	26.0	35.2	39.1	32.1
Households	28.7	21.7	18.8	19.4	14.9	22.6	24.1
Foreign sector	2.7	1.5	4.0	0.4	4.6	3.3	3.4
TOTAL	72.4	69.8	83.2	56.2	59.2	106.6	100.1
As per cent of GNP	10.6	9.4	10.6	7.5	7.7	13.3	12.1

a) Through securities and loans from financial intermediaries but excluding trade credit.
b) Preliminary.

The main impact is again being achieved through the effect of higher interest rates on the mortgage market.

The Housing Sector

Housing starts have levelled off since last autumn and there was a fairly sharp fall in May. Residential construction, however, continued to rise in the first quarter of the year and it seems clear that the impact of tight monetary conditions is going to be a good deal less marked than in 1966. In the second half of that year the volume of residential construction fell by 20 per cent as the supply of mortgages

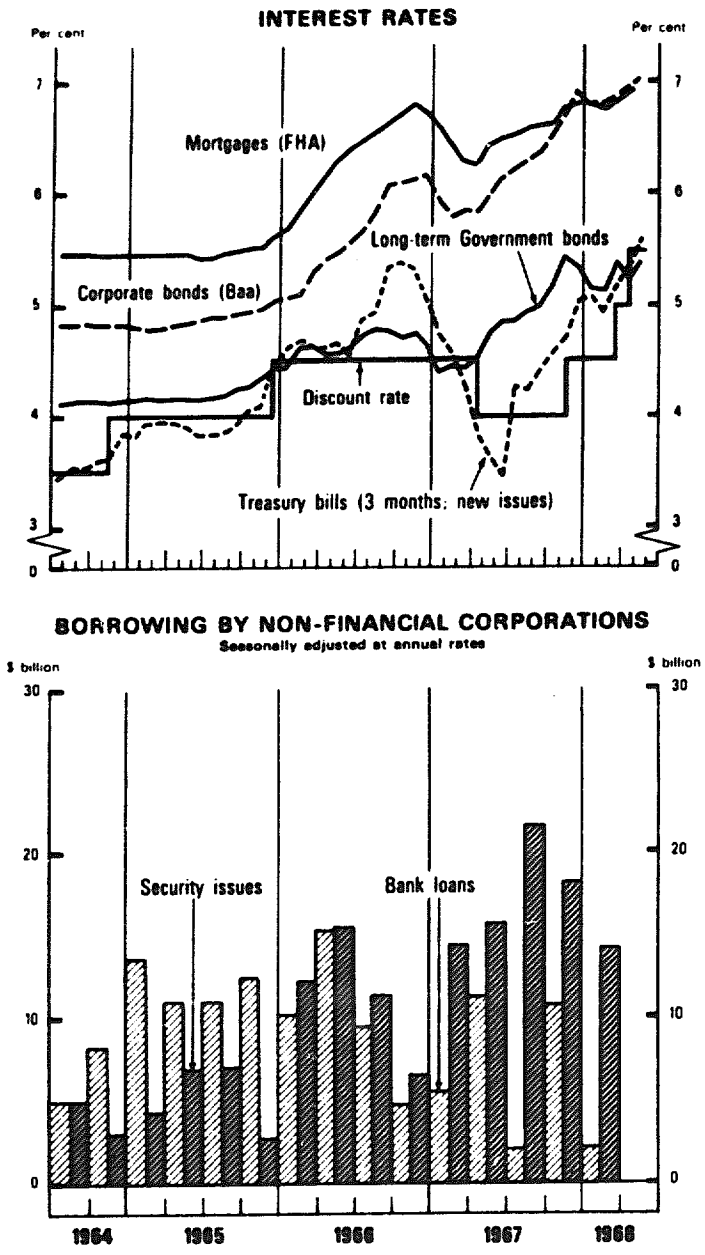
TABLE 18.
Commercial banks: Acquisition of credit market instruments
Seasonally adjusted, annual rates, $ billion

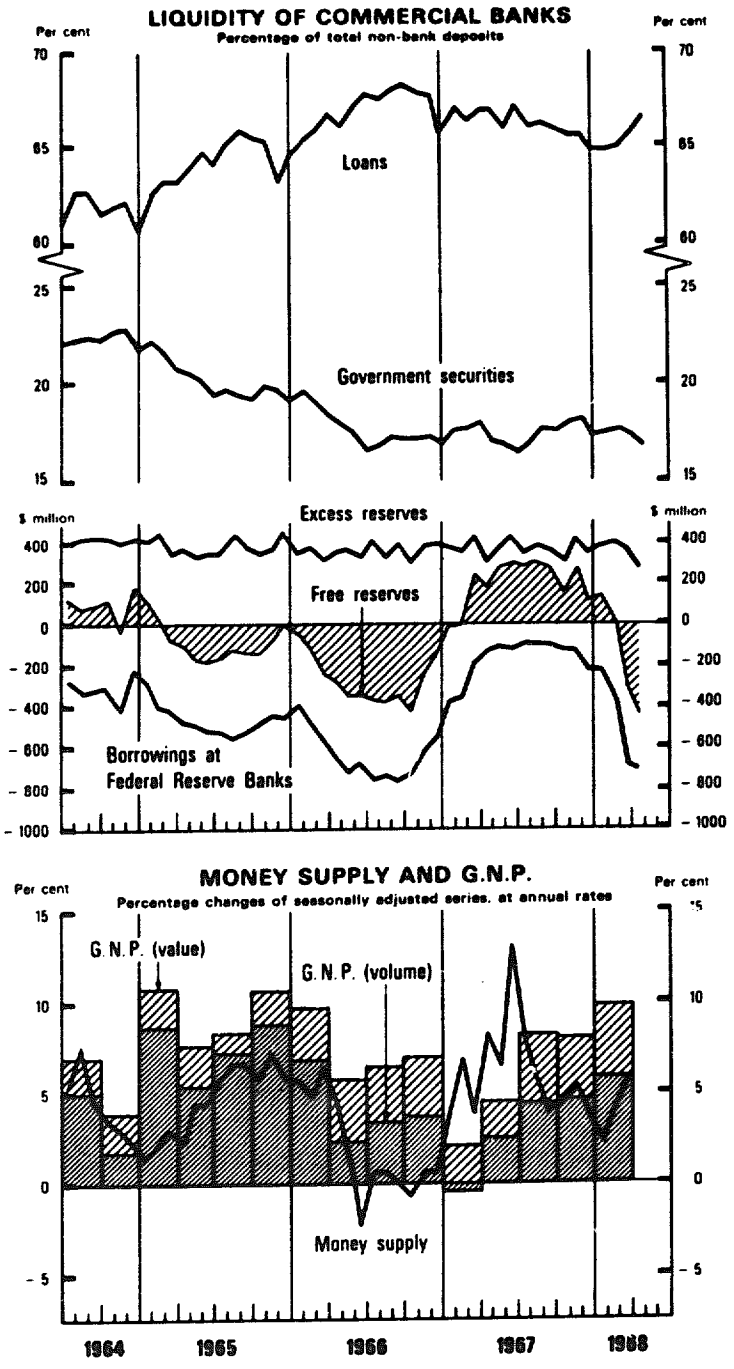
	1965	1966	1967	1966 Q1	1966 Q2	1966 Q3	1966 Q4	1967 Q1	1967 Q2	1967 Q3	1967 Q4	1968 Q1[a]
US Gov't securities	-2.3	-3.4	8.8	-2.7	-0.3	-5.7	-4.8	17.9	-0.3	23.6	-5.9	4.8
Other securities	5.0	2.5	9.8	2.9	7.6	-0.1	-0.7	9.5	14.4	4.8	10.3	5.9
Mortgages	5.6	4.7	4.6	5.4	5.4	4.3	3.6	2.0	3.5	6.0	6.7	5.6
Consumer credit	4.7	3.1	2.2	3.5	3.1	3.4	2.4	1.3	2.0	3.1	2.4	3.9
Bank loans	16.4	8.2	6.5	9.8	16.0	5.2	2.0	1.7	7.6	6.7	9.8	1.1
Other credit	-0.5	2.0	3.1	1.7	0.5	1.1	4.5	5.1	1.7	1.5	3.9	1.2
TOTAL	29.0	17.0	34.8	20.6	32.3	8.1	7.0	37.6	28.9	45.8	27.2	22.5
Free reserves (end of period) $ million	-2	-165	107	-246	-352	-368	-165	236	297	268	107	-315
Liquidity ratios												
Loans/deposits	64.4	65.7	64.9	66.8	67.8	68.1	65.7	66.8	67.1	65.7	64.9	65.5
Gov't. securities/deposits	19.0	16.9	17.2	18.2	16.7	17.1	16.9	17.8	16.3	17.4	17.2	17.2

a) Preliminary.

CHART G

UNITED STATES - MONETARY INDICATORS





from Savings and Loan Associations virtually dried up, because, given the impossibility of adjusting debtor rates on outstanding mortgages, they were unable to attract deposits at the prevailing interest rates (see Table 20).

Following this experience, various measures have been taken to alleviate the pressure on the housing industry resulting from tight monetary conditions. Thus, to improve the flow of residential mortgage funds, upward adjustments were made early this spring by some states with low interest ceilings on conventional mortgages. Also, Congress temporarily suspended the statutory contract rate ceiling of 6 per cent on Government-underwritten home mortgages, and the FNMA shifted its secondary market operations to a weekly auction system, through which yields for eligible mortgages are determined by market forces. In addition, the Home Loan Banks are better equipped than in 1966 to act as a buffer against credit stringency, having built up their liquid assets in the course of 1967. The Savings and Loan Associations managed in the course of last year to build up their reserves of cash and government securities to nearly $ 13 billion in

March 1968 from $ 10 billion in September 1966 and, simultaneously to work down their debt to the Home Loan Banks to $ 4.3 billion in March 1968 from a peak of $ 7.3 billion in July 1966.

The Business Sector

As already noted, the banks are in a good position to satisfy business credit demand. In addition, there is considerable scope for firms to shield themselves from credit restraint in the short run by resorting to internal financing, relying on their cash flow, and the drawing down of previously accumulated liquid assets as occurred in the second half of 1966. Higher sales have substantially improved corporate cash flows, with corporate profits running at a seasonally adjusted annual rate of $ 89 billion in the first quarter. Corporations borrowed heavily in the long-term market in 1967 to consolidate short-term debts and to improve their liquidity by acquiring short-term assets (see Table 21). As these needs diminished towards the end of last year, capital market borrowing by corporations declined and in the first quarter of 1968 it accounted for the smallest proportion of total corporate funds since late 1966. The smaller recourse to domestic markets in early 1968 probably also reflected government restrictions on transfers of capital abroad and the consequently large volume of securities sold in foreign markets. However, towards mid-year domestic capital market financing appears to have stepped up again.

The preceding analysis suggests that monetary policy by itself probably could not have produced a sufficient cooling off in the economy unless it had been pushed to the point where severe financial strains and imbalance would have been inevitable. It is therefore fortunate that fiscal action has been taken. This will, however, take some time to become fully effective; in the meanwhile, given the present inflationary climate, monetary policy will have an important supporting role to play in checking any unforeseen surge in business investment demand or undue drop in the personal savings ratio. External considerations would also point to a cautious approach to any relaxation of monetary restraint, with the emphasis more on selective action to ease pressures on hard-hit sectors, e.g. housing, rather than any significant general lowering of the whole structure of interest rates.

TABLE 19.
United States: Factors affecting bank liquidity
$ billion

	Jan.-Sept. 1966	Oct. 66-May 67	Jun-Oct. 1967	Nov. 67-May 68
1. Change in gold stock	-0.5	-0.1	-0.1	-2.6
2. Increase in note circulation	-0.4	-1.3	-1.0	-1.7
3. Other market factors[a]	-0.4	-1.8	-0.3	0.6
4. Total market factors	-1.3	-3.2	-1.4	-3.7
5. Open market operations	1.6	3.2	1.3	3.5
6. Changes in reserve requirements	-0.9	0.9	0.0	-0.5
7. Total policy factors	0.7	4.1	1.3	3.0
8. Change in free reserves (4 + 7)	-0.6	0.9	-0.1	-0.7

a) Mainly government transactions and changes in required reserves resulting from changes in level and composition of deposits.

TABLE 20.
United States: Financing of residential construction
$ billion, seasonally adjusted, annual rates

	1965 I	1965 II	1966 I	1966 II	1967 I	1967 II	1968 Q1[a]
Residential construction by:							
Households	18.9	20.2	19.3	17.4	14.5	17.6	20.2
Other	8.2	6.8	7.1	4.9	7.7	9.0	8.1
TOTAL	27.1	26.8	26.4	22.3	22.2	26.6	28.3
Financed by:							
Mortgages from savings and loan associations	9.1	8.6	6.8	0.8	5.4	9.8	7.8
Other	18.0	18.2	19.6	21.5	16.8	16.8	20.5
TOTAL	27.1	26.8	26.4	22.3	22.2	26.6	28.3

a) Preliminary.

TABLE 21.
United States: Sources and uses of funds in the non-financial business sector
$ billion seasonally adjusted, annual rates

	1965	1966	1967	1966 I	1966 II	1967 I	1967 II	1968 Q1[a]
Capital expenditures	83.4	94.2	90.9	92.0	96.5	88.2	93.6	94.1
Acquisition of financial assets	24.5	19.7	18.7	25.9	13.6	10.3	27.0	25.6
Total uses (= total sources)	107.9	113.9	109.6	117.9	110.1	98.5	120.6	119.7
Internal funds	71.0	76.3	76.6	74.7	77.8	75.2	78.0	79.1
Credit market borrowing	29.6	33.5	37.2	41.0	26.0	35.2	39.1	32.1
Bank loans	12.2	9.9	7.4	12.6	7.1	8.4	6.4	2.2
Securities	5.4	11.4	17.4	13.8	8.9	15.0	19.7	14.1
Other	12.0	12.2	12.4	14.6	10.0	11.8	13.0	15.8
Other liabilities[b]	7.3	4.1	-4.2	2.2	6.3	-11.9	3.5	8.5

a) Preliminary.
b) Including statistical discrepancy.

GERMANY

The German authorities have continued the policy of active monetary ease adopted towards the end of 1966. The recovery, which started last autumn with a steep rise in investment in machinery and equipment and a reversal of the inventory cycle, was primarily the result of impulses emanating from the Federal investment programme, combined with a favourable profits picture. But the ready availability of credit and its reduced cost played an important supporting role in promoting the better investment climate.

The revival of economic activity has been reflected in a buoyant demand for credit, the most notable feature being a DM 8 billion increase in borrowing by the private sector between the first and second halves of 1967. Bank lending to the domestic non-financial sector picked up sharply towards the end of last year, a large part of it probably reflecting stock accumulation. Public sector borrowing also showed some increase in the second half of 1967. There was a swing in total credit market borrowing, public and private, of over DM 11 billion between the two half-years, an increase of 63 per cent (see Table 22).

In addition to massive reductions in minimum reserve requirements, amounting to about DM 6 billion between January and September 1967, the Bundesbank has subsequently initiated open-market purchases of long-term bonds, amounting to DM 1.3 billion in the second half of last year, or nearly 7 per cent of total sales on the domestic market in that period (see Table 23). As a result of these and other factors, bank liquidity has been added to on a substantial scale, the ratio of secondary liquid assets to deposits reaching 8.8 per cent at the end of January 1968 against 4.9 per cent a year earlier. Of the DM 7.2 billion increase in the banks' net liquidity position last year, DM 1.6 billion was used to repay central bank debt and DM 2.1 billion was invested in domestic liquid assets; but the largest part, DM 3.5 billion, took the form of foreign liquid assets. Bank liquidity did not show much change in the first four months of 1968 and the continued investment by the banks in foreign liquid assets led to a decline in their domestic liquidity in the same period.

The expansionary monetary policy has been reflected in a sharp drop in short-term interest rates, the call money rate averaging 2.6 per cent between mid-March and mid-April, or still well below the 3 per cent discount rate (see Chart H). Long-term rates, after their decline through 1967 and a slight upturn in February-March, fell further in April and May. Given the ease of monetary policy, an even greater decline could perhaps have been expected. Among

TABLE 22.
Germany: Total borrowing by domestic non-financial sectors
DM billion

	1965 I	1965 II	1966 I	1966 II	1967 I	1967 II[a]
Public Sector	2.9	5.6	1.3	7.4	5.5	8.8
Business	18.2	14.9	15.1	8.9	5.8	11.7
Residential construction	6.8	9.6	7.1	9.1	6.4	7.3
Households	0.1	1.0	0.4	0.2	–	0.9
TOTAL	28.0	31.3	24.2	25.5	17.6	28.7

a) Figures for 1967 II provisional.

TABLE 23.
Germany: Factors determining bank liquidity
DM billion

	1965 I	1965 II	1966 I	1966 II	1967 I	1967 II	1968 Jan.-Apr.
Market Factors[a]	–1.85	–2.53	–2.09	1.84	0.16	0.60	–0.14
Policy Factors[b]	–0.28	1.00	–1.00	1.01	2.27	4.16	–0.14
Central bank credit	1.30	0.34	2.61	–1.85	0.85	–2.43	0.31
Change in liquidity	–0.83	–1,19	–0.48	1.00	3.28	2.32	0.03
Invested in:							
Domestic liquid assets	–0.96	–0.91	–0.44	0.08	1.14	0.95	–0.67
Liquid assets abroad	0.13	–0.28	–0.04	0.92	2.14	1.37	0.70

a) Foreign transactions, change in note circulation, government transactions and change in required reserves resulting from changes in deposits.
b) Open market operations and changes in minimum reserve requirements.

TABLE 24.
Germany: Sales and purchases of securities
DM billion

	1966 I	1966 II	1966 Total	1967 I	1967 II	1967 Total
Net new issues of domestic securities (issue prices)	4.1	3.6	7.7	7.9	9.0	16.9
of which:						
Shares	1.6	1.1	2.7	0.9	1.0	1.9
Bonds	2.5	2.5	5.0	7.0	8.0	15.0
Net purchases of foreign securities by residents	0.3	0.4	0.7	0.8	1.4	2.2
Total sales on the domestic market	4.4	4.0	8.4	8.7	10.4	19.1
of which bought by:						
Bundesbank	–	–	–	–	1.3	1.3
Banks	0.8	0.8	1.6	5.5	6.0	11.5
Non-banks	3.6	3.1	6.7	3.2	3.1	6.3

the limiting factors has been sales of German bonds by foreign holders because yields, after deducting the 25 per cent withholding tax, fell below rates in the Euro-bond market. Moreover, past experience, and recent developments abroad, have induced a cautious attitude among German investors, and market expectations appear to have been preponderantly on the side of further upward pressure on interest rates, checked only by strong monetary ease. As a result, domestic investors outside the banking system have, until recently, been hesitant in purchasing long-term assets, still bearing in mind the large book losses suffered in 1965 and 1966 when the prices of outstanding bonds suffered drastic reductions. Throughout the whole recession period, investment in liquid assets has remained more attractive to the public, total non-bank liquidity rising by nearly 14 per cent last year.

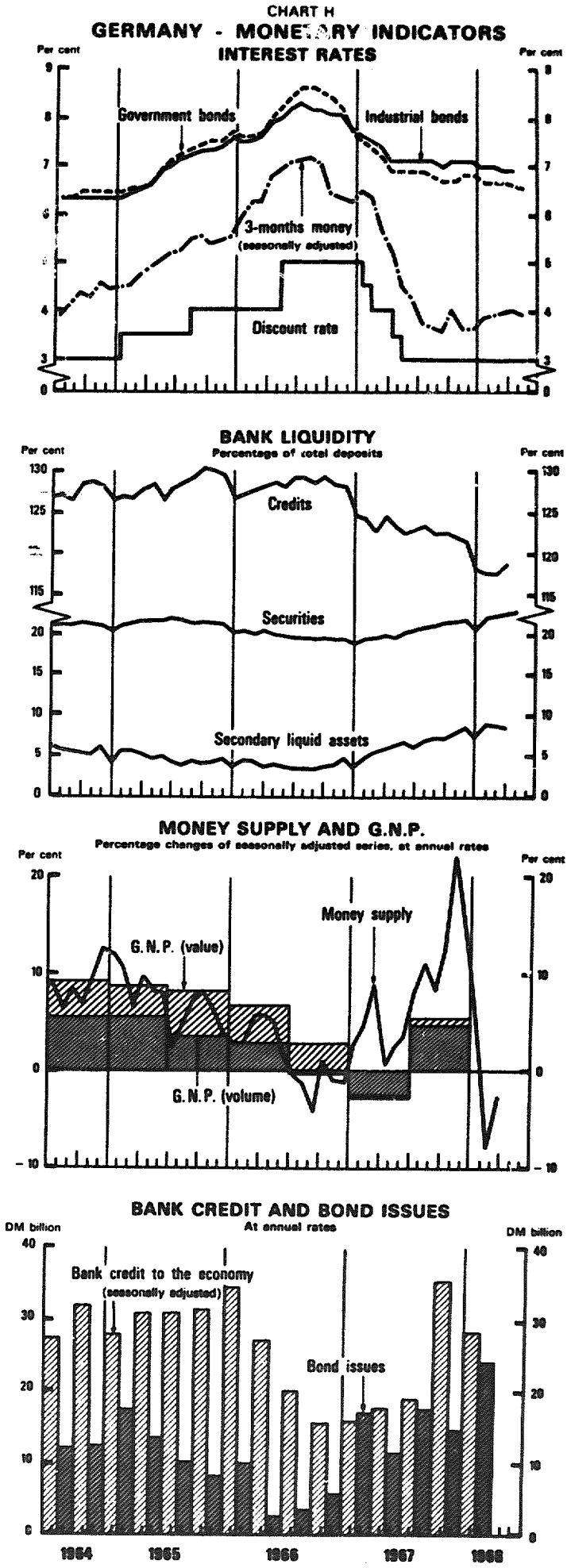
Strong demand by borrowers for long-term funds has necessitated a continued rationing of public authority access to the capital market. Net new borrowing in the security markets reached a new record level in 1967, the bulk of the new issues coming from the public authorities and the banks, the latter floating issues of mortgage and communal bonds in very large amounts (see Table 24). The largest part of total security sales, DM 11.5 billion, was taken up by the commercial banks, primarily reflecting the easy policy pursued by the Bundesbank which allowed the banks to add substantially to their earning assets at a time when loan demand remained moderate.

Monetary ease should continue to facilitate credit market borrowing through 1968. The Federal government deficit will probably not change much. Spending by the Länder and local authorities should have been relatively high in the first half but may not rise much in the second, given the high indebtedness of most communes. [1]

Private credit demand has been reviving; in the first half of the year borrowing to finance inventory accumulation has probably been high. Business fixed investment expenditure is also rising, but since internal cash flows should remain adequate, the total upswing in private borrowing may remain moderate.

Should the present expansion—which comes primarily from a revival in public and private fixed

1. For a discussion of local authority finance in Germany see OECD *Economic Outlook*, No. 1, July 1967, page 19.



investment and a swing in inventories, with consumer demand lagging—slow down to an undesirable extent in the coming months, monetary policy could probably not provide much of a boost. Resort to fiscal stimulus would be necessary. But the continuation of monetary ease is highly desirable on balance of payments grounds to ensure that the continuing abnormally large current surplus is covered as far as possible by capital outflows.

The extent of the monetary ease encouraged by the authorities since the end of 1966 has raised fears in some quarters that the high rate of liquidity creation will constitute an inflationary danger when the economy returns to more normal rates of capacity utilisation. It is probably true that had budgetary policy become sufficiently expansionary at an earlier date, there would have been less need, on domestic grounds, for so drastic a switch in monetary policy. And if fiscal policy had been more successful in moderating the scale of the recession, the current surplus would have been smaller and there would have been less need, on external grounds, to stimulate so large a capital outflow. But with large margins of unused resources remaining, consumer demand hesitant and the continued advance of productive investment therefore uncertain, concern about excess liquidity may be premature. It may well still take one or two years to take up the remaining slack in the economy, and this should provide ample time for excess liquidity to be mopped up. The more immediate concern would seem to be to ensure that the recovery is not in any way impeded by lack of credit availability or rising interest rates.

Other Major Countries

The following paragraphs discuss, more briefly, monetary policies in Japan, Canada, the United Kingdom, Italy and France.

Monetary policy in Japan was tightened in the course of 1967 to bring the excessive rate of economic expansion under control. Bank rate was raised in September and again in January, by 0.365 per cent each time, to reach 6.21 per cent. The main weapon used by the authorities, known as " window guidance ", is effectively a system of direct quantitative control over bank lending. Thus, in the first quarter of this year banks were requested to limit their credit expansion to 71 per cent of that recorded a year earlier, and a ceiling of 78 per cent (which, in fact, entailed no relaxation) was set for the second quarter. At first the economy seemed to be responding less rapidly than in the past to this form of monetary restraint, possibly because the enterprise sector has been strengthening its liquidity position. But from January onwards the pace of industrial activity has slackened, probably reflecting primarily the onset of an inventory adjustment, and there has been evidence of a downward adjustment in fixed investment plans.

The Japanese authorities are relying on monetary policy to steer the economy through the present phase of adjustment. In part, this is because it has only proved possible to achieve a modest tightening of fiscal policy. Since the main factor behind the excessive rate of expansion was the extremely vigorous and, in the longer run, unsustainable business investment boom, reliance on monetary policy may not be inappropriate. But problems may arise, as in 1965, when the time comes to steady the economy and gradually move into a renewed expansion. There may be some risk that the downturn of investment will become too sharp and slow to reverse.

In Canada monetary policy began to be tightened last autumn. At first this was primarily for internal reasons, but in the closing months of 1967 and early 1968 external events clearly required monetary restraint. Thus, having been raised to 7 per cent in January in response to strong exchange pressures, the bank rate was further increased to 7½ per cent in March, following the rise in the United States discount rate. With policy tightening, monetary expansion has slowed down markedly; in the six months following last November non-bank liquidity grew by only 1 per cent, seasonally adjusted, and the rise in interest rates accelerated, especially at the shorter end of the market. By mid-May the yield on 3-month Treasury bills was close to 7 per cent, compared to 5 per cent in early November and long-term government bonds rose from 6.3 to 6.9 per cent in the same period. After this rates declined and in early July the bank rate was reduced to 7 per cent. Although the resurgence of economic activity is likely to prove less marked in Canada than in the United States, there is likely to be little scope for easing monetary policy in the near future so long as considerable tightness prevails south of the border.

Moreover, continued restraint would also seem appropriate on internal grounds, given the priority that needs to be given to restoration of better cost/price stability.

In the UNITED KINGDOM monetary policy was expected to play its part in restraining domestic demand pressures during the period between the devaluation and the March budget. The bank rate was raised to 8 per cent and the banks were required to regard their mid-November lending totals as their upward limit " for most purposes and in the aggregate ". Lending for all non-priority purposes was restricted, particularly credit associated with imports of manufactured goods, the new ceiling applying to all lending outside the public sector except lending identified with financing of exports.

Although these restrictions may have somewhat moderated the private credit boom that started after mid-1967, aggregate bank loans continued, in fact, to rise quite sharply in early 1968; clearing banks' advances exceeded the £5 billion mark by mid-April and continued to rise in the following month. It is possible that the £225 million increase between 15th November and mid-May took place largely in loan categories outside the ceiling, but it is evident that some slippage is unavoidable in any programme not applying equally to all types of lending. In the United Kingdom there is also a high degree of substitutability between different kinds of credit and the recent credit expansion may, at least indirectly, have helped to finance the very strong upturn of domestic demand since the later months of 1967. Consequently, the Bank of England further tightened its restrictions on bank lending in late May, setting a new 104 per cent ceiling in terms of last November, roughly the mid-May level, and now including loans for export. The banks are asked to continue giving priority to lending for export transactions, but must make room for such lending within the new ceiling by curtailing lending to persons and for other non-priority purposes. In the first month after these new measures were introduced bank advances fell back sharply to roughly 103 per cent of the mid-November level.

With tighter credit and rising interest rates in the United States and the Euro-dollar market, United Kingdom rates remained high in early 1968. There was some decline in short-term rates in March when the bank rate was reduced to 7½ per cent, but there seems little prospect of any further easing in view of current monetary tightness in the United States and international markets.

In ITALY credit demand has remained strong, in line with the continued rapid growth of the Italian economy. In the absence of serious demand pressures the authorities have maintained an essentially easy monetary policy. The improvement in the budget, implying smaller financing needs, has helped keep rates down, but towards the end of 1967 and early this year there was some upward pressure, influenced by conditions in international financial markets.

Monetary policy in FRANCE became somewhat more expansionary after mid-1967, resulting in an eased liquidity position of the banks and an acceleration in the growth of non-bank liquidity. Over the year as a whole, the latter rose by 11.7 per cent against 9.6 per cent in 1966. Despite a somewhat weaker trend of economic activity last year, bank credit grew by 17.5 per cent, compared with 14.9 per cent in 1966.

The relative monetary ease was not, however, sufficient to bring about a reduction in interest rates. Short-term rates rose during the second half of last year, with the call money rate reaching 5 per cent in December, and varying around this level up to the end of April. Long-term yields moved around the levels reached in 1966, some decline in the spring being later wiped out and a further rise taking place in early 1968.

The events of May/June have posed something of a dilemma for the French monetary authorities. The loss of confidence set off substantial capital outflows and led to the reimposition of exchange controls; by mid-June the call money rate had risen to 5¾ per cent, and in early July the official discount rate was raised from 3½ to 5 per cent. Given, however, the substantial margin of unused resources and the uncertain outlook for private investment, the domestic situation seems to call for the continuation of easy monetary conditions, despite the large increases in wages and other benefits. A relatively easy monetary policy is, in fact, a pre-condition for turning these income injections into real output, continued ease being particularly important to overcome temporary financing problems of the enterprise sector in the face of rising costs,

thus reducing the temptation to raise prices. Recognising this, the authorities acted at the end of June to increase bank liquidity both by raising the discount limit and by alleviating reserve requirements. It may be necessary to continue policy along these lines for quite some time to come, although, as and when it becomes clear that the economy has been lifted onto a higher growth path, a gradual tightening of policy to mop up excess liquidity would be appropriate. In the meanwhile, the authorities will, no doubt, wish to relax and remove exchange controls as soon as possible, and may find it desirable to use selective monetary measures to restrain capital outflows through the banking system.

INTERNATIONAL CAPITAL MOVEMENTS

Over the last twelve months, international capital movements have been strongly influenced by speculative factors; repeated attacks against sterling both before and after the devaluation, short-lived speculation against the Swedish krona and the Canadian dollar, massive private gold purchases from September until the suspension of sales by the Gold Pool countries in mid-March, and more recently large outflows of funds from France. At the same time the pattern of international capital movements has continued to be influenced by more normal cyclical factors, particularly the continuing monetary ease in Germany and the significant tightening in the United States. With these powerful and often conflicting cross-currents, it is difficult to assess whether any underlying readjustment of capital flows between the United States and other major financial centres has been under way. But in an attempt to throw some light on this issue, the latter part of this section takes a look at the longer run trends in some of the components of OECD countries' capital accounts over the 1960s.

Speculative Capital Flows and Gold Purchases

The early-1967 revival of confidence in sterling was short-lived. The United Kingdom's basic balance of payments position weakened in the second quarter and, as monetary conditions in the United States started tightening once more, funds began to move again across the Atlantic, repeating the see-saw movement which has been a familiar feature over the last few years (Chart I). Aggravated by events in the Middle East, a speculative attack built up on the pound through the summer and early autumn. United Kingdom short-term interest rates were maintained at extremely high levels, but, with confidence lacking, the covered interest differential moved against sterling and there were substantial net outflows of banking funds, mainly sterling, but also on foreign currency account. The pressure eased in October, but in November, despite very large official intervention in the spot and forward markets, the existing parity proved untenable.

The first bout of heavy speculation in gold followed hard on the heels of the devaluation of the pound, as fears about the dollar began to mount. Over the fourth quarter as a whole, the drain from official gold stocks, mainly concentrated in early December, amounted to $ 1.4 billion. The foreign exchange and gold markets then became somewhat calmer, largely because of the new United States' balance of payments programme and the improvement in the United Kingdom's trade balance after the dock strikes, and speculation subsided until about the end of February. But confidence in the reserve currencies weakened again in early March, with another flight into gold, the decline in official stocks over the first quarter as a whole again totalling $ 1.4 billion.

The precise nature of the impact of these large gold sales on OECD countries' balance of payments, and its mechanism, is not easy to analyse (see inset). But, generally speaking, such transactions tend eventually to have their greatest effect on those countries whose exchange position is weakest, and

the runs on gold appear to have led to a marked reduction in short-term capital flows to the two reserve currency countries. In the three years through the third quarter of last year the combined inflow of certain forms of short term capital had run at an average annual rate of $ 1.4 billion (see Chart I). Moreover, with monetary conditions in Western Europe, particularly in Germany, easing sharply relative to those in the reserve countries, it had moved from $ 0.4 billion in the six months ended March 1966 to a plateau of about $ 2 billion a year. In the last six months, these influences should have worked even more strongly in the reserve countries' favour; but the net inflow of such funds fell almost to zero. The burden of this decline appears to have fallen on the United Kingdom, where the net outflow of banking and short-term non-monetary capital and unrecorded transactions amounted to $ 1.3 billion. In the United States, by contrast, the growth of private dollar balances was only a little less than in the preceding six months. (It may, however, be significant that while the inflow from foreign branches of United States banks accelerated to meet the growing pressure on head offices' liquidity, the build-up by other holders slowed down quite sharply.)

It is not yet possible to obtain a clear view of the effects of the gold crisis on the other OECD countries' balances of payments. But it is apparent that gold hoarding was accompanied by substantial switching into Continental European currencies in both the fourth and first quarters. Despite continued monetary ease in Europe and intensive Central Bank operations around the turn of the year, the EEC countries and Switzerland recorded only approximate balance on banking account in the six months ended March 1968, in contrast with an outflow of $ 0.6 billion a year previously. But the total net supply of banking funds by major non-reserve countries was little changed because of a substantial net outflow from Canada in the most recent period, despite the growing tightness of Canadian monetary conditions since the autumn of 1967. (The first few weeks of 1968 saw a large net outflow of short-term monetary and non-monetary capital because of fears that Canada would be disproportionately affected by the United States balance of payments programme, fears which were only dispelled when Canada was excluded from most aspects of the programme in early March.)

The suspension of gold sales by the Gold Pool countries on 15th March and the United Kingdom budget announced on 19th March led to something of a watershed in April. Funds began to move out of the Common Market countries and into Canada; while pressure on sterling fell sharply. It therefore seemed that movements of short-term funds were returning to a pattern more in line with underlying monetary and cyclical developments. In May and June the markets were again perturbed by the French

THE IMPACT OF GOLD HOARDING

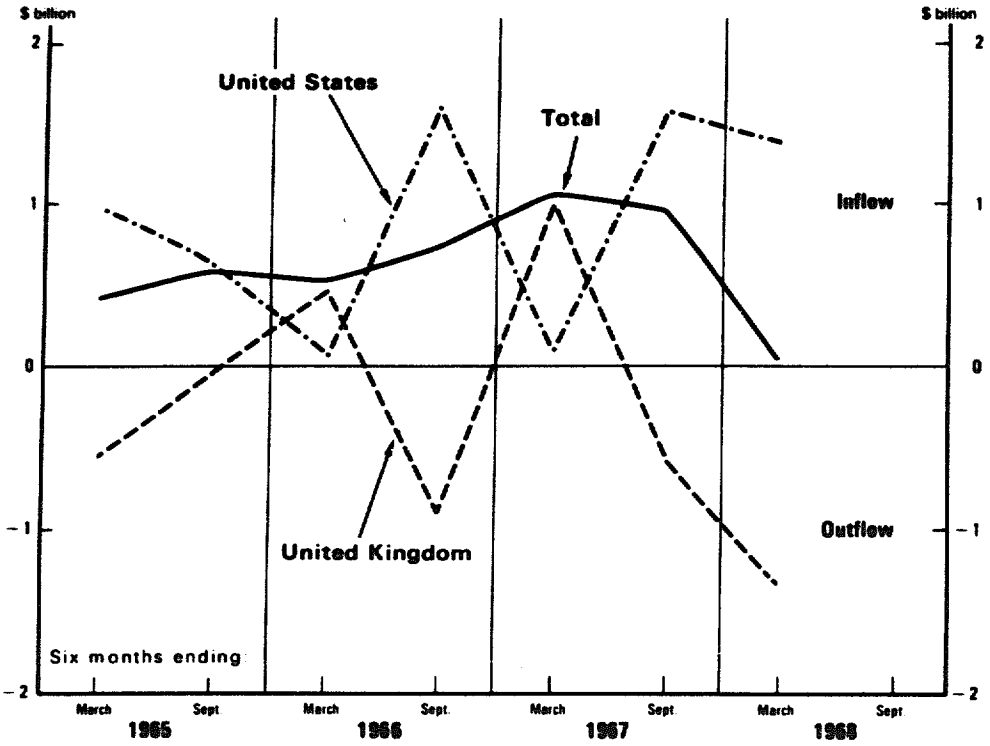
The dual nature of gold—as a commodity and a financial asset—entails that upon entering the sphere of official monetary transactions it gives rise to an excess of claims over liabilities, which is destroyed when gold is withdrawn from official holdings. Consequently, when purchases of gold by private holders exceed the supply of newly-mined gold (or, for non-Communist countries, newly-mined gold plus net Sino-Soviet sales), the balances on official settlements of all countries taken together add to a net deficit (while in previous years, when gold was being added to official stocks, the net sum was a surplus). Where the counterpart of this deficit will appear depends on the recording convention adopted: if, as in the IMF Balance of Payments Manual, gold held outside the official sector is treated as a commodity, a sale by official to private holders should show up as an import of goods; if it were recorded as an increase in the net financial assets of the private sector, it would show up as an export of capital. In practice, however, transactions in gold involving the private sector tend almost entirely to escape recording (in particular, when they do not involve a physical movement from one country to another) and are therefore subsumed under the "unrecorded transactions" item of the balance of payments, which in the summary presentation adopted by the OECD is combined with the capital account.

In the simplest case it would be the countries whose citizens were making the gold purchases whose balance of payements would stand to be adversely affected. This presupposes that they make use of their own currency, converting it into dollars (the currency used for settlement in the free market), to make the purchase. In practice, however, both banks and individuals hold large balances of foreign currencies (particularly dollars and sterling) which can be used instead of domestic currency to finance gold purchases, the choice of the currencies used depending on confidence factors, arbitrage considerations, etc. The adverse impact may in this way be shifted to other countries.

The dollars acquired by the Bank of England against gold sales were subsequently exchanged for gold with the other Central Banks participating in the Gold Pool according to the existing quota arrangements. Thus, other things being equal, a country with a share in the Gold Pool greater than the amount of its currency used directly or indirectly to buy gold would have seen its dollar holdings rise (or, in the case of the United States, its official liabilities fall) by that much more than the decline in its gold holdings—and vice versa.

CHART I

SELECTED SHORT-TERM CAPITAL FLOWS AND THE GOLD CRISIS



In recent years there have been contrasting swings in certain types of short-term capital movements in the United States and in the United Kingdom. In the latest period, the sum of these movements appears to have been sharply affected by the gold crisis.

Total

United States short-term liabilities to non official holders, including Certificates of Deposit

United Kingdom net banking and non-monetary short-term capital movements. The latter are adjusted for special transactions and in the most recent period include the exchange adjustment on predevaluation forward contracts entered into by the Bank of England. As these mature, the decline in liabilities converted at the new rate of exchange would be less than the cost of settlement at the rates of exchange (based on the old parity) fixed by the original forward contract. An adjustment is therefore required to cover the total outflow of funds

The particular items in the reserve countries' balances of payments shown here are, of course, not the only ones influenced by arbitrage or confidence considerations; but they serve to illustrate the close interdependence of the two reserve currency countries.

The causal relationships linking shifts in these short-term capital balances of the two countries are not always directly evident. In particular, they may be obscured by the fact that the large changes in the United Kingdom have taken the form predominantly of inflows or outflows of sterling balances, with changes in the balancing item also significant in some periods; while net movements in the banks' foreign currency position have been of less importance. But changes in the relative yields on short-term investment in London and New York, and in the state of confidence, will lead to " switching " between holding sterling in the former and holding dollars in the latter; and it is reasonable to suppose that the same factors will also affect the building-up or running-down of recorded trade credits or unrecorded " leads and lags " in the United Kingdom. On the other hand, changes in the net foreign exchange position of banks operating in London will be dampened by the fact that they act as a " channel " for the investment of Euro-dollar funds by residents of other countries—and that the United Kingdom authorities impose limits on their building-up of a net asset position.

It is difficult to quantify the factors which may have determined the level of the combined inflow into the two countries. In a general way it is probably related to the size of their overall deficit on other transactions and also to any underlying secular tendency for private holders to build up gradually balances of currencies habitually used in international settlements. But clearly the inflow into either country taken separately will be affected by changes in monetary conditions and confidence factors in each reserve centre relative to the other, and the combined inflow into the two countries together will be affected by changes in their monetary conditions relative to those in other important centres. Moreover, in recent periods it is likely to have been modified in favour of the reserve countries by concerted Central Bank efforts to smooth out short-term fluctuations in the foreign exchange markets.

crisis. But although a large part of the money leaving France may have gone in the first instance to neighbouring countries, the net outflow of funds from continental European countries as a group also appears to have increased substantially: over the second quarter as a whole the EEC countries and Switzerland together recorded a decline of $ 0.6 billion in their official reserves and net IMF position. The main beneficiary of this outflow was the United States, where the build-up of private dollar balances appears to have somewhat exceeded $ 1 billion (seasonally adjusted), swinging the capital account as a whole into surplus. But the difficulties for the French franc brought renewed pressure on the pound sterling: this, however, eased after the announcement on 8th July of progress towards new

TABLE 25.
Total capital[a] flows 1966-1967
$ billion

	1966	1967	1966 I	1966 II	1967 I	1967 II
United States	-2.18	-4.80	-1.44	-0.75	-3.29	-1.51
United Kingdom	-1.40	0.20	-0.25	-1.15	1.70	-1.49
Reserve currency countries	-3.59	-4.60	-1.69	-1.90	-1.59	-3.00
Canada	0.75	0.40	0.48	0.27	0.43	-0.03
Japan	-1.32	0.12	-0.30	-1.03	0.34	-0.22
France[b]	0.03	0.25	0.04	0.0	-0.07	0.33
Germany	0.54	-2.30	0.37	0.17	-1.40	-0.90
Italy	-1.85	-1.17	-0.80	-1.05	-0.58	-0.59
TOTAL EEC	-0.90	-2.90	-0.10	-0.80	-1.87	-1.03
Other OECD	1.85	1.49	0.74	1.11	0.79	0.70
TOTAL OECD	-3.20	-5.49	-0.86	-2.34	-1.89	-3.59

a) Including banking funds and unrecorded transactions.
b) Transactions with non-franc countries.

arrangements for offsetting fluctuations in the sterling balances of sterling area countries.

Total Capital Flows

The apparent net capital outflow in all forms (including unrecorded transactions) from the OECD area jumped from $ 3.2 billion in 1966 to $ 5.5 billion in 1967 (Table 25). In practice, however, the available evidence suggests that this was largely due to gold speculation and that there was probably only a fairly modest rise in the genuine capital outflow.[1] Thus, the apparent capital outflow was particularly high in the second half of 1967 ($ 3.6 billion against $ 2.3 billion a year earlier); yet, despite the fact that at the same time the OECD area's current surplus with the rest of the world was falling quite sharply (see Chart L), there is nothing in the official reserve movements recorded by non-OECD countries to suggest that such an increase did in fact take place (Table 7).

1. The fact that the apparent capital outflow rose by as much as $ 2.3 billion appears to indicate that the major part of the adverse impact of gold speculation fell on the balance of payments of OECD countries. This does not necessarily mean that there may not have been substantial private gold purchases by non-OECD countries. It does suggest, however, that if such purchases were substantial they tended to be financed directly or indirectly out of existing holdings of OECD currencies (probably mainly dollars and sterling) rather than by conversion of non-OECD currencies into dollars.

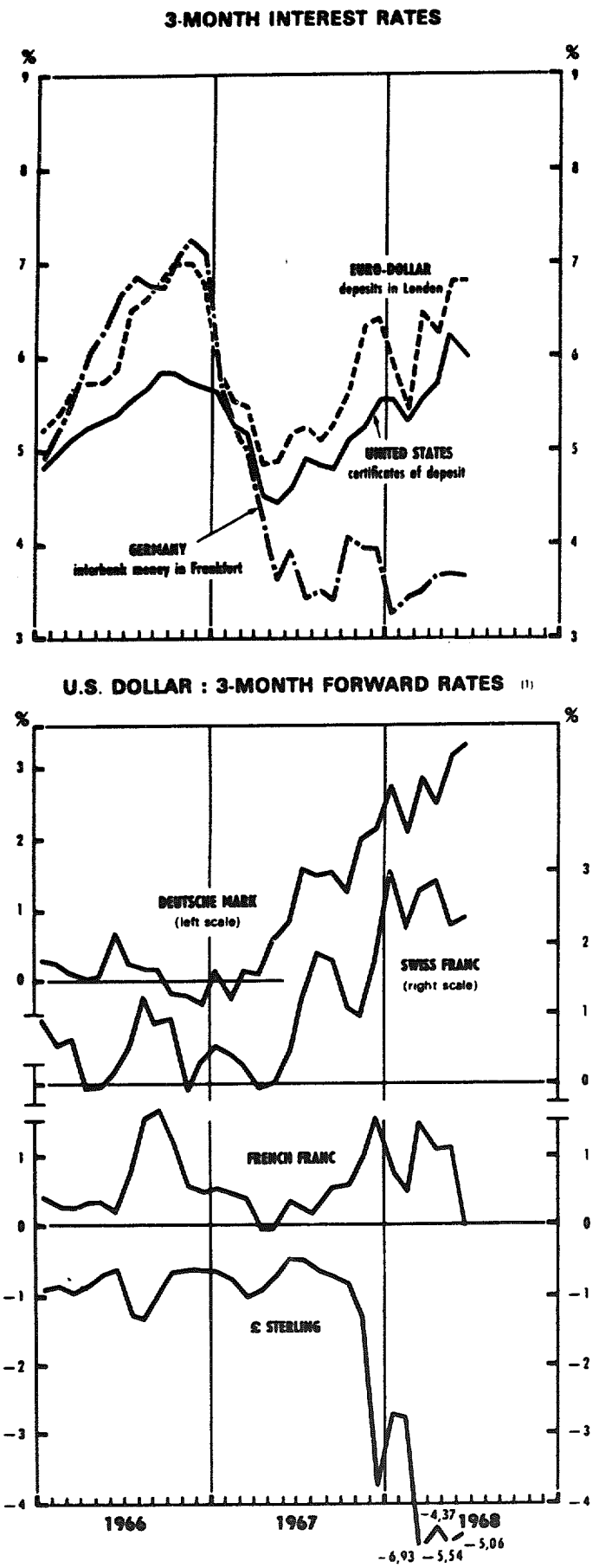
Cyclical Capital Movements

While the cyclical component of international capital movements can hardly be quantified with any degree of accuracy, there is little doubt that, as in earlier years, capital flows have owed much to the waxing and waning of relative monetary tensions, which were a corollary of different cyclical developments in the major OECD countries. In this respect the international scene was dominated by the change in German monetary policy towards aggressive ease from the beginning of 1967 and the gradual shift towards a restrictive monetary policy in the United States from mid-1967 onwards (see Chart J).

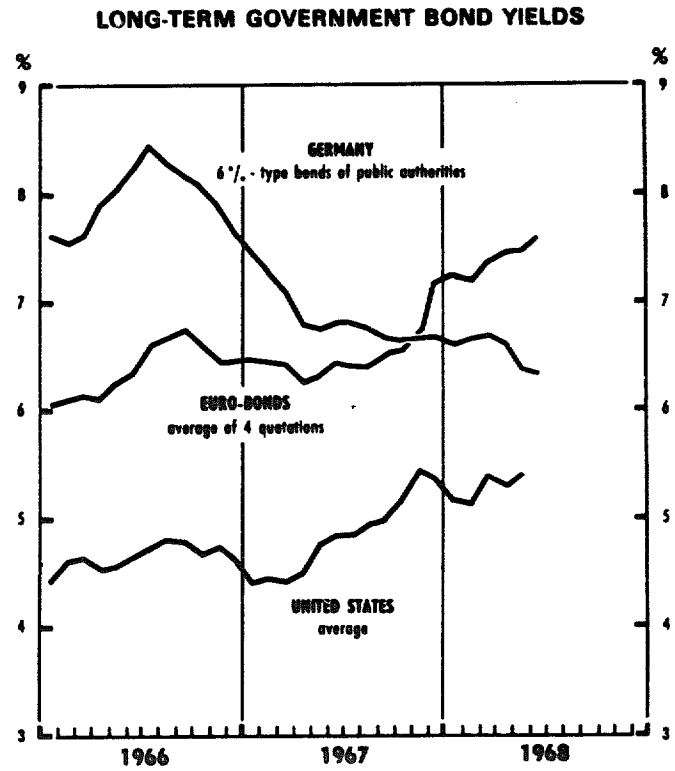
The tightening of monetary conditions in the *United States* appears to have contributed quite powerfully to the decline in the net capital outflow in all forms from a seasonally adjusted annual rate of $ 7 billion in the first half of 1967 to a $ 2½ billion rate in the second. In the first half of the year United States commercial banks, with short-term interest rates receding rapidly and their liquidity position substantially improved, had made substantial repayments of funds borrowed during the 1966 squeeze in the Euro-dollar market and in Canada —improving their net foreign position at a seasonally adjusted annual rate of $ 2 billion. From mid-1967 onwards, however, when the trend of short-term interest rates was sharply reversed, borrowing abroad resumed, and the banks' net short-term indebtedness to private foreigners increased at a

CHART J

INTEREST RATES



(1) Calculated in per cent per annum as premium (+) or discount (—) on the spot rate of the European currency.



seasonally adjusted annual rate of $ 3¾ billion in the second half of 1967 and at a $ 2.2 billion rate in the first quarter of 1968. There was also a sharp reversal of the previous tendency towards a liquidation of foreign holdings of United States equities. Foreign acquisition of such equities continued at a high rate into the early months of 1968, reflecting the attractions of Wall Street in the current phase of the cycle.

In the second half of last year there were, however, other forces operating in the opposite direction. With investment slack and an improved supply of internal funds, the liquidity position of the non-financial business sector tended to improve in the second half of the year, and there was some spill-over into capital exports, particularly in the fourth quarter when further tightening of the balance of payments programme was widely anticipated. Following the introduction of the new balance of payments measures on 1st January 1968, there was a sharp reduction in the capital outflow over the first quarter of this year. The private long-term capital balance, in fact, swung round to an inflow at a seasonaly adjusted annual rate of $ 1 billion [1] from

1. Excluding the $ 210 million direct investment of the Royal Dutch/Shell group in the Shell Oil Company of the USA (see footnote 2, page 40).

an outflow of $ 2.7 billion in 1967; this inflow appears to have continued in the second quarter.

In *Japan* tighter monetary conditions contributed powerfully to the $ 1.4 billion improvement in the capital account, the major part of which reflected a turn-round in the flow of banking funds (see Table 26). This development was partly connected with the slower growth of Japanese exports—entailing a smaller increase than previously in short-term export finance —but mainly represented a shift to cheaper foreign sources for the financing of Japanese imports. There was a similar swing in short-term non-monetary capital, presumably also connected with the reduction of the trade surplus. Net exports of private long-term capital declined but little, and there were higher outflows on official account. In the first five months of 1968, with less buoyant domestic developments, no further tightening of monetary conditions and the trade surplus tending to increase again, there was some deterioration in the capital account as compared with a year earlier. This was more than accounted for by a sharp turn-round in movements of short-term banking funds. Japanese long-term trade credits continued to run at high levels, but a higher proportion was financed with long-term capital raised abroad, partly on the Euro-bond market.

The reduction in the net capital outflow from *Italy* from nearly $ 2 billion in 1966 to slightly over $ 1 billion in 1967 is also largely the result of a turn-round in the movement of banking funds. The cessation of the active swap policy pursued by the central bank until the autumn of 1966 was probably the main contributing factor; rising domestic credit demand also put some pressure on the banks' liquidity position and, in the first half of 1967, the temporary easing in the Euro-dollar market induced a rise in demand for foreign currency credits to residents. With domestic long-term interest rates remaining appreciably below those prevailing abroad, in particular in the Euro-bond market, estimated outflows of partfolio capital continued at their previous high rate, and Italy maintained its newly established position as a substantial exporter of long-term capital.

In *Germany* the easy course pursued by the monetary authorities coincided with slack business conditions. With business investment at year-end running 25 per cent below the levels recorded in the first half of 1966 (seasonally adjusted), the business sector improved its liquidity position to the extent of becoming a net supplier of funds to German financial markets. Taking 1967 as a whole, the capital account of the balance of payments (including banking funds and unrecorded transactions) showed a net outflow of $ 2.3 billion against a net inflow of $ 0.5 billion in the previous year.

Of this $ 2.8 billion swing, $ 0.7 billion was accounted for by banking funds, while the rest was about equally distributed between short-term and

TABLE 26.
Capital movements 1966-1967
$ billion

	Banking funds		Other short-term capital		Long-term capital		*Of which:* Private		*Of which:* Official	
	1966	1967	1966	1967	1966	1967	1966	1967	1966	1967
United States	2.82	0.90	0.07	–0.54	[illegible]08	–5.15	–2.90	–2.66	–2.18	–2.50
United Kingdom	–0.98	–0.21	–0.13	0.49	–0.29	–0.08	–0.06	0.06	–0.23	–0.14
Reserve currency countries	1.84	0.69	–0.06	–0.05	–5.36	–5.23	–2.95	–2.59	–2.41	–2.63
Canada	–0.43	–0.32	0.23	–0.56	0.95	1.28	0.96[a]	1.29[a]	–0.01	0.0
Japan	–0.38	0.51	–0.13	0.42	–0.81	–0.81	–0.67	–0.58	–0.14	–0.23
France[b]	0.04	0.37	–0.09	–0.10	0.08	–0.02	0.16	(0.06)	–0.07	(–0.07)
Germany	–0.10	–0·80	0.58	–0.72	0.06	–0.78	0.46	–0.44	–0.40	–0.34
Italy	–0.39	0.18	–0.42	–0.34	–1.05	–1.00	–0.94	–0.94	–0.11	–0.06
TOTAL EEC	–0.22	–0.06	0.27	–0.92	–0.95	–1.92	–0.26	(–1.32)	–0.69	(–0.60)
Other OECD	0.12[c]	–0.27	..	..	..	..	..	..	..	..
TOTAL OECD	0.93[c]	0.55	..	..	..	..	..	..	..	..

a) Including security transactions by public sector.
b) Transactions with non-franc countries.
c) Excluding Switzerland.

TABLE 27.

Long-term capital flows 1960-1967

$ billion

	Average 1960-63		Average 1964-65		Average 1966-67	
	O.C.	P.C.	O.C.	P.C.	O.C.	P.C.
United States	-1.55	-2.58	-1.65	-4.45	-2.34	-2.78
United Kingdom	-0.31	-0.01	-0.36	-0.57	-0.18	0.01
Reserve currency countries	-1.86	-2.59	-2.01	-5.01	-2.52	-2.77
Canada[a]	..	0.78	..	0.80	..	1.12
Japan	-0.01	0.14	-0.08	-0.07	-0.18	-0.63
France[b]	-0.15	0.40	-0.08	0.44	-0.07	0.11
Germany	-0.21	0.36	-0.29	0.32	-0.37	-0.01
Italy	0.02	-0.13	0.05	0.07	-0.09	-0.94
TOTAL EEC COUNTRIES	-0.36	0.62	-0.39	1.06	-0.64	-0.79
TOTAL ABOVE	-2.23	-1.06	-2.49	-3.23	-3.35	-3.07

a) Total long-term capital.
b) Transactions with non-franc countries only.
O.C.: Official long-term capital.
P.C.: Private long-term capital.

private long-term capital. In addition to a $ 0.5 billion swing in unrecorded transactions (probably reflecting the extension of trade credits to abroad) the change in the short-term capital account reflected a $ 0.8 billion swing in the short-term indebtedness of the business sector. The latter also contributed $ ½ billion to the turn-round in private long-term capital account by increasing its loans to foreigners and reducing its own indebtedness to them. Most of the remaining shift in the long-term capital account was due to higher exports of portfolio capital. While foreign investors appear to have shifted substantial amounts out of German bond holdings into higher yielding Euro-issues, German investors stepped up their net purchases both of foreign bonds and of foreign equities. There was little change in the net flow of direct investment capital.[1]

Allowing for speculative inflows—partly on banking account and partly unrecorded—the underlying tendency towards increasing capital outflows appears to have continued into 1968. With long-term interest rates now appreciably lower in Germany than in some important financial markets abroad the outflow of private long-term capital (mainly loan and portfolio capital) accelerated very sharply in the first five months of 1968 and reached $ 650 million, more than in the whole of 1967.

1. Leaving aside the effects of the Texaco-DEA transaction in June 1966.

2. The exceptionally high net outflow of private capital from the United Kingdom in the first quarter of 1968 largely reflected the Royal Dutch/Shell group's taking up its rights in the Shell Oil Company of the USA; it also included, however a large outflow of portfolio capital to Australia.

Longer-term trends

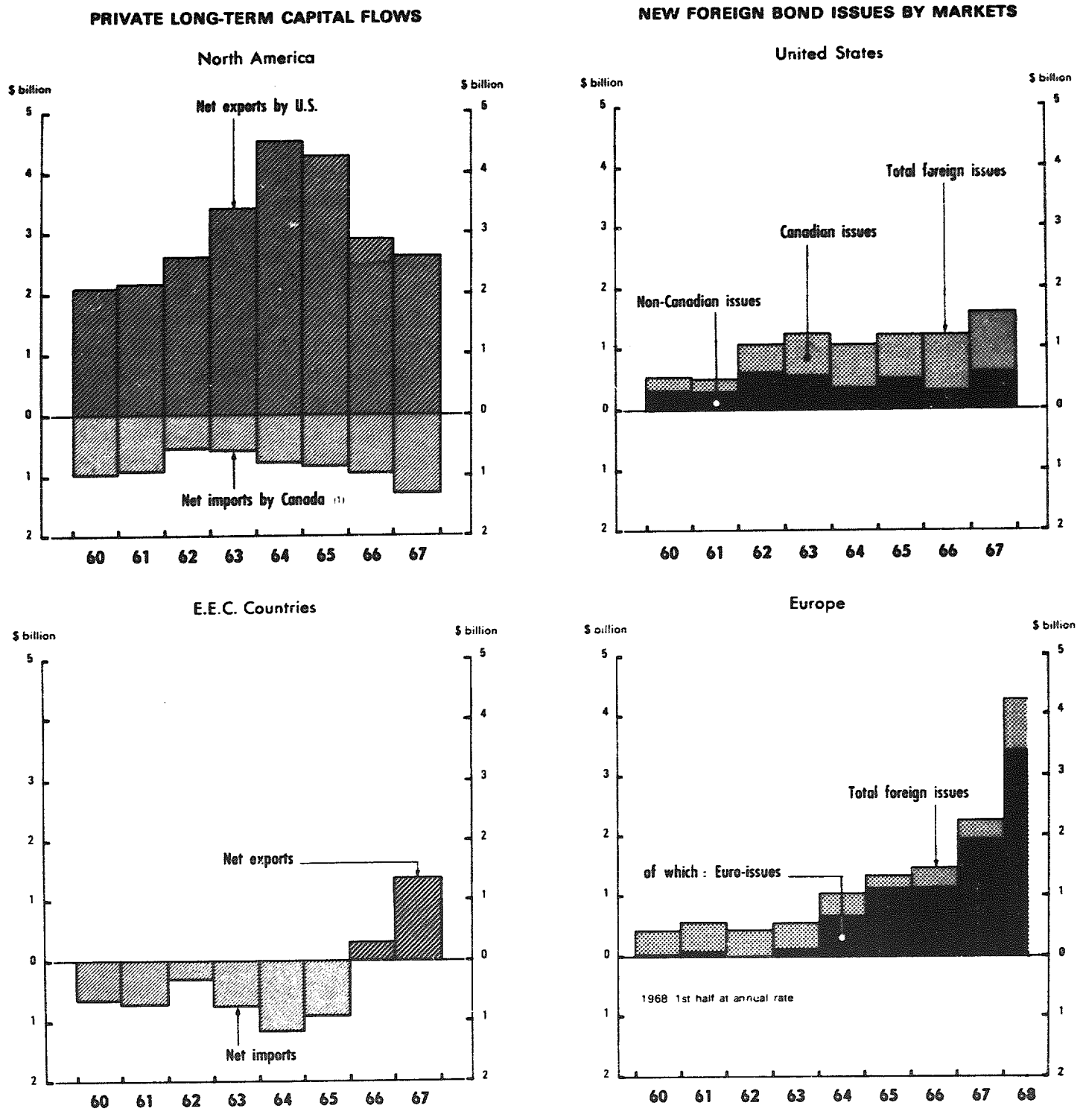
Taking a longer period and concentrating on the long-term capital balances of the reserve currency countries, the EEC countries, Canada and Japan, there have been important developments which do not seem to be entirely attributable to changes in the relative cyclical positions of these countries.

After rising only slowly in the first half of this decade, the outflow of *official long-term capital* from these countries has risen quite sharply in the last two years, from $ 2.5 billion in 1964/65 to $ 3.4 billion in 1966/67 (Table 27). Although this was a fairly general trend, four-fifths of the increase was accounted for by the United States alone.

Private long-term capital flows, on the other hand, showed important and divergent shifts in this period. By 1966/67 the net outflow from the United States, which exceeded $ 4 billion in 1964/65, had reverted to $ 2¾ billion, not much more than the level recorded in the early 1960s (Table 27). Deducting the net inflow into Canada, the same conclusion applies to the net outflow from North America to third countries (Chart K). The United Kingdom's balance on private capital account followed a similar development, with a sizeable outflow in 1964/65 reverting to the previous position of near-balance in more recent years.[2]

CHART K

INTERNATIONAL CAPITAL MOVEMENTS



1. Including security transactions by public sector

At the same time, Japan emerged as a major supplier of long-term funds, with a net outflow on private account exceeding $ ½ billion in the last two years. And the EEC countries changed from a net importing to a net exporting position, with, in 1967, an outflow of $ 1.3 billion. Whilst the trend for the EEC area as a whole was fairly clear, the trend for individual countries differed, outflows first from Italy and then from Germany expanding rapidly in response to conjunctural developments.

Several factors appear to have contributed to this change in the pattern of private long-term capital movements, some of which may prove to be of a longer lasting nature. The improvement in the private long-term capital balance of the two reserve currency countries undoubtedly reflected the measures taken to reduce capital outflows. Another factor has been the growing amount of export finance extended by leading countries other than the United States. This partly reflected efforts of the governments concerned to promote exports by extending refinancing and credit guarantee facilities, and partly—notably in the cases of Italy and Japan—a growing proportion of heavy equipment goods in total exports.

A third factor seems to have been the expansion and improvement of the European financial markets, in particular the emergence of the Euro-bond market triggered off by the imposition of the Interest Equalization Tax in the United States. The capacity of this market approached the $ 2 billion mark in 1967, four times the volume of the United States market for non-Canadian issues, and may be well in excess of $ 3 billion in 1968. Existence of the Euro-bond market gives borrowers access to the domestic capital markets of virtually all Continental Western European countries, despite the continuation of controls on new issues denominated in domestic currencies in some of these countries. Thus, the Euro-bond market has become an important and rapidly growing alternative source of funds not only for countries (both within and outside the OECD area) which, prior to 1963, used to rely heavily on the United States capital market; but, since 1965, particularly for United States companies operating abroad. More recently the Canadian government and other Canadian borrowers have placed sizeable amounts of medium-term notes on the Euro-market.

The origins of funds supplying the Euro-issue market cannot generally be traced statistically; they are unlikely to be entirely European. But the substantial increase in the outflow of portfolio capital from the EEC countries from an estimated total of $ ¼ billion in 1965 to $ 1¼ billion in 1967 suggests that these countries may have become important suppliers of funds to that market—a development which could easily be explained by the fact that yields in the Euro-bond market have risen above those prevailing in the domestic markets of the EEC countries. More recently Germany has clearly been becoming an important direct supplier of funds to the Euro-bond market. With interest rates on the market for foreign DM-issues now at about the same level as German domestic bond yields German

TABLE 28.

Sources and uses of funds of US subsidiaries operating in Europe

	1960-63	Average 1964-65	1966-67	1960-63	Average 1964-65	1966-67
	$ billion			Per cent		
Capital expenditure						
Plant, equipment, property	1.53	2.43	3.48	63	60	60
Other	0.90	1.64	2.32	37	40	40
TOTAL	2.43	4.07	5.80	100	100	100
Financed by:						
Funds from US[a]	0.63	0.90	0.87	26	22	15
Reinvested earnings	0.33	0.37	0.42	13	9	7
Depreciation	0.70	1.30	1.91	29	32	33
Local funds	0.77	1.50	2.60	32	37	45
Memorandum items:						
US direct investment capital transfers[b]						
TOTAL EUROPE	0.78[c]	1.41	1.30			
of which:						
Continental Europe	0.60	1.14	0.93			

a) Excludes purchases of existing enterprises and minority interests by US incorporated firms; may include US financing other than supplied by US parent companies. (See also b).

b) Includes purchases of existing enterprises and minority interests by US incorporated firms.
Excludes amounts raised in Europe by US parent companies (in particular "Delaware" companies) and used for the financing of direct investments.

c) Excludes Ford transaction in 1960.

investors have been taking up major proportions (from January to April 1968 about two thirds) of newly issued foreign DM-bonds.[1]

A fourth element which contributed to the change in the pattern of capital flows was the deceleration in the flow of United States direct investment funds to Europe. In 1966-67, the net flow to Europe was slightly below the peak recorded in 1964-65, and the flow to Continental Europe was approximately midway between the high and the low points recorded respectively in the mid and early sixties (Table 28). While this development was undoubtedly influenced by the voluntary programme introduced in 1965 to restrain United States foreign direct investment, the tendency for returns on manufacturing investment in the United States to rise in relation to the returns achieved by United States companies operating in Europe may also have contributed (see Table 29). The scissors movement of rates of return is partly a cyclical phenomenon. But with a tendency for the United States economy to be run at higher levels of capacity utilization than heretofore, and the reverse true for Europe, the long-term average around which the rates of return fluctuate may perhaps be more nearly equal on both sides of the Atlantic. It also seems possible that the wave of United States investments in Europe occasioned by the formation of the EEC and EFTA may be waning.

Moreover, the improved functioning of the European financial markets discussed above has probably been an important factor behind the increase in local borrowing in Europe by United States subsidiaries in Europe (Table 29). Even before the introduction of the voluntary programme, the share of local financing of their investment had risen from 32 to 37 per cent. In 1966-67, it rose further to perhaps 45 per cent, despite the rapid increase in capital expenditure. The moratorium on capital outflows to the greater part of Continental Western Europe contained in the new programme is bound to cause, while it lasts, a further rise in the proportion of local financing. (Borrowing by US companies in the Euro-bond market exceeded $ 1 billion in the first half of 1968, which is more than the total for 1966 and 1967.)

TABLE 29.
United States : Return on manufacturing investments
Per cent

	1960	1961	1962	1963	1964	1965	1966
Direct investment in Europe	16.7	14.1	11.8	12.7	14.0	12.9	11.2
US Domestic manufacturing	11.1	10.2	11.8	12.2	13.8	15.1	15.2

Note: Return on direct manufacturing investments in Europe represents the US share of net earnings for the year applied to book value of these investments at the beginning of the year. Return on domestic manufacturing represents net income applied to net worth at the beginning of the year.

It may be premature to conclude that significant structural changes in the United States and Continental Europe have begun to re-shape the pattern of international capital flows in an equilibrating fashion. Cyclical influences have clearly been important in the recent shift in the relation between long-term interest rates in the two areas. And the effect of these cyclical influences may have been magnified by the fact that neither the United States nor Germany has been able to achieve the counter-cyclical policy mix appropriate to domestic considerations; demand management has relied unduly on restrictive monetary policy in the United States, and the reverse is to some extent true of Germany. Nonetheless, with the process of tariff discrimination now virtually at an end and with the progressive improvement of European financial market mechanisms, there are some grounds for expecting an underlying reduction in the capital flow from North America to Europe. Probably the crucial factor will be the longer-run trend in interest rate differentials between the two sides of the Atlantic. If in the coming years the United States were to operate at higher average levels of capacity utilisation than in the first half of the 1960's, and the reverse were true of Europe, then, with appropriate monetary policies, at least part of the narrowing of these differentials over the last two years could prove fairly permanent. In this case recent experience suggests that the impact on international capital movements could be substantial.

1. The recent spate of foreign DM-issues is explained by the fact that, for confidence and other reasons, there has been a sharply widening gap between yields on Euro-DM-issues and the interest rate level prevailing on the market for straight Euro-dollar-issues (i.e. other than issues convertible into shares). Most of the foreign DM-loans have been handled by international banking consortia and hence are treated here as Eurobonds.

PAYMENTS EQUILIBRIUM AFTER THE GOLD CRISIS

Pulling together the trends in international current and capital transactions discussed in previous sections, the main features of the international payments scene over the last 12-18 months can be summarised as follows:

i) Until the late summer of last year, the steady deterioration in the combined current account position of the reserve currency countries was more than offset by an improvement in their combined capital balance. Since then, however, and at least through the first quarter of this year, the combined capital outflow has run at a much higher level; so that the deficit on official settlements, which had been $ 1.5 billion in 1966, rose to $ 4.2 billion in 1967, and to as much as $ 5.7 billion in the twelve months up to March of this year (Tables 30 and 31);

ii) The sharp rise in the EEC countries' current surplus, which was resumed again in the early months of this year, was matched by a roughly corresponding rise in the combined capital outflow from these countries, leaving the combined surplus on official settlements unchanged at around $ 1½ billion;

iii) The big deterioration in Japan's current account position in 1967—which was reversed at the beginning of this year—was offset by changes in the capital account, and her official settlements position has continued to be in approximate balance. The Canadian official balance improved in 1967, with the reduction in the current account deficit more than offsetting the decline in capital inflow; but the speculative attack on the Canadian dollar in the first quarter of this year led to an official settlements deficit of $ 0.8 billion (followed by a reflux of funds in the second quarter).

iv) The other OECD countries as a group have remained roughly in equilibrium on official settlements, with a reduction in their combined current deficit paralleled by a smaller net capital inflow.

TABLE 30
Balances on official settlements
$ billion

	Twelve months ending	
	March 1967	March 1968
Reserve currency countries	-1.7	-5.7
EEC [a]	1.8	1.4
Canada and Japan	-0.3	-0.8
Other OECD	0.3	0.0
TOTAL OECD [a]	0.1	-5.1
Primary producers [b]	0.8	1.9
WORLD TOTAL [c]	0.8	-3.2
Official gold transactions with the private sector	-0.2	-2.9
International organisations	0.2	-0.1
Statistical discrepancy	0.8	-0.3

a) Including net settlement to France on behalf of the Overseas Franc Area.

b) Estimated on the basis of reserve statistics reported by primary producing countries. The data for the period ended March 1968 have been adjusted to discount the estimated change in the dollar value of sterling area countries' reserves due to the devaluation of the pound.

c) Excluding the Sino-Soviet area. In the treatment adopted in this table the balance of official settlements of the Sino-Soviet area would be reflected either in purchases or sales or gold included here as gold transactions with the private sector or in the statistical discrepancy.

It is only when these figures are put together that the full impact of the gold crisis on international payments equilibrium becomes apparent. In the year ending in March 1968 the official settlements deficit of the reserve currency countries was $ 4 billion larger than in the preceding twelve-month period. But at the same time the official position of the other OECD countries taken together was also *worse*—rather than better, as might have been expected—by $ 1.2 billion. There was, it is true, an improvement in the position of the primary producing countries, with their official settlements surplus rising to around $ 2 billion as their current account position improved, with perhaps also some increase

TABLE 31.
Summary balances of payments, 1966 and 1967
$ billion

	1966			1967		
	Current balance	Capital movements	Balance on official settlements	Current balance	Capital movements	Balance on official settlements
United Kingdom	-0.09	-1.40	-1.49	-1.34	0.20	-1.14
United States	2.16	-2.18	-0.03	1.69	-4.80	-3.11
TOTAL RESERVE CURRENCY COUNTRIES	2.07	-3.59	-1.52	0.35	-4.60	-4.24
France	0.17 [a]	0.03 [a]	0.46 [b]	0.0 [a]	0.25 [a]	0.34 [b]
Germany	0.08	0.54	0.62	2.43	-2.30	0.13
Italy	2.12	-1.85	0.27	1.72	-1.17	0.56
Other EEC	-0.30	0.38	0.08	0.10	0.31	0.42
TOTAL EEC	2.06	-0.90	1.42	4.26	-2.91	1.44
Canada	-1.05	0.75	-0.30	-0.39	0.40	0.01
Japan	1.25	-1.32	-0.07	-0.19	0.13	-0.06
Other OECD North	-0.79	1.01	0.22	-0.71	0.83	0.11
Other OECD South	-0.92	0.85	-0.07	-0.65	0.66	0.01
TOTAL OECD [c]	2.62	-3.20	-0.33	2.66	-5.49	-2.74

a) Transactions with non-franc countries.
b) Including net settlements on behalf of the Overseas Franc Area.
c) In contrast with Tables 33 and 35 OECD totals shown here are not adjusted for inconsistencies in recording of intra-OECD transactions.

in capital receipts. But by far the largest counterpart to the $ 5 billion official settlements deficit recorded by the OECD countries was the loss of around $ 3 billion of monetary gold. [1]

Official Financing During the Gold Crisis

The two reserve currency countries' gold holdings fell by $ 2.7 billion in the twelve months to end-March (see Table 32). The other main item financing their deficit was a substantial build-up of liabilities to national monetary authorities. In part, this reflected a large accumulation of sterling by the United States, as the counterpart of support to the pound; but there was also a significant increase—of the order of $ 3½ billion— in the reserve centres' combined liabilities to other countries; on the other hand there was also some improvement in the reserve currency countries' net IMF position.

1. Comparing the two twelve-month periods there was also a large swing in the statistical discrepancy which arises largely from the asymmetrical reporting of surpluses and deficits, and a much smaller swing in national monetary authorities' liabilities to international organisations.

Although the official balance of the other OECD countries was clearly affected by the gold crisis, their net loss of gold came to only $ 0.6 billion. Their holdings of currency assets rose by as much as $ 2.5 billion, or by $ 1.9 billion more than their overall surplus; this reflects both the receipt of dollars against gold by participants in the Gold Pool, and some Central Bank assistance to the United Kingdom. The counterpart was a reduction in these countries' combined net IMF position, resulting primarily from the United Kingdom's repayment of the balance of its 1964 drawing, and the drawing by Canada in the first quarter of 1968.

Most of the remaining increase in the reserve countries' recorded liabilities to other monetary authorities is to be found in the currency holdings of non-OECD countries, which, after discounting the capital loss, in dollar terms, incurred by sterling area countries as a result of the devaluation of the pound, increased by about $ 1.5 billion. These countries' gold holdings also rose substantially, by $ 0.6 billion. South Africa added $ 0.2 billion to its reserves from current production, while there were also purchases of gold by some countries of the Middle East and North Africa.

The Adjustment Process in 1968

On current account the main feature of the last 18 months has been the further aggravation of the disequilibrium between the reserve currency countries and the European Economic Community. In 1967, the United States and the United Kingdom had a combined current surplus of only $ 0.4 billion, compared with a 1960-67 average of $ 2.6 billion, while the EEC countries had a combined surplus of as much as $ 4.3 billion, compared with an average of $ 1.8 billion over the 1960-67 period (Table 33).

The outcome for current balances forecast for 1968, as derived from the trends in trade and invisibles discussed earlier, is shown in Table 34. Although important shifts seem likely in the second half of the year, for the year as a whole the changes from 1967 are not very striking. The improvement expected for the United Kingdom may be slightly more than offset by a deterioration of the same order of magnitude for the United States. Both countries should show an improvement on current invisibles (of about $ 1 billion taken together), but the improvement in the United Kingdom's trade balance seems likely to be much more than outweighed by the deterioration in that of the United States, which may be of the order of $ 1¾ billion. On the assumptions discussed elsewhere the French current balance may deteriorate by around $ ½ billion, and the combined current surplus of the EEC by about the same amount, with most of the change coming on invisible transactions.

Japan's current balance is expected to improve by as much as $ 1 billion. For Canada little change is expected, with a substantial deterioration in invisibles not quite made up by an improvement on

TABLE 32
Financing of official settlements 1966-1967 and 1967-1968
$ billion

RESERVE CURRENCY COUNTRIES

Twelve months ending:	United States March 1967	United States March 1968	United Kingdom March 1967	United Kingdom March 1968	Total March 1967	Total March 1968
BALANCE ON OFFICIAL SETTLEMENTS	-1.7	-1.8	-0.1	-3.9	-1.7	-5.7
Financed by (— = helps to finance deficit):						
Liabilities to national monetary authorities	-0.1	-1.5	0.1	-3.7	0.0	-5.2
Special non-monetary transactions	-0.4	-0.1	0.1	0.0	-0.4	-0.1
Net IMF position	-0.4	0.1	0.1	0.8	-0.4	0.9
Liabilities to other official institutions	0.1	-0.2	0.0	0.0	0.1	-0.1
Change in reserves	-0.8	0.0	-0.3	-1.0	-1.1	-1.1
Gold	-0.6	-2.5	-0.4	-0.2	-0.9	-2.7
Currency assets	-0.2	2.4	0.0	-0.8[c]	-0.2	1.6

OTHER OECD COUNTRIES

Twelve months ending:	EEC[a] countries March 1967	EEC[a] countries March 1968	Canada Japan March 1967	Canada Japan March 1968	Other OECD countries March 1967	Other OECD countries March 1968	Total March 1967	Total March 1968
BALANCE ON OFFICIAL SETTLEMENTS	1.8	1.4	-0.3	-0.8	0.3	0.0	1.8	0.6
Financed by (+ = helps to finance surplus):								
Special non-monetary transactions	0.4	0.0	0.0	0.0	0.0	0.0	0.4	0.0
Net IMF position	0.7	-0.2	0.1	-0.5	-0.1	0.0	0.6	-0.8
Miscellaneous	0.1	-0.1	0.0	-0.3[b]	0.0	0.0	0.1	-0.4
Change in reserves	0.6	1.8	-0.3	0.0	0.4	0.0	0.6	1.8
Gold	0.3	-0.5	0.0	-0.1	0.1	-0.1	0.4	-0.6
Currency assets	0.3	2.4	-0.3	0.1	0.3	0.0	0.2	2.5

a) Including net settlement to France on behalf of the Overseas Franc Area.

b) Including $0.3 billion Canadian drawings on swap lines with the United States.

c) Including $0.5 billion assets previously held in liquified form in the United States and incorporated into the reserves in November 1967.

trade account. The other main change expected is for Spain where a substantial improvement is anticipated following the devaluation, a large part taking the form of increased tourist earnings. Taken together the OECD area's combined current surplus is expected to increase, mainly reflecting a rise in the trade surplus, but also a recovery in invisible earnings which were adversely affected by the hostilities in the Middle East in 1967.

On capital account, the main factors determining the outcome for 1968 will be the impact of the new United States balance of payments programme on the one hand, and the speculative forces working against the pound sterling and the French franc on the other. Such indicators as are so far available suggest that the United States programme is working more or less as intended. Allowing for the possibility of some slippage in the programme—but at the same time for the fact that the United States capital account should be benefitting from the current high level of interest rates—it is estimated that the non-monetary capital account should improve this year by $ 1-1½ billion, with a further gain of not far short of $ 1 billion from the programme relating to short-term bank lending.[1] It also appears that so far this year the United States capital account has benefitted from attractive investment opportunities on the New York securities market and, more recently, also from speculative uncertainties in Europe.

As already noted, however, the combined position of the reserve currency countries in the first quarter of the year was adversely affected by the massive private purchases of gold (see page 34). And the pound sterling has continued to be under pressure in the exchange markets in the second quarter. If, however, the current account position of the reserve currency countries begins to improve markedly in the second half of the year, the resultant improvement in confidence could well lead to some reversal of earlier speculative movements. A substantial reduction in the combined capital outflow from the reserve currency countries, and consequent reduction in their deficit on official settlements, would then be likely.

1. For more details of the United States balance of payments programme, see US country note on pp. 88 to 93.

TABLE 34
Forecast changes in current balances, 1967 to 1968
Changes in $ billion

Change in:	Trade balance	Current invisibles	Current balance
Reserve currency countries	–1.35	+1.10	–0.25
France	–0.20	–0.25	–0.45
Other EEC	+0.10	–0.10	0
Canada	+0.40	–0.55	–0.15
Japan	+1.10	–0.10	+1.00
Other OECD	+0.60	+0.25	+0.85
TOTAL OECD [a]	+0.60	+0.35	+1.00

a) In contrast with Tables 33 to 35 OECD totals shown here are not adjusted for inconsistencies in recording of intra-OECD transactions.

TABLE 33
Current balances in 1967 and 1968 and longer-run trends
$ billion Estimates and Forecasts

	Average 1960-63	Average 1964-67	1967	1968
United Kingdom	–0.01	–0.76	–1.34	–0.60
United States	2.44	3.42	1.69	0.70
Total reserve currency countries	**2.44**	**2.66**	**0.35**	**0.10**
France [a]	0.80	0.21	0.0	–0.45
Germany	0.43	0.23	2.43	1.75
Italy	0.10	1.67	1.72	2.10
Other EEC	0.23	–0.04	0.10	0.40
Total EEC	**1.56**	**2.07**	**4.26**	**3.80**
Canada	–0.86	–0.71	–0.39	–0.55
Japan	–0.42	0.38	–0.19	0.80
Other OECD North	–0.53	–0.78	–0.71	–0.40
Other OECD South	–0.18	–0.71	–0.65	–0.10
TOTAL ABOVE	2.02	2.90	2.66	3.65
Adjustments [b]	-0.4	0.4	0.3	(0.0)
OECD current balance with rest of world	**1.6**	**3.3**	**2.9**	**3.6**

Note: During the 1960s current balance positions of the major countries have shown a marked cycle with a turning point in 1963-1964. The two four-year periods shown for reference have been chosen as far as possible so as to minimise this phenomenon and bring out the longer-run trends.

a) Transactions with non-franc countries.

b) For inconsistencies in recording of intra-OECD transactions.

The Turning Point

The comparison of annual current balance figures for 1967 and 1968 hides the much more dramatic changes which took place in the course of 1967 and early 1968 but which are expected to be sharply reversed during the course of this year (Chart L).

The combined current surplus of the reserve currency countries, which was running at an annual rate of $ 2.3 billion in the second half of 1966, had been transformed into a combined deficit of $ 0.7 billion (annual rate) by the second half of 1967, and this deficit is expected to have increased further to around $ 1¾ billion in the first half of this year. This prolonged deterioration owes something to special factors: the dock strike and the initial adverse effects of devaluation for the United Kingdom, and the abnormally high level of United States imports in recent months. More fundamentally, it reflects the course of domestic demand in the countries concerned and elsewhere. From the latter part of 1966 to the middle of last year a period of moderate demand in the reserve currency countries coincided with a slowdown in a number of other important countries. And from the middle of last year a pick-up in demand elsewhere was accompanied by an even greater acceleration in the reserve currency countries.

The counterpart of these trends can be seen in the current balances of almost all other countries. The EEC's current surplus, which remained steady at around $ 4¼ billion in the two halves of 1967, seems likely to have risen further to some $ 5 billion in the first half of this year (annual rates). The sharpness of the recovery in Japan's current balance and the continuing low level of Canada's current deficit in the first half of this year clearly both owe a great deal to developments in the United States. Similarly, the primary-producing countries have seen their current deficit with the OECD area reduced to unusually lows levels since the middle of last year. [1]

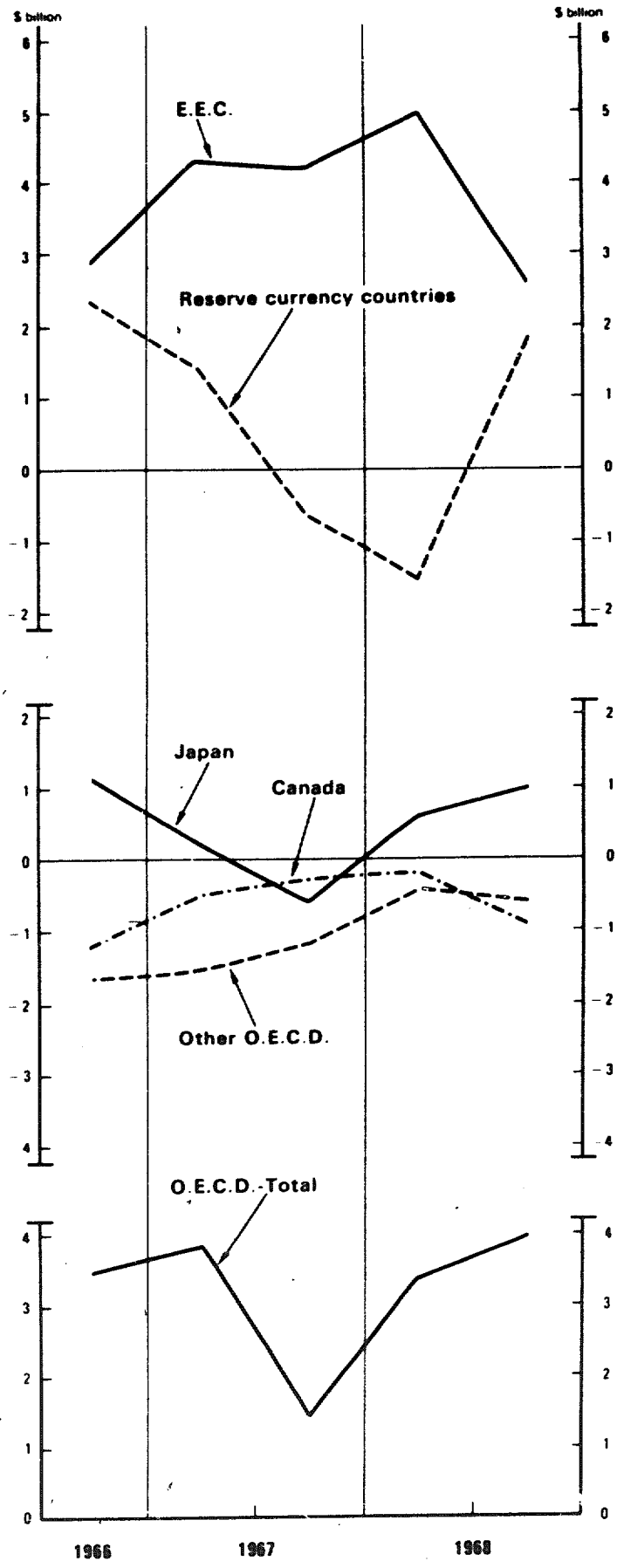
Action to check the excessive rate of domestic expansion in the reserve currency countries was delayed, but has now been taken in both countries. If it is successful, there can be no doubt that it will lead to a radical change in trade and payments positions, which will be powerfully reinforced in the second half of this year by the reversal of a number of the special factors. The projections made here

1. In this case special factors have been particularly important.

CHART L

CURRENT BALANCES, 1966 - 1968

seasonally adjusted half - yearly figures at annual rates



suggest that the combined current account position of the reserve currency countries might improve by around $ 3½ billion (annual rate) between the two halves of this year, i.e. by enough to reverse the major part of the deterioration experienced over the 18 months since the second half of 1966. All but a small fraction of such a swing would reflect a change in the combined trade balance, resulting primarily from an absolute fall in imports which is expected to be about 1 per cent for the United States and 4 per cent for the United Kingdom.[1]

A change of this order of magnitude could be expected to be mirrored in the trading position of more or less all other countries. There might, however, be one or two exceptions. Japan has already entered into a cooling off period and her current balance may continue to improve in the second half of the year, although at a much slower rate. The three smaller European countries which have devalued should also improve their position.

The main part of the improvement in the position of the reserve currency countries will probably be absorbed within the OECD area, with a swing of around $ 2½ billion for the EEC and of perhaps $ ½-¾ billion for Canada. There might also be some further rise in the OECD area's combined current surplus with non-OECD countries, because the payments position of these countries has been, in general, unusually favourable during the last twelve months. But a development of this kind cannot go on indefinitely, and with the growth of the primary producer's export earnings likely to slow down in the second half of this year, new trends will emerge in 1969.

The prospect, then, seems to be for an unusually sharp reversal of trade and payments trends, not yet apparent in the figures at present available but which could emerge rather rapidly in the coming months. It should be emphasized, however, that the figures put forward above are based on the assumption that domestic demand is effectively moderated in the reserve currency countries, while at the same time a sustained rate of domestic expansion continues elsewhere. If there are doubts as to whether action will be fully appropriate on either score—as there may well be—there must also be doubts about the timing and magnitude of the shifts in the remainder of this year. But there can be little doubt that changes in the right direction will shortly begin to be felt, and these should be a major factor making for a return of confidence in the international monetary system.

Prospects for 1969

With the slowdown of domestic expansion in the reserve currency countries likely to continue at least to the middle of 1969, the current balance positions should shift further. At the present time, however, it is not possible to forecast how far these changes may go. The pace of expansion in the reserve currency countries (and Japan) will depend on how policies evolve in the countries concerned, which will, no doubt, be partly determined by the progress made towards better external equilibrium. Developments in France will depend on how successfully policies are directed to converting the rise in incomes into additional real demand rather than successive price and cost increase. And equally important is the question whether further action will be needed—and taken—to sustain the pace of domestic expansion in other continental European countries in the face of the weaker trend in export demand.

It may, nevertheless, be useful to consider possible developments in 1969 against the background of countries' balance of payments objectives and earlier experience. (All figures will be shown at annual rates.)

The United Kingdom authorities are aiming to achieve a basic surplus of $ 1.2 billion before the end of 1969. Given expectations concerning long-term capital movements this would seem to require the achievement of a current surplus of the order of $ 1½ billion. The United States authorities aim to achieve a substantial increase in the current surplus, but have not set any specific quantitative target. A current surplus of $ 3½ billion might, however, tentatively be put forward as a reasonable minimum aim for the second half of 1969. This would be about the level actually achieved in the period 1964-67; and would seem a possible outcome after a cooling-off period of the kind now be-

1. Most of the swing of over $2 billion forecast for the United States would be attributable to the cessation of special factors boosting imports in the first half of the year, but the underlying rise in imports should also slow down sharply towards the end of the year. The size of the swing for the United Kingdom results partly from the fact that most of the adverse terms of trade effects from the devaluation are expected to have been worked out by the middle of this year.

ing envisaged. Taken together, this would give a combined current surplus for the reserve currency countries of around $ 5 billion, i.e. a further improvement of about $ 3 billion from the possible outcome envisaged above for the second half of 1968.

The EEC has not yet formulated a specific medium-term balance of payments objective. Each of the Member countries, however, has as an objective the achievement of some surplus on current account matched by capital outflows. The Dutch authorities have suggested that the Netherlands should have a surplus on *current account* of at least 1 per cent of national income (0.9 per cent of GNP). The German authorities have suggested that it would be appropriate for them to aim at a surplus on *goods and services* of about 1 per cent of GNP. This latter aim, applied to the EEC countries as a group, would yield a target surplus on current account of $ 1½ to $ 1¾ billion (a surplus of goods and services of $ 3.6 billion, offset by net transfers which are currently running at just under $ 2 billion). This compares with an average of $ 1½ billion achieved in 1960-63 and $ 2 billion in 1964-67.

Japan's medium-term aim is to achieve a current surplus of $ 1½ billion by 1971. Given that the Japanese economy is now moving into a cooling-off period, it seems possible that a surplus of the order of $ ½ to $ 1 billion might be recorded in the second half of 1969. Over the longer run, Canada is aiming to eliminate its current deficit. In the light of probable developments in the United States, however, a continued deficit of the order of $ ½ to $ 1 billion in 1969 would seem likely. For Canada and Japan together, this would mean little change between the second halves of 1968 and 1969.

The other OECD countries as a group have a current deficit, which averaged $ 1.1 billion over the last eight years. Some of these countries devalued last autumn, but, at the same time, they will be experiencing increased competition from the United Kingdom. A combined current deficit of $ 1½ billion in the second half of 1969 might be a possible outcome, implying a deterioration of almost $ 1 billion from the rather favourable outcome forecast for the second half of 1968.

If such " aims " were to be simultaneously achieved in the second half of 1969, the recorded current surplus of the OECD area would be over $ 5 billion. This would be significantly higher than anything achieved in the past. It follows, therefore, that these current balance aims could not all be achieved simultaneously, or that their achievement would require a substantial increase in the net capital outflow to the rest of the world, which would otherwise be put into an impossible position.

One possibility would be that the current surplus of the EEC countries might virtually disappear (it fell to $ 0.4 billion in 1963-64), leaving the combined current surplus of the OECD area at roughly the level forecast for the second half of this year. This could come about if, with rapid domestic expansion, extra-EEC imports rose by, say, 11 per cent, while extra-EEC exports rose by only 4 per cent, with a further loss of shares in third markets. Factors working in this direction would be the continuing impact of the United Kingdom and other devaluations, and the possibility that recent events in France may herald a period of larger money wage increases within the EEC. On the other hand, as noted in an earlier section, the productivity performance of the EEC countries has generally been unusually favourable during the 1964-67 period of easing demand pressures. On balance, therefore, there may be some doubts as to the likelihood of such a sharp deterioration in the EEC's trade balance, unless it resulted from the re-emergence of excessive cost and price increases in continental Europe, or, alternatively, serious recessions in the countries pursuing restrictive policies.

An alternative, and no doubt more desirable, outcome would be a change in the traditional pattern of capital flows such as to make possible the financing of a larger current surplus for the OECD area as a whole. Over this period it would seem likely that the reserve currency countries will have to continue to rely fairly heavily on capital controls (although they will, no doubt, hope to be moving towards a situation in which it will be possible to relax these controls). On this assumption, it might be reasonable to expect a combined capital outflow of the order of $ 5 billion. This would imply the achievement of approximate balance on official settlements for the two countries, with a surplus for the United Kingdom offset by a continuing, but much reduced, deficit for the United States.

Taking Japan, Canada and the smaller European countries, it would seem reasonable to assume a net capital inflow of roughly the same order as their combined current deficit (put above at $ 1-1½ billion). With the exception of Switzerland and Austria,

these countries all have relatively low reserves, and given their easy access to the main international financial centres, have in the recent past tended to show approximate balance on official settlements.

From the above, it follows that if the EEC had a current surplus of, say, $ 1½ billion, it would have to be recording a combined capital outflow of at least this magnitude, and more than this to the extent that the primary producing countries continued to build up their reserves and/or the reserve currency countries were to move into combined surplus on official settlements. The EEC registered an average capital *inflow* in all forms of $ 0.82 billion in 1960-63, and an outflow of $ 0.68 billion in 1964-67 (Table 35). In 1967 the outflow rose to as much as $ 2.91 billion (Table 31), and could even rise further in 1968. But this has occurred in a rather exceptional cyclical situation and partly as the result of policy actions specifically designed to diminish pressures on international short-term money markets. On the other hand official exports of long-term capital from the EEC are running at a rate of about $ 0.6 billion, and in 1967 the outflow of private long-term capital rose to over $ 1 billion, with a number of reasons to suppose that this may be the beginning of a more permanent and not entirely cyclical trend (see pages 40 to 43).

In conclusion, it would seem that the prospects for decisive progress towards better international payments equilibrium within the present international monetary framework depend in the first place on how much and how quickly the current account positions of the reserve currency countries respond to a slower rate of domestic expansion (and devaluation in the case of the United Kingdom). Over the slightly longer run, however, an equally important factor will be the success achieved in maintaining a substantial level of long-term capital outflows from the European Economic Community.

TABLE 35.

Main items in the balance of payments of OECD countries, 1960 to 1967

$ billion

	Average 1960-1963			Average 1964-1967		
	Current balance	Capital movements	Balance on official settlements	Current balance	Capital movements	Balance on official settlements
Reserve currency countries	2.44	-5.41	-2.97	2.66	-5.27	-2.61
EEC	1.56	0.82	2.47 [a]	2.07	-0.68	1.61 [a]
Canada	-0.86	0.97	0.11	-0.71	0.78	0.06
Japan	-0.42	0.56	0.15	0.38	-0.39	-0.02
Other OECD	-0.79	1.63	0.93	-1.49	1.85	0.37
1. TOTAL OECD	2.02	-1.43	0.68 [a]	2.90	3.71	0.59 [a]
less:						
Official gold transactions with private sector [b]	0	0.52	0.52	0	-0.17	-0.17
Other adjustment items	0.4 [c]	0.6	0.2 [d]	-0.4 [c]	0.5	0.1 [d]
2. CONSOLIDATED BALANCE OF OECD AREA WITH THE REST OF THE WORLD	1.6	1.3	0.3 [a]	3.3	3.8	0.5 [a]
Reconciliation:						
3. Rest of the world's balance of official settlements, as recorded by non-OECD countries			0.3			0.6
4. (= 2 - 3) Statistical discrepancy (excess of recorded surpluses = +)			0.6			0.1

a) Including net settlement to France on behalf of the Overseas Franc Area.

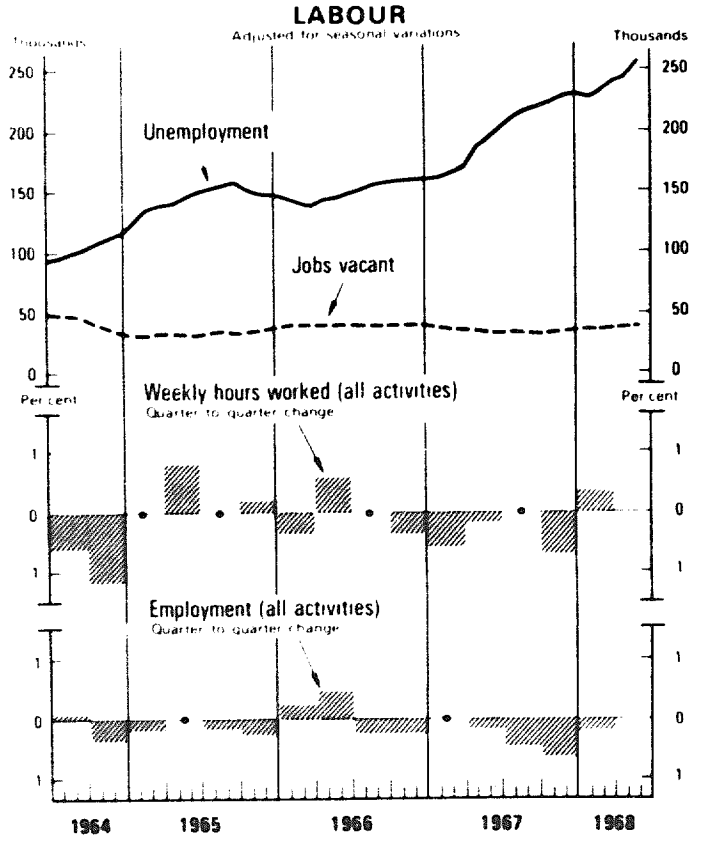
b) Net increase in world official gold holdings = +

c) Adjustment for inconsistent recording of intra-OECD transactions. Excess of recorded surpluses = +.

d) Identified official monetary transactions with International Organisations. Net increase in official liabilities = —.

PROSPECTS IN FRANCE AFTER THE STRIKES

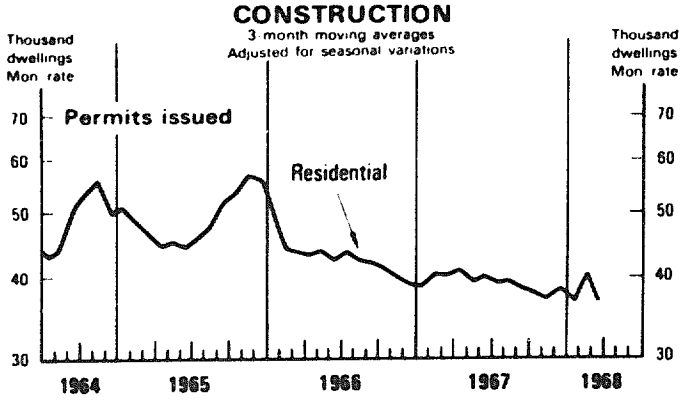
Before the strikes began in May, some acceleration of the growth of output seemed to be taking place in France, but it was uncertain whether it would suffice to prevent a further increase of the margin of unused capacity and unemployment. On current account, external transactions with non-franc countries seemed likely to remain in approximate balance. The virtual cessation of activity for several weeks and the subsequent wage increases granted inject a new and substantial element of uncertainty into the prospects. But because the events of May/June were dramatic, there may be a danger of exaggerating the economic problems left in their wake. Although the authorities are faced with a difficult task, important options remain open. France entered the strike period with quite important spare capacity in most sectors. The policy problems therefore are different from those of some neighbouring countries which earlier experienced wage explosions. In brief, there is a choice between a policy which would moderate the rise in prices as far as possible, so as to permit higher money incomes to work themselves out in the form of higher real demand or, alternatively, of letting higher costs be reflected quickly in higher prices, entailing both a lower rate of expansion of output and the risk of a price-wage spiral and loss of competitive power.

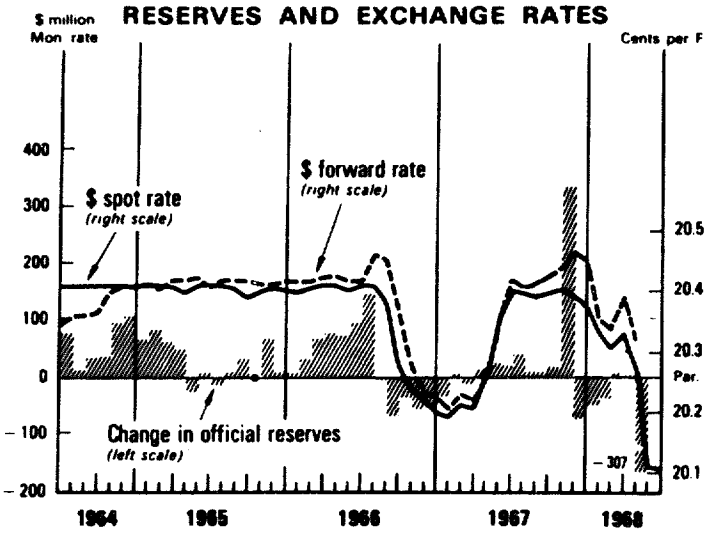


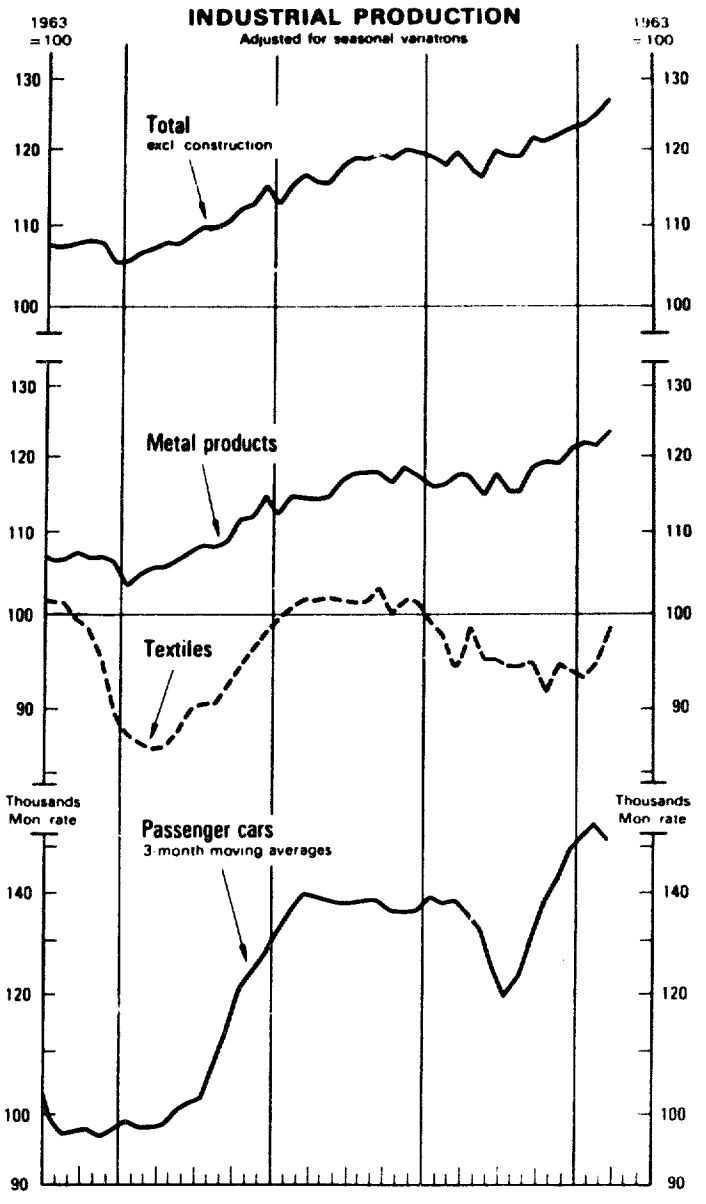
Events up to May

In the first quarter of 1968 the increase of industrial production had speeded up to an annual rate of about 10 per cent. With the exception of textiles, all the main branches of industry showed advances, the largest being in automobiles (which had been particularly affected by the slowdown in the middle of 1967), chemicals and basic metals. Construction, after little advance last year, also made some headway in the first quarter.

This expansion appears to have been due chiefly to exports, which, after a standstill during the first eight months of 1967, rose at a seasonally adjusted annual rate of over 20 per cent from September to April. This sharp increase reflected the recovery in Germany (with its repercussions on the Netherlands and Belgium) and strong demand for imports by the United States and the United Kingdom.

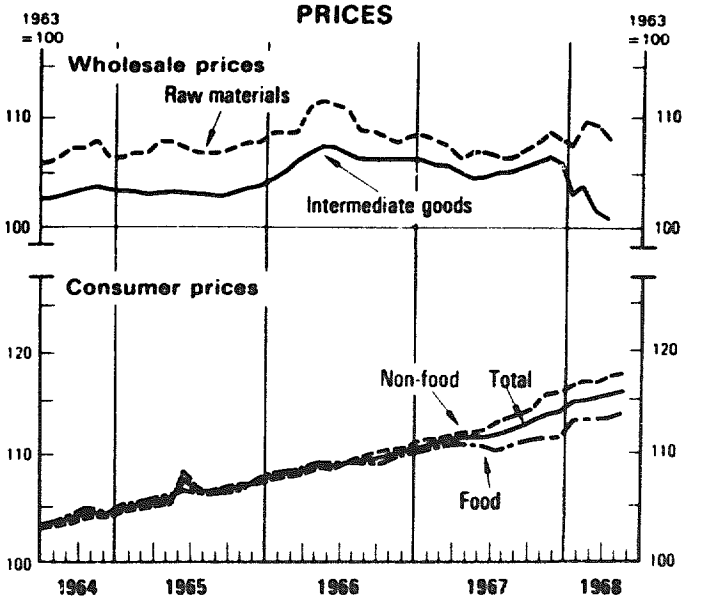






The increase in real disposable income of households slowed down significantly during 1967, and again at the beginning of 1968. This was the combined result of a fall in overall employment, increased taxation, modifications in the Social Security system and an accelerated rise in prices. Current indicators suggested only a modest rise of private consumption in the early months of 1968, following a 4.1 per cent increase in 1967 (and 4.7 per cent in 1966). The growth of private productive investment accelerated in 1967 (about 6 per cent in volume as against 4.5 per cent in 1966). But residential construction advanced little (1 per cent); building starts only increased by 2.3 per cent, despite steps by the government last summer to encourage building. Stock-building seems to have been on a fairly small scale up to the early months of 1968. The extension of the value-added tax to the retail stage on 1st January, 1968, led retailers to run down their stocks before that date and there is no clear evidence that this trend was subsequently reversed.

The increase in economic activity was however insufficient to have much effect on employment. Some of the increase of unemployment in the summer and autumn of 1967 may have been more statistical than real, and due to special measures governing unemployment assistance. But this cannot explain the continuation of the trend in recent months (increases of 7,000 in March and 4,400 in April, 1968, seasonally adjusted). The total number of hours worked by wage earners declined by 1.8 per cent in the twelve months to April 1968, with an even sharper fall in manufacturing.



By 1967, there was a cumulative gap of the order of 2 per cent between the actual level of GDP and its potential growth calculated on the assumptions of the IVth and Vth Plans (see Chart M). The potential increase in labour productivity and in the labour force may have been even higher than officially estimated in recent years; if one assumes a potential GDP growth of 6 per cent, the gap amounted to 5 per cent of GDP in 1967. The widening margin between potential and actual GDP in recent years was reflected both in the continued increase in the number of job seekers and in the decline in recorded participation rates, probably corresponding to under-utilisation of the potential labour force. These two estimates of the gap between potential and actual output in 1967 suggest that over a period of three years it would take a growth rate of at least 6 per cent, or on the alternative assumption as much as 7½ per cent, to absorb the margin of unused resources existing by the beginning of 1968. In practice, obstacles such as shortages of skilled labour and lack of geographical and professional mobility limit the speed with which this slack could be taken up.

The increase in industrial production in early 1968 mobilised some latent productivity reserves but did not reduce the substantial margin of unemployed resources. In March, 84 per cent of enterprises reported that, given more orders, they could produce more with existing capacities and employment levels. In many industries—clothing and textiles, household equipment, food processing, construction materials—increased production of the order of 10 to 15 per cent seemed feasible, and only the car industry appeared near full capacity utilisation at unchanged employment levels.

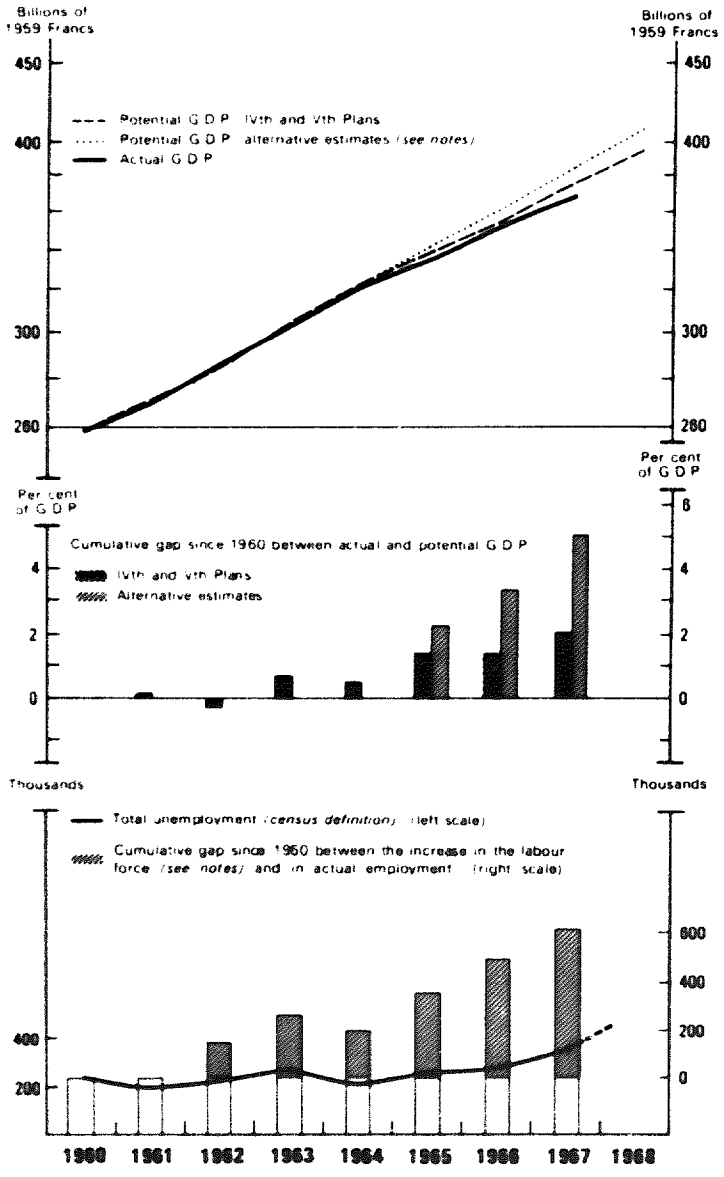


CHART M

FRANCE

POTENTIAL AND ACTUAL G.D.P., LABOUR UTILIZATION AND UNEMPLOYMENT, 1960 - 1968

Potential Output. The broken line shows "potential output" calculated on the productivity and employment assumptions incorporated in the IVth Plan (1960-1965) adjusted for the increase in the civilian labour force resulting from repatriation from Algeria and demobilisation; from 1966 onwards it shows the assumption concerning the annual rate of growth of potential output incorporated in the Vth Plan (5 per cent). The dotted line shows, from 1965 onwards, an alternative estimate of potential output (6 per cent p.a.) obtained by combining a potential productivity increase of 5 per cent compared with 4.5 per cent assumed in the Vth Plan, with the growth of the potential labour force. The latter, as calculated by the French authorities, is based on net immigration of labour and on the age and sex structure of the population, adjusted by extrapolating the trend in activity rates for specific age groups observed between the censuses of 1954 and 1962. Since the 1954 census took place at the moment of a cyclical trough, whereas that of 1962 corresponded to an upswing in activity, the official figures probably over-estimate the underlying trend in activity rates. But the figures shown here are adjusted for the increase in the school population in the active age group, and this may partly offset the upward bias.

Labour Utilisation. The solid line in the bottom half of the chart (left scale) shows unemployment according to census definitions as calculated by INSEE (the figure for the first four months of 1968 was estimated by multiplying the number of unsatisfied job applications, seasonally adjusted, by 1.9). The histogram corresponding to the right hand scale represents the total cumulative gap since 1960 between the potential labour force (as calculated by the French authorities, adjusted for the increase in schooling) and actual employment. It is thus a measure of unutilised labour resources, based on the assumptions about participation rates incorporated in the estimates of the potential labour force.

Although the extension of the value-added tax to the retail stage pushed up the consumers' price index by 1 per cent in January, a cumulative price rise was avoided—probably because of the relatively easy supply position. Prior to the tax adjustment, prices had been increased as the result of policy decisions (e.g. rises in public utility charges and changes in social security regulations). Influenced by such measures, the consumer price index between April 1967 and 1968 rose by 4 per cent, thus wiping out a considerable part of the intervening rise in wages (hourly rates in manufacturing rose by a little less than 6 per cent).

At the end of January the Government took steps to make the impact of public finance in 1968 slightly expansionary rather than, as would otherwise have been the case, slightly restrictive. The January measures—mainly tax reliefs for households and supplementary public investment and appropriations for the Fonds de Développement Economique et Social—had a budgetary incidence of Frs 2.4 billion. This reversed the previous prospect that, because of the changes in the social security system, the net overall borrowing requirement of the public sector in 1968 would fall by Frs 1 billion (0.2 per cent of GDP). The Government also took extra-budgetary measures—e.g. raising the low-cost housing programme—involving additional expenditure of about Frs 1 billion. In April, hire purchase terms for cars were eased.

Thus prior to the strikes, and allowing for the less favourable export prospects for the second half of 1968, it seemed reasonable to expect that GDP in 1968 would rise by about 5 per cent—a rate which would have accorded with the medium-term target postulated by the Plan but which would not have led to any absorption of spare resources. Public expenditure, both current and capital, seemed certain to increase faster than in 1967, as did residential construction. Some reconstitution of stocks seemed probable. Private productive investment was expected to increase less than in 1967 according to the INSEE surveys. The main uncertainty concerned consumers' expenditure. The effect of faster expansion on employment and consumers' incomes seemed likely to be delayed; and the January tax reliefs seemed likely to offset only part of the effects of previous measures to extend the value-added tax and speed up tax collection. Official estimates made in April put the rise of consumers' expenditure in real terms at 3.7 per cent for 1968—a figure that implied hardly any acceleration in the course of the year. These domestic trends, and the probable development of foreign markets, would have been consistent with the maintenance of approximate balance on external current transactions with non-franc countries for the year as a whole, with some deterioration in the second half.

The Strikes and their Aftermath

The Effect of the Strikes on Output and Demand

The scale of the May/June strikes has no equivalent in the economic history of France, or indeed of other Member countries. More than 10 million wage and salary earners, out of a total of some 15 million, stopped work for about three weeks or longer. The strikes spread over most of manufacturing industry and a considerable part of construction, and various services were affected to differing degrees. The majority of civil servants stopped work and railway traffic came to a standstill. In banking, insurance and other services, work stoppages were of shorter duration. Retail trade and transport of goods by road were little affected. There was practically no direct impact on agriculture. At the time of writing it is difficult to measure exactly the number of workdays lost and even more difficult to estimate the resulting loss of output. Even in industrial sectors such as basic metals and engineering, where the movement was very widespread, a number of enterprises continued to work or stopped only for a few days; the distribution of electricity and gas for non-industrial users was not interrupted. On the other hand, the general disruption of economic activity held back production of enterprises not on strike; and after the return to work, normal rates of output may not have been resumed without some delay.

On the basis of information at present available, it is estimated that some 4 to 4½ per cent of the annual output of manufacturing industry, and perhaps 3 per cent of that of building and construction, may have been lost during the strikes. Smaller losses seem plausible for the rest of output, except tourism and entertainment. In total, GDP, which was likely to increase at an actual rate of about 2½ per cent between the second half of 1967 and the first half of 1968, may have dropped instead by about 4 per

cent, allowing for some recuperation in late June. These are rough estimates, and the corresponding figures in Table 36 are merely illustrative.

The strikes have probably caused significant changes in expenditure. Total private consumption during May/June must have been reduced globally because of the loss of incomes of wage earners and self-employed. Purchases of some types of goods must have been cut back by lack of supplies and spending on certain services (e.g. travel and entertainment) was virtually impossible. There was also heavy buying of some food items and a few other consumer goods, but there may have been some disinclination to buy less-essential goods. The reduced volume of private consumption was met to some extent by running down trade stocks, and was probably partly financed by personal dis-saving. Fixed investment must have been reduced considerably more, if only because of the widespread suspension of deliveries of machinery and equipment whether locally produced or imported. Investment in construction may have been less affected, at least outside the main urban areas. Exports of goods were interrupted for nearly a month, as both production and shipments were largely suspended.

The scope for catching up on lost output in the coming months varies considerably from one sector to another. Seasonal factors may limit considerably the possible recuperation in the construction industry, and very little recuperation can be expected in services linked to tourism. On the other hand, most other services should be able to make good a fair part of their losses. In industry, most branches (except for cars and certain capital goods) have considerable margins of spare capacity which should enable them to make good a significant part of the losses so long as adequate demand is forthcoming.

On the demand side some recuperation is likely with respect to investment and exports, deferred consumer purchases, and replenishment of inventories. This should provide a temporary boost that may last until the early autumn. Despite the substantial wage increases which became effective on 1st June, private consumption may be temporarily adversely affected by the reconstitution of savings and repayment of loans incurred during the strikes. According to the general settlement, 50 per cent of the wages corresponding to the strike period were to be paid as an advance, subject to a degree of repayment in the form of additional unpaid work until the end of the year. The other 50 per cent represents a once-for-all loss of wage incomes. Allowing for the loss of production bonuses and for the fact that strikes lasting beyond the 4th June were not in principle covered by this arrangement, the loss can be tentatively estimated at 3 to 4 per cent of the annual wage bill; in addition many types of non-wage personal incomes were reduced appreciably in May/June. However, from the autumn onwards, consumers' demand should begin to reflect the full impact of the May/June settlements.

The Wage Settlements

Wage increases were obtained by nearly all those in salaried employment, not only the strikers. Official estimates have not yet been published for either the average wage increases by industrial sector or the total increases in the wage bill. The basic lines of settlement in industry, services and for agricultural labour are included in the " protocole de Grenelle " prepared on 27th May after discussions between the authorities, the employers and the trade unions. These broad lines have been completed in particular industries or firms in the course of sub-

TABLE 36.

France GDP, Industrial Production, Imports and Exports

	Percent change			Indices 1967 = 100			
	1967	1968 forecasts		1967	1967	1968	1968
		Pre-May	Revised [a]	I	II	I Estimate	II Forecast [a]
GDP at constant prices	4.4	5	3½	98.9	101.1	97	110
Industrial production	2.2	7	4	98.8	101.2	94	114
Imports, value [b]	4.4	9½	8	98.4	101.6	94	122
Exports, value [b]	4.4	11	7	98.9	101.1	93	121

a) Based on the policy assumptions discussed later in this note.
b) Customs basis.

sequent negotiations, in some cases after a prolongation of the strikes.

A feature of the protocol was the increase of the guaranteed minimum hourly wage (SMIG) from 2.22 to 3 francs (35 per cent) and the alignment of the minimum agricultural wage (SMAG) previously at 1.92 francs, to the new SMIG (an increase of 56 per cent). In addition, lower regional minima were increased through a reduction of the " zones d'abattement ". About 1½ million workers (of which 400,000 in agriculture) were previously getting less than the new minimum wage. Allowing for some secondary effects on workers previously in the range just above the new minimum it can be estimated that these changes will raise the national wage bill by around 1 per cent.

For the main body of wage and salary earners the increases stipulated in the protocol are: 7 per cent on 1st June, over the level of end-1967 incorporating increases already obtained since 1st January 1968; and an additional 3 per cent on 1st October. The additional advantages obtained, in particular settlements by sectors or firms, can be tentatively assumed to represent 1 or 2 percentage points for a full year. This estimate includes an allowance for the reduction of working hours agreed in principle in the protocol, the implementation of which is spread over the next year or two in different ways for the various sectors.

The effects of the settlement on average earnings for calendar year 1968 are very different from the effects calculated on a comparison of end-1967 with end-1968. On the basis of the Grenelle agreements the rise in average earnings between 1967 and 1968 would have been around 10 per cent. Allowing for the additional benefits negociated subsequently, but subtracting the income lost during the strikes, annual earnings per employee might rise by around 7 per cent. On the other hand, the increase of average wage and salary earnings per employee between the end of 1967 and the end of 1968 can be tentatively estimated at between 13 and 14 per cent.

Special agreements were reached for civil servants and for the workers of public enterprises, providing increases of the same order of magnitude as in industry and private services. The settlement implies a considerable relative improvement in the position of wage and salary earners in this sector, since the increases originally scheduled for 1968 were lower than seemed likely in the private sector (around 5 per cent in public enterprises).

At the same time, certain decisions were taken increasing net current public transfers to households. The scales of reimbursement for medical expenses under the social security scheme have been raised by 5 percentage points, partly reversing a decision taken in November 1967. Increases in pensions, family allowances and some other social benefits have been introduced or announced in principle.

Possible Outcome for 1968

The year 1968 can be divided into three sharply contrasting periods. The first four months were characterised by the export-led expansion and other developments already described. The loss of output and reduced expenditure of May/June will be followed by certain offsetting changes, the effect of which may last until the early autumn. Developments in the fourth quarter of the year, however, will be mainly determined by the economy's response to the large wage increases and to the policy measures taken during the summer.

The figures given in Tables 36 and 37 for the second half of the year are not forecasts in the usual sense: they are rather estimates of what the results might look like for the second half of 1968, and for 1968 as a whole, if policy is successfully directed to price moderation and expansion along the lines discussed below. Thus the figures allow for an acceleration in the underlying trend in output, as well as an estimate of the recuperation of production losses likely under these conditions. On these assumptions GDP in calendar year 1968 might show an increase of 3½ per cent over 1967, against the 5 per cent which seemed likely before the strikes, with a 4 per cent increase in industrial production. These figures would imply, however, that between *end*-1967 and *end*-1968, and disregarding the once-for-all loss incurred during the strikes, GDP would show an increase of around 6½ per cent and industrial production of around 10 per cent.[1]

Estimates of foreign trade and invisible current transactions in 1968 can only be very tentative. Apart from the direct impact of the disturbances in May/June and of the changes in underlying trends

1. The figures in Table 36 for the two halves of 1968 show a greater swing in output since in the first half year a relatively high first quarter was followed by a quarter in which output was curtailed by the strikes.

TABLE 37.

France[a]
Balance of Payments
Value, million dollars, Estimates and forecasts

	1967 I	1967 II	1967 Year	1968 Q1	1968 Q2-Q3	1968 Q4 [b]	1968 Year [b]
SEASONALLY ADJUSTED							
Exports	4,900	5,100	10,000	2,800	5,150	2,850	10,800
Imports	4,800	5,000	9,800	2,650	5,150	3,000	10,800
Trade balance	100	100	200	150	—	-150	—
Services and transfers, net	-100	-100	-200	-50	-300	-100	-450
Current balance	—	—	—	100	-300	-250	-450
UNADJUSTED:							
Current balance	-50	50	—	..			-450
Long-term capital [c]	35	-50	-15	..			
Short-term capital and unrecorded	62	-160	-100	..			
Franc Area, net settlement	129	-50	80	..			
Balance on non-monetary transactions	176	-209	-33	-107			
Commercial banks net	-168	537	369	-38			
Change in reserves	27	336	363	-85			

a) Balance with non-franc countries on a transactions basis.
b) Based on the assumption that the policies adopted are along the lines discussed in this note.
c) Excluding special transactions.

which may have followed the wage settlements, psychological factors and recent Government measures may have considerable effects on the timing of imports and exports. The figures shown in Table 37 do not take any such psychological or purely timing factors into account.

On the basis of experience in other countries, it is assumed that about half of the short-fall in exports during the strikes will not be made up in the following months and will reflect a once-and-for-all loss. It is further assumed that the effect of the recent cost increases will not have any significant impact on the underlying trend of exports this year. Empirical evidence for other countries indicates that export performance is quite sensitive to changes in demand pressures, but that changes in relative costs and prices, though important over the longer run, tend to be felt rather slowly. Exports are therefore assumed to rise by about 9 per cent between the fourth quarters of 1967 and 1968, roughly in line with the growth of France's overseas markets. (This would imply little increase over the high export level achieved in the first quarter of 1968, because of the expected unfavourable development of export markets in the second half of the year). Put together these assumptions give an export forecast for the year 1968 of 7 per cent.[1]

The forecast of imports reflects conflicting factors. The loss of output and income during the strikes will be a depressing factor. But bottlenecks, and higher stockbuilding in the coming months may pull in imports. And on the policy assumption discussed below, the underlying trend from the beginning to the end of the year would be higher, e.g. perhaps 15 per cent. In all, it is estimated that for the year 1968 imports might rise by perhaps 8 per cent. No allowance is made for speculative imports, which might be important (and might only be partly prevented by the temporary measures of protection already announced).

Invisibles will be adversely affected. There must have been—and may still be—some heavy losses on tourist receipts, although these should be partly offset by somewhat lower French tourist expenditure abroad. The once-and-for-all net loss in the second and third quarters is put here at $ 150 million and it is also assumed that there will be some continued deterioration in the underlying trend in the invisible balance between the beginning and the end of the year.

1. The export and import growth rates discussed here are consistent with those shown in Table 37 which refer only to transactions with non-franc countries.

On these assumptions—which may be optimistic as far as imports are concerned—the trade balance might be in approximate equilibrium in 1968, and the current account might show a deficit of $ 400-$ 500 million. By the fourth quarter the underlying current deficit might be running at an annual rate of around $ 1 billion, compared with the approximate balance achieved in the fourth quartter of last year.[1] Of this deterioration about one half would have been likely to take place in any case, while the other half would be due to the higher underlying rate of domestic expansion. If the rate of internal price increase were greater than here assumed, and the rate of expansion were consequently less, the outcome on the balance of payments would probably be different. With a faster rise in domestic prices adverse speculative factors would be more important; on the other hand the slower rate of expansion would make for weaker underlying rise in imports.

Policy Measures [2]

Apart from taking certain immediate policy measures to cope with the more urgent problems created by the disturbances and their aftermath the French authorities have made various statements concerning the broad lines and objectives of their policy to be defined in detail in the next few months. They have stated in particular their determination to defend the parity of the franc and to refrain, except very temporarily, from any reversal of the trend towards opening the French economy to international competition. They have also indicated that the solution to the current problems lies fundamentally in an accelerated growth of the national output and that it is the Government's intention, by appropriate interventions, to limit the extent of price increases in the coming months.

Foreign exchange control

As from 31st May, exchange control measures were introduced; additional measures were announced in July. These are intended to be temporary and to place no obstacles in the way of normal current transactions. However, a limit was fixed for foreign travel allowances of 1,000 francs per journey and per person (100 francs for one-day journeys).

Measures relating to foreign trade

France has implemented the reduction or elimination of import duties scheduled for 1st July under the EEC arrangements and the Kennedy round. But certain temporary measures concerning imports and exports were adopted.

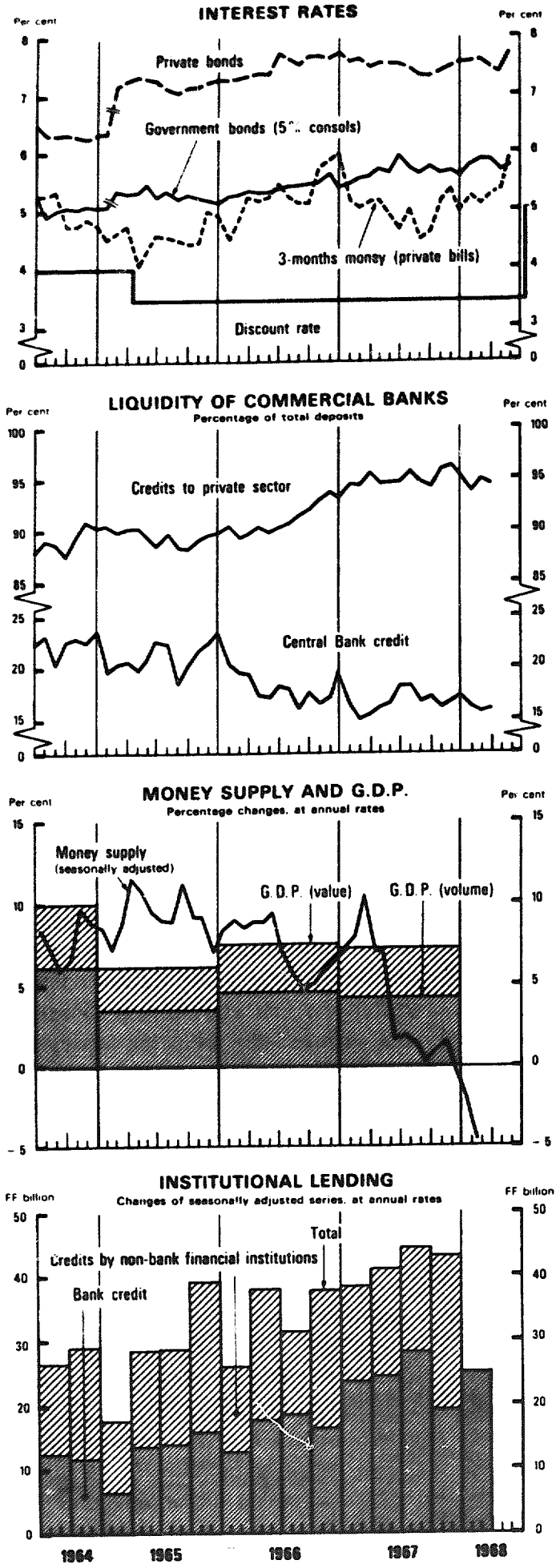
Quantitative restrictions on imports set ceilings for the whole of 1968 for certain electrical household appliances (10 per cent above the 1967 level) and for certain groups of textile products (levels equal to, or slightly higher than, in 1967). It is not yet known precisely how the implied ceilings for the second half of 1968 compare with actual imports in the early months of this year. For iron and steel products, the ceiling up to 31st December represents the average level of the first months of 1968. For imports of motor vehicles, quotas were fixed for the period 1st July to 1st November, 1968, representing increases of 15 per cent for private cars and 10 per cent for industrial vehicles, compared with the levels reached in the corresponding period of 1967. In all cases the quotas apply to imports from all origins.

Temporary *administrative supervision* was introduced in respect of imports of electronic components, machine tools, dyestuffs, industrial rubber, laminated panels and certain textile products.

Two different types of *export subsidy* were provided. For exports of capital goods there was already in operation a system of insurance against " economic risk ", i.e. the risk of abnormal increases in costs between the signing of the export contract and the time of delivery. It was decided to extend the coverage of the system—by including lorries and tractors, by reducing the minimum value of the contract from 1 million to 100,000 francs, and by allowing adherence to the schemes, under certain conditions, for work already under way in execution of

1. These figures are on a transactions basis. On a payments basis the outcome might look very much worse because of adverse swings in leads and lags, illegal exports of bank notes, etc., which on OECD balance of payments definitions, appear as capital or unrecorded transactions. The French authorities are in the process of changing their reporting procedures from an exchange record basis to a transactions basis. This estimate of the *underlying* deficit makes no allowance for the continued carry-over of disturbance effects from the strikes themselves into the fourth quarter nor, on the other hand, for the possibility that, with the introduction of temporary export subsidies, some exports may be brought forward from the early months of 1969 into 1968.

2. Based on information available up to 10th July, 1968.



uninsured export contracts. Moreover, it was decided that, for all contracts finalised before 1st January 1969, all cost increases above the levels ruling in April-May should qualify as abnormal cost increases eligible for subsidy. The discontinuation of this system in respect of exports to France's EEC partners, scheduled for 1st July, was postponed.

For all other exports—excluding agricultural and energy products, tobacco and works of art—a temporary subsidy was introduced amounting to 6 per cent of the wage component of the value of exports recorded at the customs between 1st July and 30th October. In practice the monthly wage and salary bill of the firm will be multiplied by the percentage share of its exports in its total sales in that month and an allowance will be added for the wage element in the cost of other inputs in order to determine the basis of the subsidy. The rate of subsidy will be reduced to 3 per cent for exports shipped between 1st November and 31st January, 1969, when this temporary arrangement will cease.

The cost of the second type of export subsidy can be very roughly estimated at 0.4 billion francs. While it is not possible to give any estimate of the cost of the subsidy to exports of capital goods, it seems unlikely that the cost of both subsidies together will significantly exceed 0.5 billion francs. Another measure concerning exports was the reduction of the preferential export discount rate from 3 per cent to 2 per cent until the 1st January, 1969.

Credit Policy

A generally easy credit policy has been adopted. Special credit facilities in order to allow enterprises having a turnover of up to 20 million francs to finance their exceptional needs of expenditure resulting from the May-June disturbances have been established.[1] Since about 90 per cent of industrial and commercial enterprises have a turnover of less than 20 million, the potential volume of advances under this scheme is rather large.

1. These special advances can represent either one month's turnover or three times the monthly wage bill, they may be granted for up to 18 months, will carry a guarantee of the Caisse Nationale des Marchés de l'État and will be rediscountable beyond quota at the Banque de France. They are additional to normal bank credit facilities, but cannot be claimed for other reasons than the immediate effects of the disturbances—e.g. for financing the subsequent wage increases.

The Banque de France—besides making various temporary amendments to the commercial banks' obligations (e.g. with respect to liquidity ratios)—is to increase by 20 per cent its re-discount margins for the next four months. It also reduced from 16 to 14 per cent the ratio for obligatory holdings of medium-term paper.

On 3rd July the discount rate was raised from 3½ to 5 per cent. This followed a loss of official reserves of $ 510 million in May and June, despite a drawing on the IMF and GAB repayment equivalent to $ 886 million.

Special Measures for Agriculture

Special measures have been announced to prevent a serious aggravation of the smaller farmers' financial position following the new wage settlements. The decision having the more important effect in the near future was to increase by 1.2 billion francs the budget subsidy to the fund supporting the markets of agricultural products (FORMA). The application of other decisions will be spread over the present and the following two years and is subject, in some cases, to new legislation. The measures include reductions in social security contributions, fiscal exemptions, and additional budget credits for agricultural investment.

Policy on Prices

The Government, having regard in particular to the problems of low-wage firms faced with large percentage cost increases, is not envisaging a general price freeze. But several steps are to be taken to limit the rise in prices:

i) Industries covered by a " contrat de programme " and producers of current consumption goods will be required to discuss with the authorities any price increases up to the end of this year which are not " extremely limited ".

ii) The prices of services and distributors' margins have been placed under surveillance. Procedures, to be agreed with the relevant trade associations, will be worked out for national and regional conventions.

iii) The Government has also indicated its intention to refrain from any immediate increase in public tariffs and rates on goods and services supplied to producers.

Tax Increases

An announcement of 3rd July foreshadowed further tax increases intended to raise 2½ billion francs.[1] The main increases envisaged are in the higher income tax brackets, duties on spirits and larger types of cars, and stamp duties. The incidence of the tax increases was chosen with a view to avoiding increases in production costs and to minimising the impact on the poorer part of the community.

Main Policy Issues

The French economy is faced with wage increases more than double the rate of the underlying productivity increases. In a fully-employed economy, the authorities would have little option but to raise taxes, cut expenditure and allow prices to rise. But in France the wage increase has come at a time when a significant margin of real resources is not being used. There is therefore a choice between allowing the increase in monetary demand to be worked out in higher prices—which would probably entail a further spiral of costs and prices; or, alternatively, in trying to limit the rise in prices, and by so doing preserve a higher level of real demand and thus stimulate a faster rise in output and therefore also in productivity. The second policy, of allowing wage increases to be absorbed to a greater extent by productivity increases, would not only postpone but also moderate the eventual rise in prices. It would require a fairly complex and coherent policy on the part of the authorities, having implications for the budget, for the profits of enterprises and for monetary policy. In order to make clear the nature of the policy options open, the following paragraphs set out the main elements of which a policy of this second sort might consist; and an attempt is made to depict the sort of internal and external conditions which might prevail at the end of the year were such policies generally pursued. The quantitative estimates must be considered as more than usually tentative.

1. With the extra tax receipts it was estimated that the net borrowing requirement for the year 1968 as a whole, would be 10½ billion francs, after adding into the budget the cost of higher wages and salaries in public administration, higher subsidies to agriculture, subsidies to exports and payments related to social security resulting from the wage awards.

EXAMPLES OF WAGE EXPLOSIONS IN OECD COUNTRIES

Although in very different circumstances, other wage-explosions have occurred in OECD countries in the 60's.

In *Italy*, hourly wage rates in manufacturing increased by 16% per annum from 1961 to 1963 with hourly earnings increasing even faster. This followed a long period of expansion combined with price stability which had largely absorbed the hitherto massive unemployment. As the wage explosion was not accompanied by any substantial acceleration in productivity growth, unit wage cost rose sharply and a large share of the increase was passed on to prices. The strong rise in private consumption and domestic demand could not be matched by an equivalent increase in real output. The resulting upsurge in merchandise imports and slowdown in exports turned the surplus on current account into a deficit which, in 1963, reached 2.3% of GNP. At the same time, consumer prices rose by 6% annually, and wholesale prices, after several years of relative stability, increased by over 4% annually. The situation was, however, drastically reversed in 1964 and 1965. A marked slowdown in the economy was accompanied by a considerable improvement in the cost-price performance, and, largely as the result of remarkably strong export performance, the current account swung into sizeable surplus.

In the *Netherlands*, a protracted situation of over-full employment and the existence of so-called "black wages" led, from 1964 to 1966, to an increase in wage rates in the private sector of 12.4% per annum — well above the gains in productivity. Although private consumption accelerated little and the savings ratio rose, domestic demand increased considerably more than real output. The deficit in the trade balance rose from an average of about $300 million a year during the 1960-63 period to over $600 million a year during the 1964-66 period. Wholesale prices increased at an annual rate of 4.5% from 1964 to 1966, and the rate of increase of consumer prices reached 5.7%. During this period Dutch export performance does not seem to have been much affected, but more recently there may have been some delayed adverse impact.

Lastly, in *France* itself between 1961 and 1962, disposable income increased by 13% annually, largely as a result of a 14% yearly increase in wages and salaries and a 21.5% yearly rise in net current transfers. Private consumption and domestic demand increased almost as much as disposable income, but since this coincided with the repatriation from Algeria of French settlers and soldiers, the additional nominal demand could, to a large extent be met by increased real output. In fact, although there was probably only a rather small margin of unused physical capacity, non-agricultural GNP (in volume) rose by nearly 6% both in 1962 and 1963. The trade surplus, which had averaged over $1 billion a year from 1960 to 1961, fell to an average of less than $0.3 billion a year during the 1962–63 period. Although higher imports helped to contain the price rise, the price deflator for consumers' expenditure accelerated from an average annual rate of increase of 4% during the 1959-61 period to 4.4% during 1962-63.

The difficulty of containing the price increases is enhanced by two factors. First, the wage increases have generally been largest for the lower-paid workers; this could lead to heavy pressure on profit margins in labour-intensive and low-wage sectors. These sectors contain many marginal enterprises which might in any case have been in danger of being submerged in the longer-run structural transformation of the French economy, but which could not be allowed to disappear overnight. Second, the events which led to the wage increases were, in themselves, of a nature liable to undermine confidence and rekindle the inflationary psychology that prevailed in the 1950s.

There are, however, two main approaches by which the Government can minimise price increases and maximise real growth. First, it can seek to induce—and, where necessary, help—both the public and private enterprise sectors to absorb part of the cost increases by some temporary shrinkage of profit margins. And second, it can accept part of the increased borrowing requirements required to pay for the higher charges with which the public administration is itself now faced.

Output, Employment and Demand

Given the margin of unused resources, it would be possible to aim at a rate of expansion somewhat faster than was previously likely, e.g. at a level of output at the end of the year perhaps 6½ per cent higher than at the beginning. Though a higher rate of increase might be feasible, structural problems and the risks of bottlenecks and skilled labour shortages might suggest a prudent target. Despite the probability of unusually large productivity gains, to raise output by 6½ per cent would require some increase in labour input, perhaps of the order of 1 per cent. Although the new settlements provide for reductions in the standard working week, this increase might be principally in the form of eliminating short-time work in some branches and more overtime in others. If so, there might be little change, and possibly some deterioration, in the employment situation.

Together with the average increase in wage and salary earnings of 14 per cent between January and December suggested above, this might raise the total wage and salary bill between the beginning and end of the year by around 15 per cent (Table 38)

TABLE 38.
France: Household Appropriation Account[a]

	1967 billion francs	Hypothetical changes end-1967 to end-1968 Per cent: *Before (b)* Allowing for impact of May-June settlements	*After* Allowing for impact of May-June settlements	Difference due to impact of May-June settlements at annual rates Francs billion
Net wages	186.4	7	15	15
Gross income of individual entrepreneurs	109.0	7½	10½	3½
Interests, rents, dividends	12.3	7	7	—
Social benefits	98.7	9	12½	3
Other income (net)	5.0	13	13	—
TOTAL	411.4	8	13	21½
Less:				
Social Security contributions	6.2	17	28	1
Income tax	23.1	18	18	—
Disposable income	382.1	7½	12½	20½
Consumption	329.2	7½	12½	17
Saving	52.9	..	..	3½

a) Shown here on French definitions rather than OECD standardized definitions.

b) In its April assessment of the Economic Budget for 1968 the authorities were forecasting a rise in consumption between calendar year 1967 and 1968 of about 7½ at current prices and it seems that this might also have been the trend *through* 1968.

Although other personal incomes (from property and entrepreneurship) may in some respects have been unfavourably affected by the recent events, they nevertheless seem likely to rise somewhat faster than would otherwise have been the case. Social benefits have also been raised. The rise of incomes will not be translated into higher direct tax payments until next year,[1] but contributions to social security will go up and, thus, slightly reduce the growth of disposable income. Although the savings ratio is likely to fluctuate sharply during the course of the year, it is assumed that the end-year level will not be substantially different from that of 12 months earlier. Thus in current prices consumption might rise by around 12 to 13 per cent between the beginning and the end of the year (5 per cent more than seemed likely before the strikes).

Leaving aside once-and-for-all losses, public consumption and investment seem likely to increase between the beginning and end of 1968 roughly along the lines originally envisaged, and it will no doubt be an aim of policy to prevent, as far as possible, any cut-back in private fixed investment plans. Stockbuilding, however, might rise a little more steeply than envisaged in sympathy with the stronger trend in consumption. In all, it would seem reasonable to expect total domestic demand to rise by about 12-13 per cent in money terms between the beginning and end of 1968, about 3½ per cent (18 billion francs) more than originally seemed likely.

Again leaving aside the once-and-for-all losses, it would seem unlikely that the underlying trend of exports would be significantly affected by cost increases in so short a time, and exports will be receiving a temporary stimulus until the end of the year from the measures recently announced. On the other hand, higher imports would be required to support the higher level of output and final demand.[2] Demand for domestic output in money terms might then rise by about 11-12 per cent, or some 3 per cent more than originally expected.

Prices and Profits

For this increase in money demand for domestic output between the beginning and the end of the year to stimulate a 6½ per cent addition to real output, the rise in the general price level would have to be limited to about 5 per cent. The maximum rise in consumer prices would be a little higher than this, perhaps 5½ per cent, because of

1. No allowance is made in Table 38 for the special income tax levy on higher incomes referred to above.

2. An increase of real output of 6½ per cent rather than 5 per cent might push the growth of imports up from 10 to 14 or 15 per cent in money terms.

TABLE 39.
France: Impact of additional wage increases on the cost structure of the enterprise sector[a]
Billion francs

	1967 partly estimated	*Hypothetical impact of additional wage increases resulting from May-June settlements (b)*
Total sales net of intermediate consumption (at market prices)	546.6	18
Costs:	390.2	24½
Imports (at domestic prices)	74.0	3½
Purchases from other sectors	7.5	—
Gross wages	153.5	12½
Social Security contributions and wage taxes	55.4	5½
Interests, rents, insurance	19.0	½
Indirect taxes	80.8	2½
Gross profits:	156.4	-6½
Income of individual entrepreneurs [c]	102.4	3
Net dividends, etc.	2.0	—
Retained profits [c]	52.0	-9½

a) The enterprise sector covers all enterprises (including unincorporated business and agriculture) but excludes the government sector narrowly defined and financial institutions.

b) Calculated on the assumption that the additional 3 per cent increase in value added at current prices resulting from higher consumer demand is divided roughly half and half between higher prices and higher output. The period corresponds to the full increase at an annual rate disregarding however the once-for all losses incurred as a result of the strikes.

c) Income of individual entrepreneurs less gross capital formation financed by them, which is included in this table under retained profits.

the extension of the value added tax last January (between January and May consumers' prices rose by 1.8 per cent, and there was probably a fairly sharp rise in June). To put it another way, given the *additional* 3 per cent increase in monetary demand, the aim might be to keep the *additional* price rise resulting from the May/June wage settlements to no more than 1½ per cent—in order to stimulate *additional* real output equivalent to around 1½ per cent of GDP.

Clearly, the problem is how to keep price increases within this overall limit without squeezing profits to the extent of exerting an adverse effect on employment and investment. Table 39 shows the cost structure of the enterprise sector in 1967, and a very tentative estimate of the possible effect on costs of the May/June wage settlements. As noted, the additional rise in money incomes resulting from the settlements might raise sales by 18 billion francs at annual rates above what they would otherwise have been. Against this it is estimated that the additional costs might be of the order of 24-25 billion francs.[1] On this reckoning, therefore, the gross profits of the enterprise sector might be 6-7 billion francs lower than they would have been. As mentioned above, there would probably also be some additional rise in the income of individual entrepreneurs; if so, the retained profits of the enterprise sector might be, say, 9-10 billion francs (or about 15 per cent) lower than would otherwise have been the case. It needs to be borne in mind, however, that before the recent events retained profits in 1968 seemed likely to show a significant improvement over 1967 (partly because of the pricing decisions taken following the changes in the system of indirect taxation). On the other hand, the French authorities have been concerned about the level of profits and profit margins for some time, and it is difficult to avoid the conclusion that with a development along the lines envisaged in Table 39 it would be difficult, if not impossible to avoid an adverse effect on employment and investment.

The impact of the wage increases will be very uneven as between sectors. Wages are likely to increase proportionally most sharply in *agriculture* because of the large number of farm workers whose wages were at or near the previous minimum. Since the more important agricultural prices are fixed in the framework of the EEC agricultural policy, the wage increase by itself would be likely to result, through much of French agriculture, in decreases of the incomes of independent farmers or dismissals of farm labour that would be socially and economically unacceptable. But the government has announced a series of measures which should, by and large, offset the increases in labour costs.

In *public enterprises*, the additional wage costs are estimated at about 3 billion francs. How far these will result in higher prices will depend largely

1. The main elements are (*a*) the additional imports referred to above and which are treated as costs of the enterprise sector in Table 39, (*b*) a 15 per cent rise in the wage bill compared with the 7 per cent increase which seemed likely before the strikes (*c*) a more than proportional rise in social security contributions and wage tax payments because social security contributions are a higher proportion of total wage cost in low-wage sectors where the wage increases have been largest, and (*d*) additional indirect tax payments roughly in line with the addition to sales.

on government decisions—a problem discussed further below.

In the *private non-agricultural sector*, on the above assumptions about prices and output, and assuming that public enterprises absorb their own cost increases, retained profits would be about 5 billion francs lower than would otherwise have been the case (in 1967 retained profits in this sector amounted to about 30 billion). The impact would, however, vary widely between industries. Rough calculations suggest that compared with an average impact of around one-sixth, some of the more labour-intensive industries, e.g. footwear and clothing, and in particular many service industries (e.g. hotels, catering, retail trade) would be much more severely affected, and in some activities particularly exposed to foreign competition profit margins might virtually disappear; industries such as oil refining and chemicals would, however, be in a considerably better position and for some enterprises the cut in profit margins might be more than offset by the increase in sales. The differences between industries (and individual firms) are so large—both in respect of the impact of the wage settlements and the adequacy or otherwise of profit levels before the settlements—that any generalisation about prices and profits risks being misleading. Nevertheless, it seems unlikely that private non-agricultural enterprises would be able and willing to maintain the necessary degree of price restraint unless they were helped, temporarily, to absorb at least part of the additional wage increases.

Fiscal Policy

Any assistance to the private non-agricultural enterprise sector, in the interests of ensuring the minimum price rise in the face of the wage settlements, would probably have to consist, in part, of fiscal or para-fiscal action. To the extent that official policy, in the broadest sense, succeeded in creating confidence that the economy was entering a period of rapid growth with only limited price increases, entrepreneurs should be readier to accept some temporary cuts in profit margins—and perhaps, in some cases, the volume of profits—without cutting back on their investment plans. But in the months immediately ahead, to ensure that activity attained a more rapid rate of growth, there would be a case for some budgetary support to the private non-agricultural enterprise sector.

Such temporary support could be provided in various ways. Since the problem would be, essentially, to afford temporary relief to the firms whose financial positions are most affected by the wage settlements, support could be tailored as closely as possible to the additional cost increases. Among various possibilities would be a temporary reduction in the wage tax, or in employers' social security contributions.[1] The Italian authorities had resort to similar measures from September 1964 to the end of 1966 when part of employers' social security contributions (amounting to about 1 per cent of GNP) were taken over by the budget.[2] As an arithmetic illustration, the temporary "budgetisation" of around 10 per cent of employers' social security contributions would roughly offset four fifths of the potential 5 billion francs cut in retained profits of private non-agricultural enterprises referred to above. A partial variant of such a measure has already been announced by the French authorities in the shape of the temporary subsidies to exporters, assessed on the wage-content of exports. This, however, may have little effect on internal prices (the cost of these measures was tentatively estimated above at about ½ billion francs). Further, to ensure that the necessary processes of structural change in the French economy are not interrupted, additional temporary fiscal incentives might be given to investment—though these would give most benefit to the capital-intensive high wage sectors and least to the harder-hit labour-intensive low wage industries.

A further step in this direction is the additional relief already announced for agriculture, costing about 1½ billion francs in 1968 and more in a full year.[3] Again, if the policy of not immediately passing on the cost increases of public enterprises were rigorously observed, additional subsidies or borrowing by this sector might amount to around

1. The latter would provide support more closely related to the additional charges on industry, for social security contributions are a larger proportion of total wage costs and will increase most in low wage industries where the wage increases have been largest.

2. On this occasion the general transactions tax and certain direct taxes were raised simultaneously.

3. The major part is to take the form of additional funds allocated to price support. With a strong rise in consumption the demand for those foodstuffs which have a relatively high income elasticity of demand would increase, tending to limit to some extent the accumulation of state-subsidised stocks and gradually reduce the burden on the budget compared with the sums initially allocated.

3 billion francs at an annual rate. For the government sector itself, additional wage increases and recruitment may cost around 3½ billion francs over a full year. The budget will also have to support the increase in net transfers to the household sector. Final decisions on several items in this field have not yet been taken (see above), but it seems possible that the net cost to the budget might be of the order of 2-3 billion francs. [1]

The scale on which action on these lines might be taken is a matter of judgement, and the possibilities suggested above are of course intended to be illustrative. It may however be useful to try to summarize the budgetary implications. The effect of the policies described above, if all possibilities were adopted simultaneously, might, at a rough estimate, increase the borrowing requirement by about 15 billion francs in a full year. On the other hand, the faster rise in incomes, as a result of the wage settlements and of the faster rate of expansion, would raise revenues more than would otherwise have been the case; and this might offset perhaps half the 15 billion francs. [2]

The actual budget outcome for the calendar year 1968 will be considerably affected by the loss of revenue during the strikes. From the point of view of the impact of the budget on the economy it may therefore be more useful to consider the rate at which the net borrowing requirement might be running *at the end of the year*. At the time of the budget estimates in April, it was put at some 5 billion francs for the year 1968, and in the absence of the strikes and the subsequent wage awards, it seemed likely that its size would be declining through the year, and that by the end of the year it might have been running at a low level. [3] The possible extra costs on the budget outlined above, partially offset by the increase in tax and other revenues, might mean that by the end of the year it would be running at an annual rate of the order of 10 billion francs (2 per cent of GDP). There might be means of reducing this by raising additional revenue or cutting expenditure in ways which did not have adverse effects on costs or real demand and employment, though the scope for this appears rather limited. But a budget deficit giving an expansionary stimulus to the economy at the end of the year equivalent to 1½ per cent of GDP might be appropriate to achieve the higher rate of expansion here being discussed.

Monetary Policy

A budgetary policy along these lines might have to be backed up by a continued easy money policy. (The authorities have already taken a number of measures to increase credit availabilities: see above). The enterprise sector in the next few months will be in a difficult financial situation, given the losses of sales incurred during the strike and the higher wage rates payable now and, again, in October. Unless sufficient bank liquidity is created, financing the large public sector borrowing requirement envisaged above, without an undesirable rise in interest rates, would be very difficult (the balance of payments deficit will, in itself, serve to reduce liquidity). So long as a certain slack in the economy remains —and it is unlikely to be fully absorbed for some time—this would be unlikely to be a cause of inflation, though as full employment of resources was approached, monetary policies would need to become less expansive.

Price Policy

The Government has announced that it hopes to limit the price rise from 1st July to the end of the year to no more than 3 per cent. This appears to be roughly in line with the suggestion made above that the price rise between the beginning and end 1968 might be held to about 5 per cent. [4] But the

1. This is consistent with Table 38: the increase in refunds on medical expenses is there regarded as a decrease in prices rather than an increase in incomes.

2. On the assumptions underlying Table 39, indirect taxes, the wage tax, and employers' social security contributions might yield an additional 8 billion francs at an annual rate by the end of the year.

3. This seemed the likely result of the timing of the 1968 budget: the income tax relief was confined to the early months of the year, whereas turnover tax collections would have accelerated with the quicker rise in consumers' expenditure in the latter part of the year.

4. There have already been quite a number of well-publicised prices increases—e.g. bread (5-10 per cent), newspapers (25 per cent), taxis (20-25 per cent), automobiles (3 per cent). Under the prevailing circumstances there could be a danger that 3 per cent will be taken as the *additional* price rise justified by the wage settlements (only part of which were immediately effective), and that it will be regarded more as a minimum than an average increase.

incidence of the cost increases is very uneven: even with budgetary support, significant price increases would be needed to maintain an adequate level of profits in the low-wage and labour-intensive sectors. It follows that there would be littl^ or no scope for immediate price increases in the capital-intensive industrial sectors for the overall target to be achieved.

In view of the prevailing psychological climate, an active price policy would seem to have an important role to play. Within the context of an overall demand management policy designed to stimulate expansion, there would be need to encourage price decisions which gave maximum weight to anticipated sales increases rather than anticipated cost increases. In large parts of the economy foreign competition should effectively check excessive price increases. In this context the decision to go ahead with the 1st July tariff reductions will be helpful, though the temporary resort to import quotas and administrative surveillance of imports could work in the other direction. In sectors not directly exposed to foreign competition, some measure of temporary price control might be appropriate.

General state of the Economy

By the end of 1968, if policies along these lines were carried through, the trend growth of the main aggregates of GDP over the preceding 12 months might be something like that shown in Table 40:

— Total domestic demand including stocks might have risen by around 12½ per cent in money terms, and by 7½ per cent in volume so long as the rise in the general price level is kept down to 5 per cent;

— The current account might have deteriorated by about $ 1 billion (annual rate) or about 1 per cent of GDP, moving from rough equilibrium to an underlying deficit of around $ 1 billion from the fourth quarter of 1967 to the fourth quarter of 1968.

— This would give a trend growth of GDP of about 6½ per cent and a rise of industrial production of perhaps 10 per cent.

TABLE 40.
France: Hypothetical Developments in Real Demand and Output from end-1967 to end-1968 on certain policy assumptions
Percentage changes, volume

	1966 to 1967	End 1967 to end 1968[a]
Private consumption	4.1	7
Public consumption	6.0	6
Fixed investment	5.8	6½
Total domestic demand (excluding stocks)	4.7	6½
Plus change in stockbuilding [b]	–0.1	1
Plus change in foreign balance [b]	–0.1	–1
GDP at market prices	4.4	6½
GDP implicit price deflator	2.7	5 [c]
Industrial production	2.2	10

a) The figures shown in the second column are only orders of magnitude.
b) Changes in stockbuilding and the foreign balance are expressed as percentages of GDP in the base period. The sum of the changes in domestic demand, stockbuilding and the foreign balance, thus equals the change in GDP, although details may not add because of rounding.
c) Based on French national accounting definitions. Because of the large wage and salary increases in public administration the rise in the deflator on SNA definitions would be higher, probably of the order of 6 per cent.

Prospects for 1969-70

By the beginning of 1969, therefore, the economy might have been pushed on to a higher growth path, and price increases might have been kept relatively modest. But by the same token the financial position of the government and enterprise sectors would have been impaired. Under these circumstances there might be a case for aiming at a sustained period of fairly rapid expansion so as to permit an improvement in the employment situation—but not such as to lead to excessive tensions in the labour market.

This would provide a climate in which it would be possible to restore profit margins and public finances with the minimum upward pressure on the price and cost level. A higher growth rate would, in time, call forth additional investment demand. As this materialised, it would be appropriate to aim for an increase in public savings and a declining budget deficit. In fact, tax revenues would already begin to increase fairly rapidly from the second quarter of 1969 onwards, as direct taxes begin to be assessed on the sharply increased 1968 money in-

comes. The authorities, too, would not wish to continue subsidies to labour-intensive low-wage industries longer than absolutely necessary, since they would tend to retard the exploitation of potential productivity gains. They would also want to eliminate as soon as possible the artificial element in public utility prices resulting from higher subsidies to public enterprises. Changes in these areas would have to be made within an overall fiscal policy designed to provide sufficient stimulus to maintain expansion.

The medium-term prospects for the balance of payments would depend in part on trends in world trade. The latter may continue to be adversely affected well int 1969 by the restrictive action taken in a number of deficit countries, but might then recover markedly. French competitive performance has been well above average during the 1960s.[1] While this was most marked in the period immediately following the 1958 devaluation, French exporters have continued to improve their market shares in the most recent three-year period, with annual export gains averaging 9.2 per cent against an average market growth of 7.5 per cent (Table 41). There are no reliable figures for absolute or relative costs in export industries in different countries, but the general evidence suggests that since 1964 French costs and prices have been rising somewhat less fast than on average among her major competitors (Chart N).

The strong export performance has been matched by a sharp rise in the propensity to import, with the ratio of imports to GNP rising from 9.6 per cent in 1959/60 to 13.8 per cent in 1966/67.[2] At the same time, there has been a steady deterioration in the balance on invisibles—mainly tourism—averaging about $ 80 million a year over the years 1961-66.

How much recent events may prove to have adversely affected the balance of payments over the longer run is difficult to judge at this date. The most immediate problem facing the French authorities is not on the current account, but on the capital account. Initially, it would seem that the capital flight was set off largely by political uncertainties. The decisive factor in the longer run is likely to be the success achieved in preventing the emergence of a price-wage spiral. International credit facilities backed by substantial first line reserves should enable the authorities to ride out short-term speculation and give time for the necessary policy adjustments to bear fruit. The development of costs and prices is also likely to be the decisive factor for the current balance of payments.

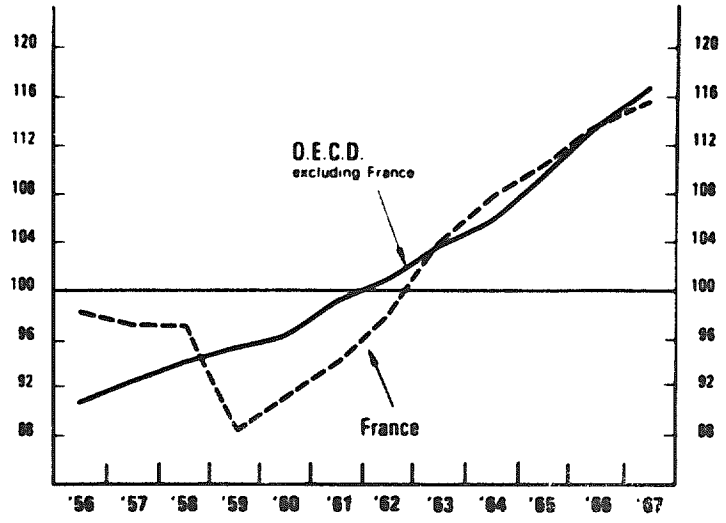
TABLE 41.
France: Export Performance 1956-57 to 1966-67
Percentages

	Growth of markets[a]	Growth of exports	Difference
1956-57 to 1959-60	6.1	8.7	2.6
1959-60 to 1963-64	5.7	8.2	2.5
1963-64 to 1966-67	7.5	9.2	1.7
1956-57 to 1966-67	6.4	8.7	2.3

a) The growth in total French exports which would have occured if French exporters had exactly maintained their share in total OECD exports to each major French market.

CHART N

G.N.P. PRICE DEFLATORS, 1956-1967
Dollar values at current exchange rates
average 1956-66 = 100



1. Taking intra-EEC trade alone, French export performance relative to the growth of French markets within the EEC over the periods shown in Table 41 was second only to that of Italy. Over the period 1956/57 to 1966/67, French gains in market shares amounted to 0.9 per cent of its intra-EEC exports, less than Italy (+4.9 per cent), but greater than Belgium (-0.3 per cent), Germany (-0.9 per cent) or the Netherlands (-2.1 per cent). Calculations made on the basis of trade in manufactures alone confirm these results.

2. Imports and GNP at constant 1958 prices.

The choice of policy options facing the French authorities is therefore an important one. As already indicated, there appears to be a broad choice between allowing cost increases to be rapidly reflected in price increases; or, alternatively, in limiting the price increases, at the cost of a temporary increase in the budget deficit and public borrowing, with the effect that the wage increases are reflected in a greater rise in real output. The advantage of the second general line of policy would be that wage and salary earners would enjoy real gains, the employment situation would be improved, and part of the cost increases resulting from the wage settlements would be offset by faster productivity growth. If, on the other hand, price rises now offset the wage awards recently made, the risk of a price-wage spiral is greater, unemployment could rise in the sectors exposed to international competition, and the damage to the balance of payments would be greater. There is likely, in any case, to be a deterioration of the current external account. But the effect of higher imports required to support faster growth would seem to be less serious than that of a continuing rapid rise of costs and prices which would inevitably cause permanent damage to France's competitive position.

DEVELOPMENTS IN OTHER MAJOR OECD COUNTRIES

GERMANY

The path of the recovery which began in the summer of 1967 was distorted by special factors around the turn of the year. It is not yet certain that the expansion has got on to a self-sustaining basis, and if the recent signs of a stronger trend in private consumption are not confirmed, further measures—probably in the form of fiscal action—may be required.

Policies

The expansionary influence of policies adopted last year is now disappearing. The special depreciation allowances accorded to investment ceased to operate last autumn; and the effects of the turnover tax rebate on stocks carried into 1968, which encouraged stockbuilding in the later months of last year, have now ended.[1] Orders under the second Federal contingency budget were placed promptly and virtually all non-housing orders had been placed by the end of the year. Most of the orders for dwellings—with a deadline in end-March—were placed by the early spring.

The Federal budget voted for 1968, with the various tax increases and expenditure cuts described in the December edition of the *Economic Outlook*, will be less stimulative than its predecessor. The increase in expenditure on goods and services is expected to level out and the internally effective deficit may be about the same as last year (DM 0.1 billion).[2] Last year's budget showed a swing, equivalent to 0.7 per cent of GNP, from a large surplus to a small deficit.

Monetary policy has become less easy in recent months, with no further increase in bank liquidity. The net secondary liquid reserves of the banks (money market investment at home and abroad less recourse to Bundesbank credit) fell to DM 15.9 billion at end-

1. The rebate acted as an incentive to firms who expected that the value-added tax introduced in January 1968 would increase the cost of stockbuilding by more than the non-refunded 15 per cent of the turnover tax paid on old stocks.

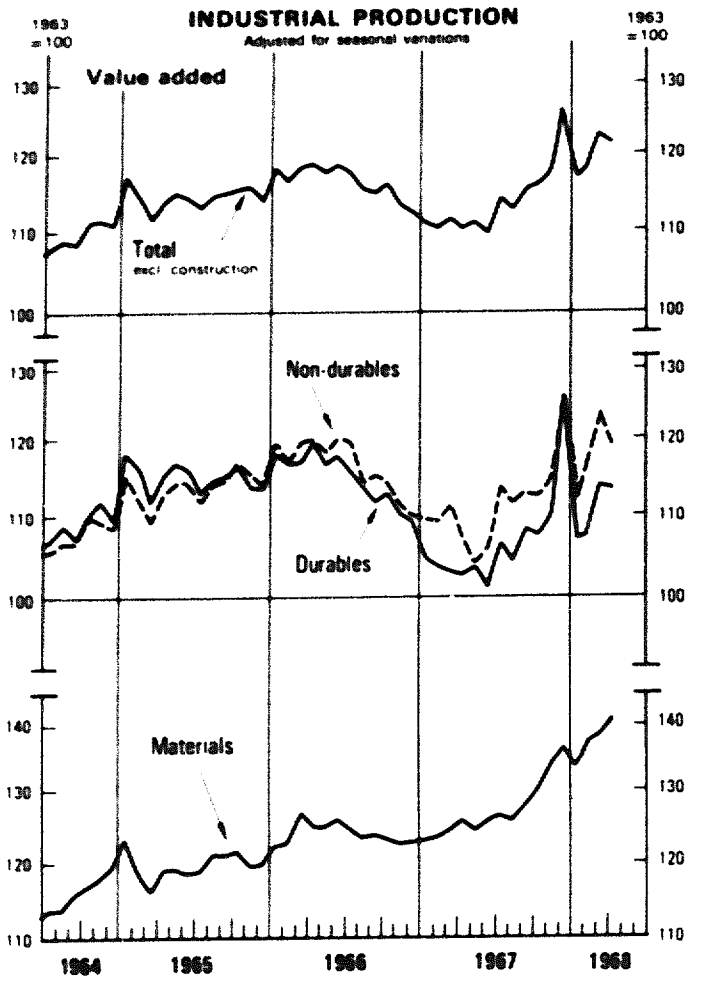
2. The financial deficit on a national accounts basis less purchases from abroad and net transfers and interest payment to abroad. The 1968 budget on a national accounts basis excludes the ERP and Equalisation of Burdens Funds. But this does not significantly affect comparability with the budget outcome in earlier years which includes these items.

Demand and Output
GERMANY

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

	1966 billion DM	From previous year 1967	From previous year 1968	From previous half-year 1967 I	1967 II	1968 I	1968 II
Private consumption	274.9	0.6	1½	0.7	0.7	1½	2½
Public consumption	75.4	3.2	2	6.5	1.0	3	1
Fixed investment	121.9	-7.5	6½	-14.8	9.3	¾	15½
Total domestic demand (excluding stocks)	472.2	-1.1	2¾	-2.5	2.8	1½	5½
*plus change in stock-building	2.0	-1.2	2¼	-3.2	3.2	3¾	-1½
*plus change in foreign balance	6.5	2.0	-½	2.9	-1.3	-¼	-¼
GNP at market prices	480.7	-0.3	4½	-2.7	4.7	5	3½
GNP implicit price deflator		0.9	2	0.0	0.6	3	2½
Industrial production		-2.2	7½	-5.5	9.4	7	5

* In the first column absolute figures are shown for "stock-building" (additions to stocks) and the "foreign balance" (net exports of goods and services). In subsequent columns, changes in stock-building and the foreign balance are expressed as percentages of GNP in the base period. The sum of the changes in domestic demand, stock-building and the foreign balance, will thus equal the change in GNP, although detail may not add because of rounding.

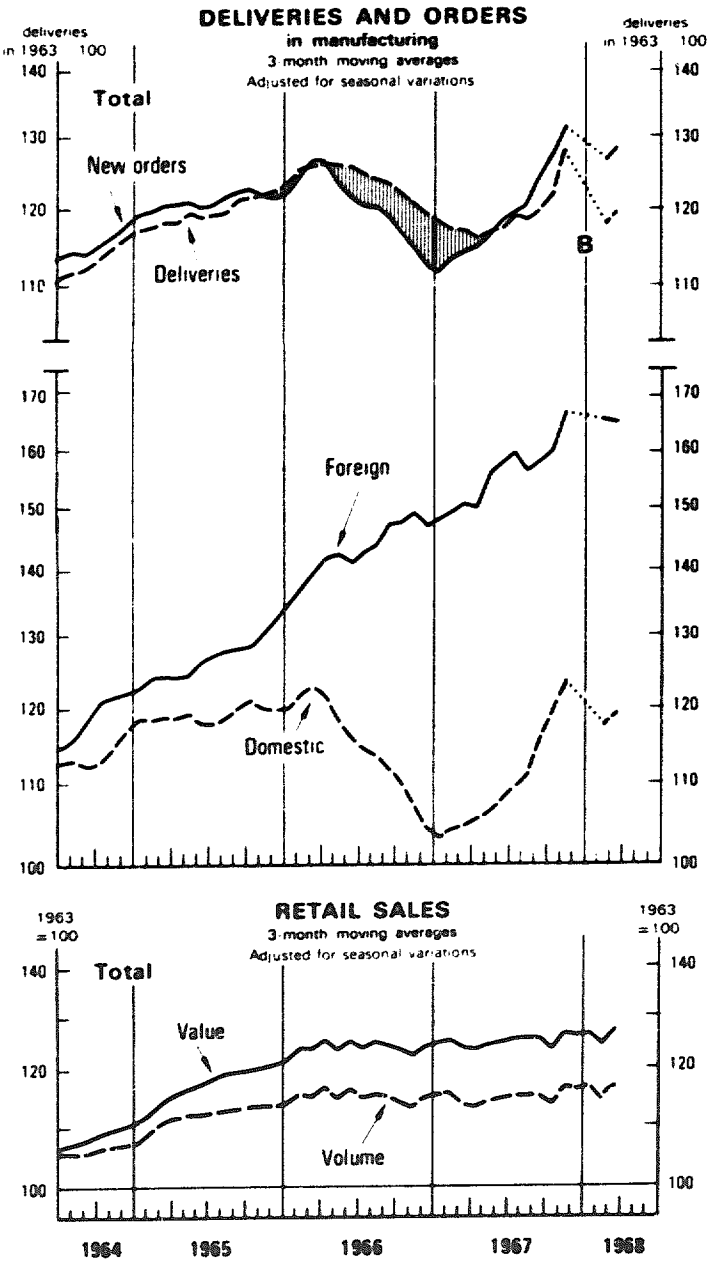


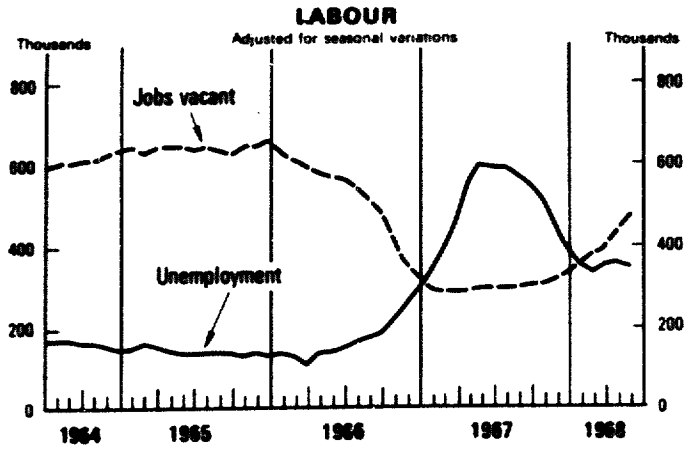
May after reaching an unprecedented DM 16.8 billion at end-February. They corresponded to 6.4 per cent of deposits from non banks at end-May, roughly the rate prevailing in early 1964 before the start of the restrictive phase of monetary policy. The Bundesbank has continued an active swap policy with a view to reconciling domestic money market needs with balance of payments requirements.

Recent Trends

Between the first and the second halves of 1967, real GNP increased at an annual rate of 4½-5 per cent on a seasonally adjusted basis; with the end of stock depletion and a strong revival of investment in machinery and equipment, domestic demand rose rather faster. Investment in building appears to have suffered a further, though slight, setback. The growth of government consumption, steep in the first half-year, slowed down, whilst private consumption advanced at the slow pace of the first half-year, as both wages and employment were rising only moderately.

There was little increase in activity in the third quarter but the fourth quarter saw a marked upturn. Apart from the factors already mentioned, anticipation of price increases resulting from the introduction of the value added and investment taxes on 1st January provided strong stimuli to demand, moving forward spending to 1967 from 1968. Preliminary figures suggest that this tendency was particularly marked in machinery and equipment. The counterpart of the strong fourth quarter was a relatively weak first quarter in 1968, with declines in retail sales, industrial orders and deliveries and flat industrial production. The two quarters combined, however, point to a relatively strong underlying trend, and the advance continued in the second quarter of this year.





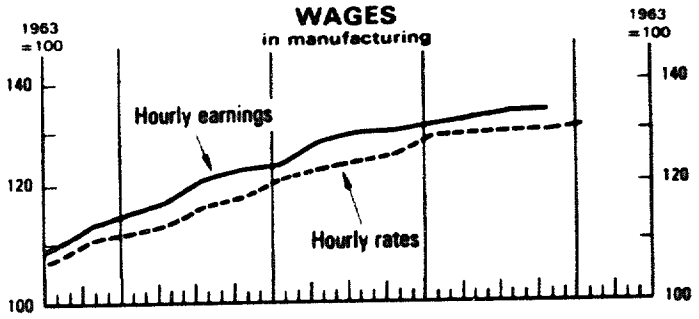
The rate of resource utilisation has increased somewhat. In manufacturing industry it rose to 84 per cent in the spring from 77 per cent a year earlier. By June the unemployment rate (seasonally adjusted) had dropped to 1.6 per cent, compared with 2.6 per cent in September and a recession peak of 2.8 per cent in May 1967. The increase in the number of reported vacancies has steepened, whilst the outflow of foreign labour has been reversed and short-time working has largely ceased. However, employment has only risen moderately as the domestic labour force is falling.

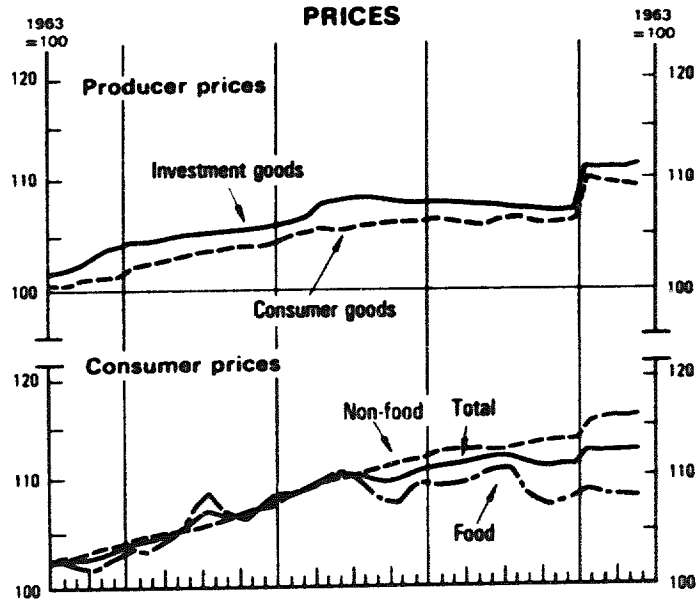
Prices have remained very stable. In the year ending in December consumer prices rose by a mere 0.4 per cent. The introduction of the value added tax pushed up the cost of living by some 1½ percentage points in January/February but seems to have caused only a temporary interruption of the flat or declining trend in industrial producer prices and building prices. Partly due to falling food prices, the consumer price index was only 1.1 per cent up on the year in June.

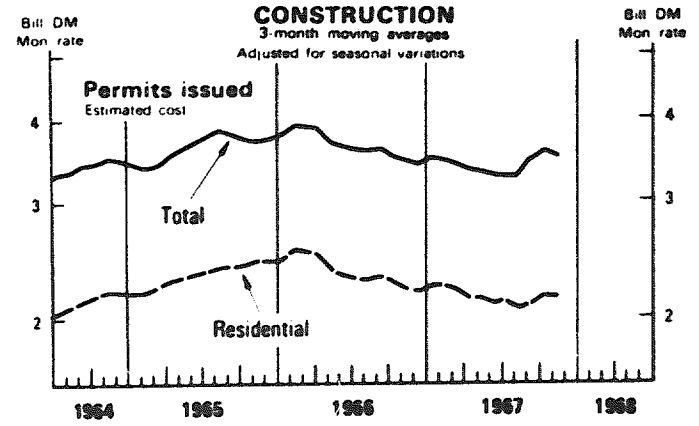
Activity on the wage front has increased recently with a number of important contract revisions taking effect in the second quarter. On the average, increases in standard hourly rates seem to have amounted to 3½-4 per cent, as against 3 per cent accorded in agreements reached during the first few months of the year. The year-to-year rate of increase of average hourly wage and salary rates in industry, including building, rose from 2.2 per cent in January to 4.2 per cent in April, but in the first quarter of 1968 average total wage and salary earnings were only 3.4 per cent up on the year.

Productivity has risen more quickly with fuller capacity utilisation. In the late months of 1967 and the early months of 1968 unit labour costs in industry were substantially lower than a year earlier, suggesting a strong improvement of business profits.

The recovery of activity was accompanied by a sharp expansion of bank credit in the later months of last year, facilitated by large repayments of business credit from abroad. This trend continued in January/May. The volume of security issues was very high in the first half of 1967 and increased further in the second, with the banks taking a high proportion of the new issues; the first five months of 1968 saw a further increase in capital market activity. The bond rate, virtually stable between the spring and end of last year has declined slightly in







Balance of payments
GERMANY

Value, million dollars
Estimates and forecasts

	1967	1968	1967 I	1967 II	1968 I	1968 II
SEASONALLY ADJUSTED						
Exports	21,697	23,450	10,704	10,993	11,550	11,900
Percent change[a]	(7.9)	(8)	(6.3)	(5.5)	(9½)	(7)
Imports	16,383	18,700	8,074	8,309	9,000	9,700
Percent change[a]	(-3.7)	(14)	(-9.8)	(9.8)	(13½)	(17½)
Trade balance	5,314	4,750	2,630	2,684	2,550	2,200
Services and transfers, net	-2,886	-3,000	-1,447	-1,439	-1,450	-1,550
Current balance	2,428	1,750	1,183	1,245	1,100	650
UNADJUSTED						
Current balance	2,428	1,750	1,288	1,140	1,200	550
Long-term capital[b]	-780		-334	-446		
Short-term capital and unrecorded[c]	-718		-5	-713		
Balance on non-monetary transactions	930		949	-19		
Change in reserves	329		-69	398	179	

a) Over previous period at annual rates, customs basis.
b) Excluding special transactions.
c) Excluding change in commercial banks' net position. Including advance payments for military imports.

recent months. With the Euro-bond rate rising, partly in response to the United States balance of payments measures, a differential against German bonds has prevailed since the close of 1967. Since the beginning of the year the banks seem on balance to have discontinued their money exports.

The external surplus on current account remained at a seasonally adjusted annual rate of $ 2½ billion in the second half of 1967. Commodity imports recovered, roughly offsetting the further increase in exports, and there was little change in the invisible balance. The surplus was to a large extent financed by a capital outflow. In the first quarter of 1968 the current surplus, on an annual seasonally adjusted basis, was unchanged, with further increases in both exports and imports and the deficit on services and transfers remaining steady. The net outflow of long-term capital rose with a big increase in German lending and portfolio investments abroad and a decline in foreign direct investment in Germany. Allowing for end-of-year operations and the run-down of military advance payments, short-term non-monetary capital and unrecorded transactions were in near-equilibrium, with German enterprises slowing down considerably repayment of their short-term debts. This was only partly offset by a net outflow of bank money, so that the balance on official settlements improved in the first quarter to $ 379 million—nearly as much as during the second half of last year. In the second quarter there was a surplus of $ 336 million which, however, seemed to owe much to the events of May and June in France.

Prospects

Although the increasing optimism of business tests and the fact that the recovery has now lasted almost a year point to continued expansion, its strength in the second half of 1968 and into 1969 remain uncertain.

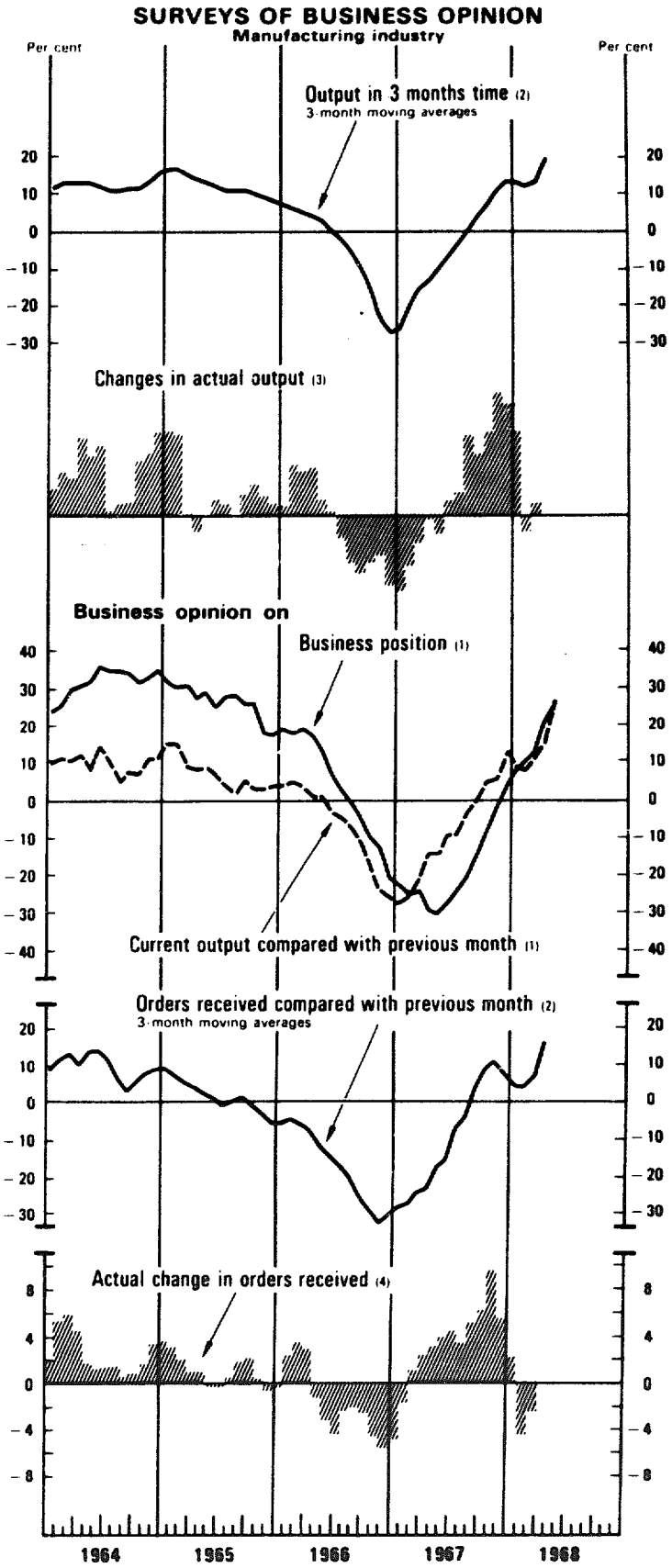
The likely trend of import demand in Germany's principal markets and the effects of the devaluations point to slower export growth.[1] Inventory accumulation, probably strong in the first half of the year, may fall back in the second. The underlying trend in housing is not strong. Spending by Länder and local authorities was relatively high in the first half of the year, helped by the second contingency budget, but the high level of indebtedness of most com-

1. Much of the 7 per cent annual rate of growth of exports forecast for the second half of 1968 corresponds to the estimated impact of the French events, which pushed part of first-half French imports into the second half and improved German export prospects on third markets.

munes may prevent much subsequent increase. Despite a sharp rise in retail sales in March/April, there would seem little reason to expect a marked rise in private consumption, unless the personal savings ratio falls. Employment is not likely to rise much, given the likely increase in productivity, and although wage increases should accelerate, they may not exceed 4 to 5 per cent at an annual rate. The 1968 Federal budget provides for a sharp reduction of the growth of transfers to households and an increase in their social insurance contributions, and the increase of the value-added tax on 1st July will have adverse effects on real incomes.

Indicators of business investment were strong in the fourth quarter of 1967 and have been weak since; but temporary factors may partly explain this pattern. Technological considerations should prove a source of strength in business investment demand, and there are no obstacles on the side of financing; business profit margins have increased significantly, internal cash flows are high, and conditions for external financing easy. Recent surveys, pointing to a marked improvement of business sentiment, also give grounds for optimism. On the other hand, capacity utilisation rates are still low in most industries, and weak consumer demand may have adverse effects on the propensity to invest in consumer goods industries. The present forecast assumes an increase in business fixed investment of 8 per cent in volume between 1967 and 1968, more than suggested by the IFO survey taken in the spring (7 per cent in value in manufacturing, compared with the 5-7 per cent suggested by last autumn's survey). Since business fixed investment was relatively low in the first half, the forecast for the year as a whole implies a very sharp rise in the second.

Nevertheless, even on the assumption of a sharp increase in business fixed investment, the expansion of GNP may slow down to an annual rate of 3 to 3½ per cent in the second half of 1968, which corresponds to an underlying rate of only 2½ per cent.[1] Idle resources would no longer be absorbed



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.

1. Any estimate of the shift of demand forward to 1967 must be somewhat arbitrary, but the indications are that it may have amounted to as much as ½ per cent of GNP. If the movement of GNP suggested in the Demand and Output table is adjusted for this, GNP shows the following half-year to half-year movements at seasonally adjusted annual rates:

1967/II	1968/I	1968/II
3½%	7%	2½%

and the margin of spare capacity could discourage business investment in 1969.

With exports increasing roughly at last year's rate, and imports recovering in sympathy with aggregate demand, the trade surplus seems likely to decline in 1968. The deficit on services can be expected to increase. Net expenditure on foreign travel, falling last year, may rise somewhat, given the better trend of consumer incomes, and the U.S. balance of payments measures may affect net receipts from foreign troops. Official transfer payments will increase with larger contributions to the EEC agricultural fund, and the decline of private transfer payments will slow down or possibly cease, with a more stable development of foreign workers' remittances associated with the better employment prospects. On these assumptions, the current account surplus could fall to a seasonally adjusted annual rate of some $ 2.2 billion in 1968/I (from about $ 2½ billion in the preceding two half-years), and to $ 1.3 billion in 1968/II.

Much of the current surplus may be financed by a further outflow of capital. On long-term account a large net outflow may continue in response to the recent American measures affecting US direct investment abroad and a continuing, possibly widening differential on long-term interest rates against Germany. On short-term account, the tendency for Germany enterprises to pay off their foreign debts (DM 4.5 billion outstanding at end-May) could well resume. But early in the year it did not seem likely that the outflow of bank money would remain as high as last year, as monetary easing could hardly be pursued with the same vigour as during the recession, and credit demand at home was growing. This prospect has been enhanced by events in the spring and early summer, which increased the attractiveness of the German money market.

ITALY

Following the rapid growth of 1967, when GDP increased by 6 per cent in real terms, the rate of expansion may be somewhat lower in 1968. In the early months of the year the growth of domestic demand seemed to decelerate, whereas exports increased strongly. Although internal demand is expected to gain strength in the second half of the year and exports may rise more slowly, the current external surplus is likely to remain substantial.

Demand and Output
ITALY

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

	1966 billion Lire	From previous year 1967	From previous year 1968	From previous half-year 1967 I	1967 II	1968 I	1968 II
Private consumption	24.3	6.1	5	6.8	5.1	5	5
Public consumption	5.5	2.7	3	2.4	2.6	3	3½
Fixed investment	7.1	9.9	7	11.2	2.9	7½	10
Total domestic demand (excluding stocks)	36.9	6.3	5	7.0	4.3	5	6
*plus change in stock-building	0.5	0.3	-½	0.4	0.3	-1	½
*plus change in foreign balance	0.8	-0.5	½	0.0	-1.4	3	-3
GDP at market prices	38.2	5.9	5	7.3	3.0	7	3¼
GDP implicit price deflator		2.7	2¾	2.6	3.2	2½	2¾
Industrial production		8.4	7	11.5	1.8	8½	9

* In the first column absolute figures are shown for "stock-building" (additions to stocks) and the "foreign balance" (net exports of goods and non-factor services). In subsequent columns, changes in stock-building and the foreign balance are expressed as percentages of GDP in the base period. The sum of the changes in domestic demand, stock-building and the foreign balance, will thus equal the change in GDP, although detail may not add because of rounding.

Policies

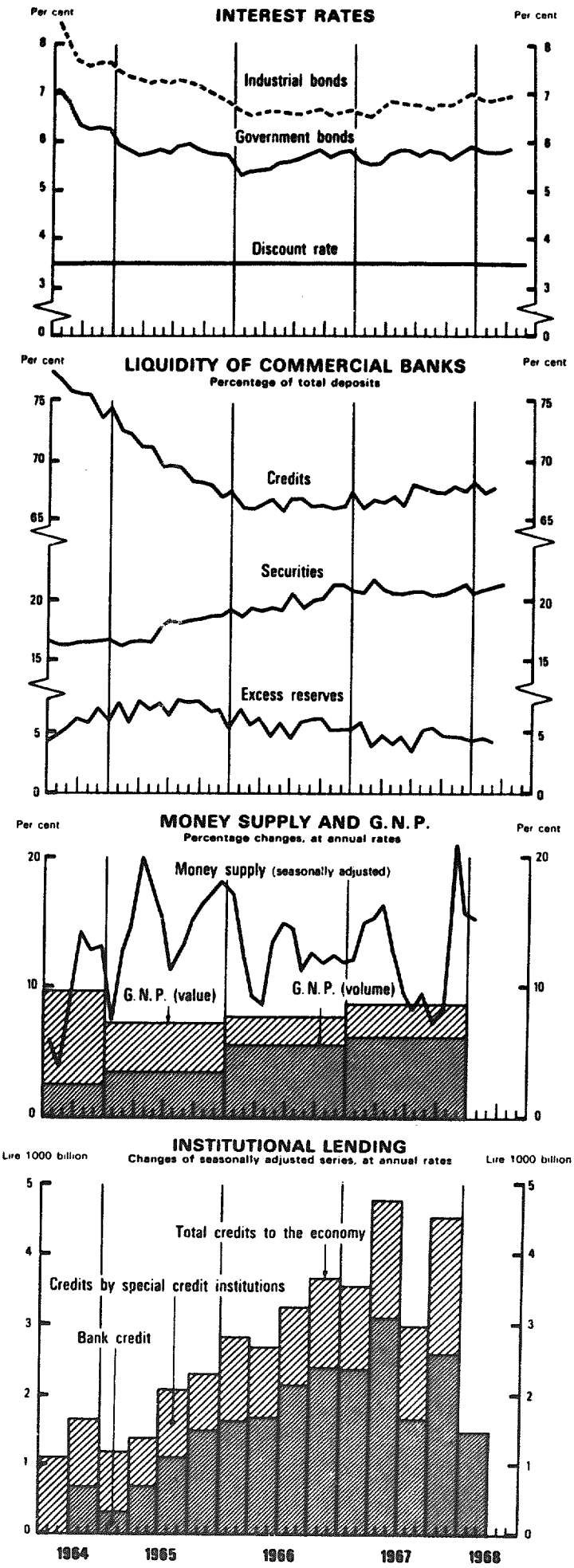
The public sector's expansionary impact on the economy was considerably reduced in 1967, partly as a result of policy decisions. In national accounts terms, and on a cash basis, net current saving of general government rose to 1.9 per cent of GNP compared with only 0.3 per cent in 1966. The main reasons were a change in the rules concerning social security contributions, certain increases in tax rates and a slower increase of public consumption. The fall in the public sector's overall deficit (from 3.3 per cent of GNP in 1966 to 1.8 per cent last year) was probably greater than intended, since cash outlays for direct public investment did not increase despite a considerable increase in approved investment projects.

The impact of public finance is likely to be more expansionary this year. The 1968 budget forecasts, compared to the initial forecasts for 1967, imply increases in both revenue and expenditure of about 10 per cent and a small rise in central government saving. On the other hand, an appreciable increase of investment expenditure could take place, but this depends not only on the higher allocations for direct investment and capital transfers in the 1968 budget, but also on the rate of implementation of accumulated unspent commitments.

Monetary and credit policy has continued to sustain growth. The expansionary impact on liquidity of both the foreign sector and the Treasury's operations was reduced last year. But the monetary authorities intervened to allow a considerable increase in bank credit to facilitate the rise in production and investment. The increase in bank credit slowed down in the first quarter of 1968 to an annual rate of about 14 per cent, compared to 16 per cent last autumn. It is not clear whether this was due to a weaker demand for credit or to a shift to the subsidized, medium and long-term credit granted by the special institutions, which has been expanding fast. Long-term interest rates have been kept fairly stable and the continuing outflow of private capital, attracted by higher rates abroad, has been accepted.

Recent Trends

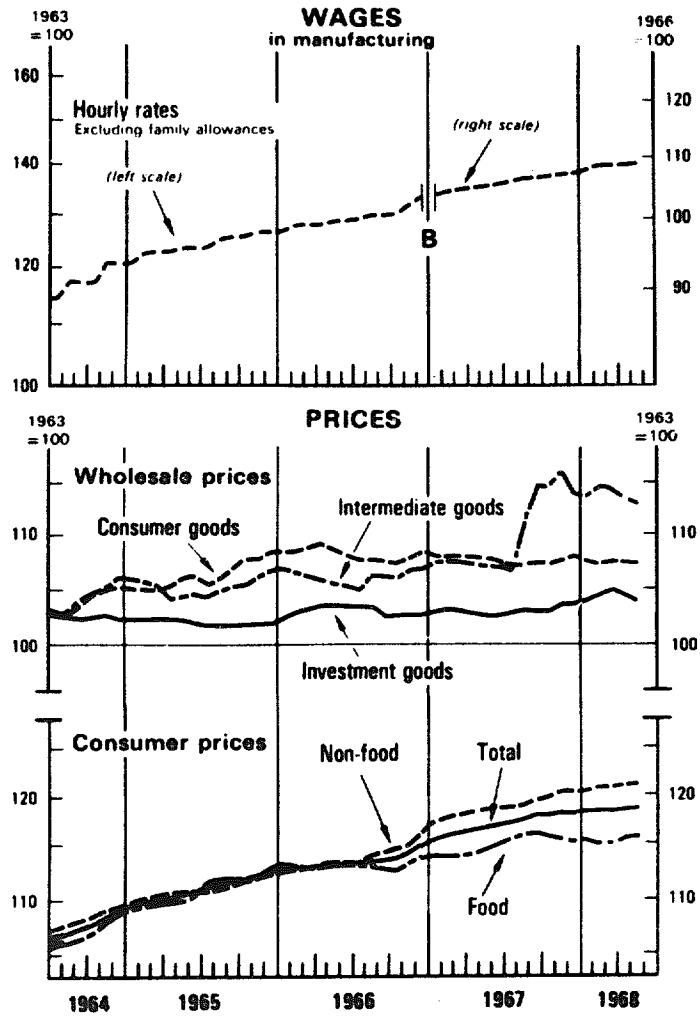
The acceleration of growth in 1967 resulted entirely from the expansion of domestic demand. Although commodity exports again increased appre-

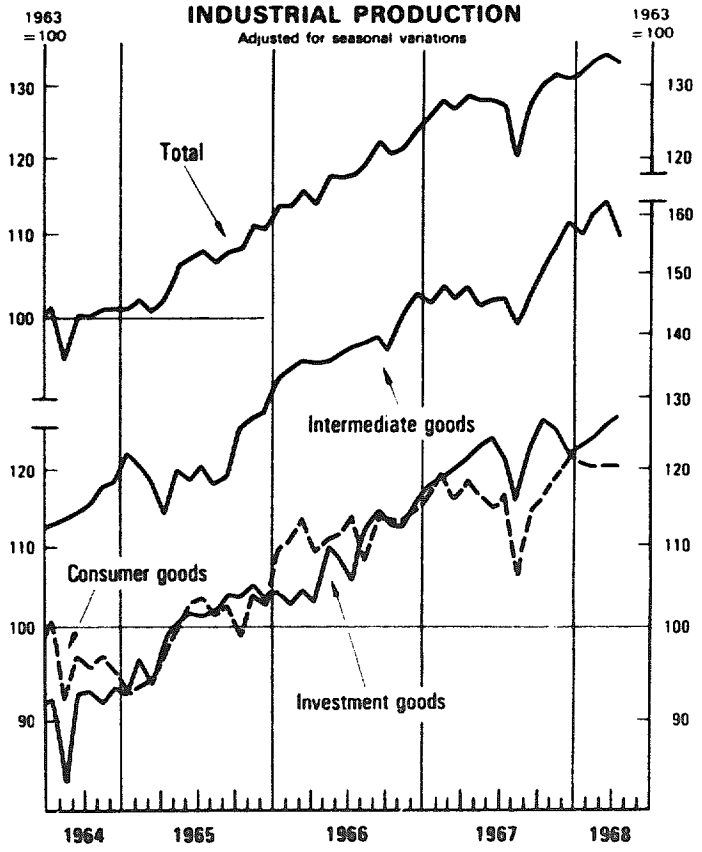


ciably, net foreign demand declined in volume for the first time in several years. Both private consumption and fixed investment were very strong and stockbuilding was higher, partly because of plentiful harvests. Residential construction increased by 4 per cent in volume after declining in the two previous years. Expenditure on machinery and equipment, excluding transport, increased by 14 per cent in real terms after a 12 per cent rise the year before, but the level reached was still below the peak of 1963. A marked deceleration in the summer of 1967 was probably due to the weakening of foreign demand and the disturbances caused by the Suez closure. The contractionary shift in public finance may also have been felt mainly during the second half of the year. But in the fourth quarter a pronounced recovery of exports was accompanied by renewed signs of strength in domestic demand.

The statistics so far available for early 1968 provide conflicting evidence, but suggest that the rate of growth of domestic demand may again have fallen off. Imports, which in the past have been very sensitive to fluctuations of domestic demand, were substantially reduced in the first four months of the year. The decrease was largely due to a sharp decline of food imports, partly real (because of favourable crops) and partly apparent (because of delays in customs clearance for imports of cereals and meat, linked with the changes in EEC regulations); there were also irregular movements in imports of crude oil. But the value of non-food import was only 2 per cent higher than a year earlier, though some other accidental factors may have been involved. Statistics of foreign exchange payments suggest somewhat brisker growth.

The seasonally adjusted index of industrial production, which had recovered in the fourth quarter of 1967, rose by 1.7 per cent in the first quarter of 1968 but flattened out in April-May. Investment in machinery appears to have slackened in the second half of 1967 and the early months of 1968. In January-April, both production and imports of machinery were barely 3 per cent above the corresponding period of 1967. But production in sectors linked to the building industry was growing strongly, suggesting that construction, both for dwellings and public works, was gathering momentum.





Production of consumer goods was flat up to April. But the index of retail sales picked up considerably in the first quarter and registrations of private cars in the second quarter reached the high level of a year earlier. Exports (seasonally adjusted), whose multiplier effects on demand are sizeable, rose at an annual rate of some 30 per cent between the second half of 1967 and the first five months of 1968.

Price and wage movements remain moderate. Price increases in the course of 1967 were partly due to special factors—e.g. the rise in international freight rates, the higher tax on petrol and certain controlled price increases. More recently the movement has slowed down. Over the year ending in May, the index of consumer prices rose by 1.7 per cent and only by 1.1 per cent for non-food commodities excluding electricity and fuel. The new index of wage rates [1] shows an increase of 3.9 per cent in manufacturing over the twelve months to May. But earnings may have been increasing faster; they had risen by 6.3 per cent between the fourth quarters of 1966 and 1967.

1. Based on 1966, the new index measures average hourly rates. It differs importantly in coverage and methods from the previous index, which was based on 1938.

Over the past two years of vigorous expansion of domestic demand, the current surplus of the balance of payments has decreased only gradually. In the second half of 1967 it was still running at a seasonally adjusted annual rate of $ 1.7 billion. The decrease was largely due to a drop of net earnings in invisibles because of lower receipts from tourism and workers' remittances and higher payments for freight. The trade account was in small surplus, in contrast with the traditional deficit prior to 1965. Provisional figures for the first quarter 1968 indicate that the current surplus increased again substantially. Exceptional factors have somewhat distorted the trade picture but invisible earnings have been rising again.

As in the last two years, outflows of non-monetary capital are largely offsetting the current surplus. Increased bank note remittances abroad are mainly responsible for the larger exports of funds in the five months to May. The commercial banks net foreign position has remained approximately in balance so far this year. There was a largely seasonal decrease in reserves in the first quarter of the year and a slight further fall in the second. On the other hand, $ 100 million worth of Canadian securities denominated in lire were bought in May while in June Italy contributed substantially to the British

Balance of payments
ITALY

Value. million dollars
Estimates and forecasts

	1967	1968	1967 I	1967 II	1968 I	1968 II
SEASONALLY ADJUSTED						
Exports	8,601	9,650	4,256	4,345	4,750	4,900
Percent change[a]	(8.4)	(12)	(14.9)	(-0.6)	(21½)	(6)
Imports	8,512	9,150	4,216	4,296	4,200	4,950
Percent change[a]	(13.2)	(8)	(9.8)	(16.0)	..[b]	..[b]
Trade balance	89	500	40	49	550	-50
Services and transfers. net	1,635	1,600	847	788	800	800
Current balance	1,724	2,100	887	837	1,350	750
UNADJUSTED						
Current balance	1,724	2,100	631	1,093	1,000	1,100
Long-term capital[c]	-1,004		-834	-514		
Short-term capital and unrecorded	-344					
Balance on non-monetary transactions	376		-203	579		
Change in reserves	595		44	551	-442	

a) Over previous period at annual rates, customs basis.
b) Half yearly growth rates seem to have been distorted by statistical and accidental factors as analysed in the text.
c) Excluding special transactions.

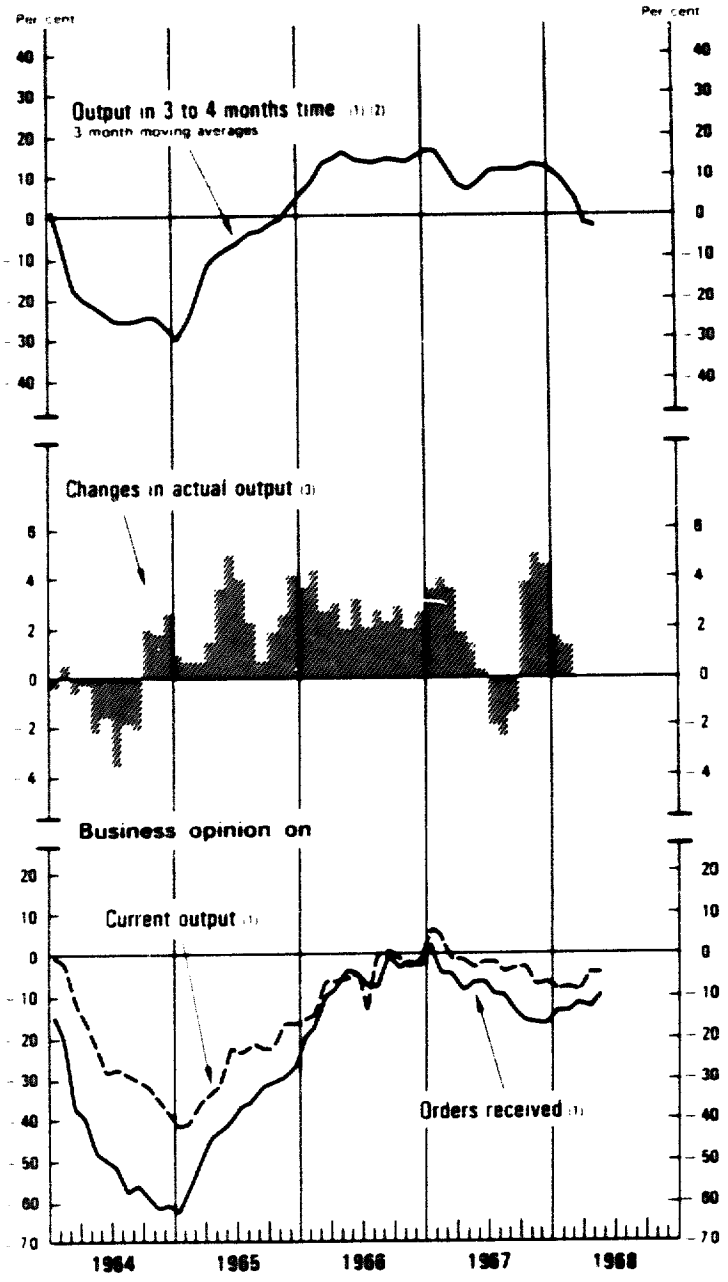
and French IMF drawings. In June official gold and currency holdings, including the reserve position in the IMF stood at $ 5.3 billion.

Prospects

The expansion of GDP in the second half at 1968, seems likely to be somewhat less rapid than previously envisaged, partly because of the probable trend in exports. On present evidence, domestic demand should expand considerably in the coming months. Private consumption is likely to continue to advance fairly rapidly. Non-farm employment rose by 2.8 per cent over the twelve months to April, the increase exceeding significantly the drop in agricultural employment and concentrated mainly in the service sector. Though the rise in wage rates appears moderate, wage-drift may be expected to become more important. Moreover, the recent increase of pensions will benefit social groups with a high propensity to consume. Public consumption is likely to rise somewhat faster than last year, stock accumulation, however, may be smaller. All the evidence suggests a continuing expansion in construction activity. Moreover, an acceleration in investment in machinery and equipment seems possible. Its apparent slowing down in late 1967 and early 1968, after the previous strong increase, may be linked to a certain widening of unused capacity margins suggested by business surveys. The more recent surveys (up to end May) indicate some reduction of unused margins in the investment goods and intermediate goods industries and a clear improvement of domestic orders, following a few months' weaker trend. The proportion of firms in the investment goods sector reporting " low " domestic orders has not been so small since the boom period of the spring 1962.

The possible deflationary impact on Italy of the British and other devaluations in November and of the measures taken to redress the United States balance of payments should be modest this year. The share of Italy's trade with the devaluing countries is relatively small, whilst Italy's recent export performance suggests that losses in third markets may be limited. The principal direct effect of the French strikes in May and June should be a shift of Franco-Italian trade from the first into the second half of the year. On the other hand, the trade measures decided upon by the French authorities could have

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 months)

a significant, though not a major, effect. Textiles, cars and domestic electric appliances amounted to roughly 20-25 per cent of exports to France (themselves 12 per cent of total Italian exports). In several of these branches exports were growing relatively fast in the early months of 1968 so that quota limitations may mean a flattening out or actual decrease of such exports in the second half of the year. Moreover in early 1968 exports benefited from certain

exceptional factors such as the sharp rise in British imports. In total a much slower expansion of Italian exports seems likely during the rest of the year, though Italy should at least maintain her share in the principal export markets outside France.

It is hardly possible to forecast the effect on receipts from tourism of the sterling and peseta devaluations and the French measures, and the opposing effects on tourism and emigrants remittances of rising incomes in the rest of Western Europe. The possibility of a further small decrease in earnings from invisibles cannot be ruled out.

The likelihood of slower export growth gives added importance to the prospects for domestic demand. If the forecasts of an acceleration outlined above are approximately confirmed, the rate of growth in 1968 may be around 5 per cent. It seems that even with a 6 per cent expansion, the rate earlier expected, there would have been little danger of strains on costs and prices. Significant margins of plant capacity seem to exist and there are also ample labour reserves only partly revealed by the unemployment ratio (3.2 per cent in April). These are partly hidden by underemployment and by temporary cyclical withdrawals from the labour market. Indeed, the potential growth of the economy compatible with internal stability seems distinctly higher than 5 per cent, both in the short, and medium terms.

The anticipated strengthening of domestic demand is expected to boost imports in the second half of the year. In addition, the statistical problems mentioned above, and the effects of the French strikes, will tend to shift imports into the second half of the year. But even assuming a substantial re-expansion of imports in the near future, it seems that the current balance of payments surplus for 1968 as a whole could well be of the order of $ 2 billion, almost equal to the levels of 1965 and 1966. On a seasonally adjusted basis, the surplus in the second half of 1968, though considerably below that of the early months of the year, would be running at an annual rate of about $ 1.5 billion, and it seems likely to remain considerable for some time.

UNITED KINGDOM

Domestic demand rose strongly in late 1967 and early 1968, with an accompanying deterioration of the foreign balance. But the measures taken since the devaluation should now moderate the rate of expansion and help to improve the current foreign balance. The Government's target is to achieve a surplus running at an annual rate of £ 500 million ($ 1.2 billion) by the end of 1969.

Policies

Measures to shift resources from domestic use towards improvement of the current foreign balance were taken in four stages.

— In November, at the time of the devaluation, Bank Rate was raised to 8 per cent, and banks were requested to hold loans at the then existing levels. The ceilings applied to all private sector lending except export financing and medium-term shipbuilding credits. Minimum deposits for hire purchase transactions on motor cars were raised. At the same time, certain measures to become effective in fiscal 1968-69 were announced, including a £ 200 million cut in public expenditure plans, the withdrawal of the Selective Employment Tax premium from all manufacturers outside the Development Areas, and the abolition of the export rebate.
— In January 1968, further cuts in public expenditure plans were announced—£ 300 million in 1968-69 and £ 416 million in 1969-70.
— In March, the budget imposed tax increases estimated to yield more than £ 900 million in a full year. The measures mainly affected indirect taxes and the corporation tax; the standard rate of income tax remained unchanged. Taking account of higher family allowances, the net increase in taxation amounted to £ 840 million. The impact on demand, although smaller, may amount to an annual rate of £ 500-600 million (almost 1.5 per cent of GDP) by the end of 1968.
— In May, the ceiling on bank advances was extended to cover all lending to the private sector, including exports.

Demand and Output
UNITED KINGDOM

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

	1966 billion £	From previous year 1967	From previous year 1968	From previous half-year 1967 I	1967 II	1968 I	1968 II
Private consumption	24.1	1.7	1½	2.1	7.6	1½	-4
Public consumption	6.5	4.0	2½	5.3	1.7	2½	2½
Fixed investment	6.7	5.0	5	6.5	4.2	4	8½
Total domestic demand (excluding stocks)	37.3	2.7	2½	3.4	5.9	2	-½
*plus change in stock-building	0.2	-0.1	0	0.4	-0.2	0	0
*plus change in foreign balance	-0.2	-1.1	1	-1.6	-3.4	2	3
GDP at market prices	37.3	1.4	3	2.1	2.1	4	2½
GDP implicit price deflator		3.0	4½	1.4	2.7	5	5
Industrial production		-1.3	4	-1.2	2.0	4	6

* In the first column absolute figures are shown for "stock-building" (additions to stocks) and the "foreign balance" (net exports of goods and non-factor services). In subsequent columns, changes in stock-building and the foreign balance are expressed as percentages of GDP in the base period. The sum of the changes in domestic demand, stock-building and the foreign balance, will thus equal the change in GDP, although detail may not add because of rounding.

New legislation has been passed governing prices and incomes policies for the 18-month period from August, when the powers under Part II of the existing Prices and Incomes Act expire. The expiring powers enabled the Government to require statutory notification of proposed increases in prices and pay, and to defer increases for a maximum of 7 months. Under the new legislation the Government is authorised to defer pay and price increases for as much as 12 months if referred to the Prices and Incomes Board; but after the 12-months period, increases could still be paid retroactively. The voluntary procedures administered by the TUC and CBI, to provide early warning of wage, price and dividend increases, are to be continued and, where possible, extended.

A ceiling of 3½ per cent (annual rate) was set, in the White Paper introducing the legislation, on all wage and salary increases resulting from settlements reached after March 20th, and the Government laid down four broad criteria against which such increases could be justified:

— Where employees make a real contribution to higher productivity, for example by accepting more exacting work or major changes in working practices;
— Where the national interest requires a change in the distribution of manpower resources which could be facilitated by a change in wages;
— Where there is a general recognition that wages are too low to maintain reasonable living standards;
— Where there is widespread recognition that wages in certain groups have moved out of line with those of other groups doing similar work.

The ceiling should cover central, local and plant agreements, and apply to "increases in basic pay rates and allowances (including basic pay scales or ranges), rates for overtime, night work, or shift work, etc." and fringe benefits. It would not, however, apply to "increases in earnings which are due to necessary increases in hours worked or the amount of work done".

The Government has indicated that applications for price increases will be acceptable only if rises in costs cannot be offset by other economies, or if—after an attempt to reduce costs—the enterprise is unable to attract sufficient capital to meet home and overseas demand. Price reductions are required where falling labour, material, fuel or capital equipment costs are not offset by other increases, or where high prices reflect excessive marketing power. Dividends are subject to a ceiling of 3.5 per cent above the amount of the ordinary dividends paid in the previous year, with possible concessions where, in the previous year, they were abnormally low. Rent increases in both the public and private sectors are liable to control, entailing early warning and the moderation or phasing of increases which seem abnormally high.

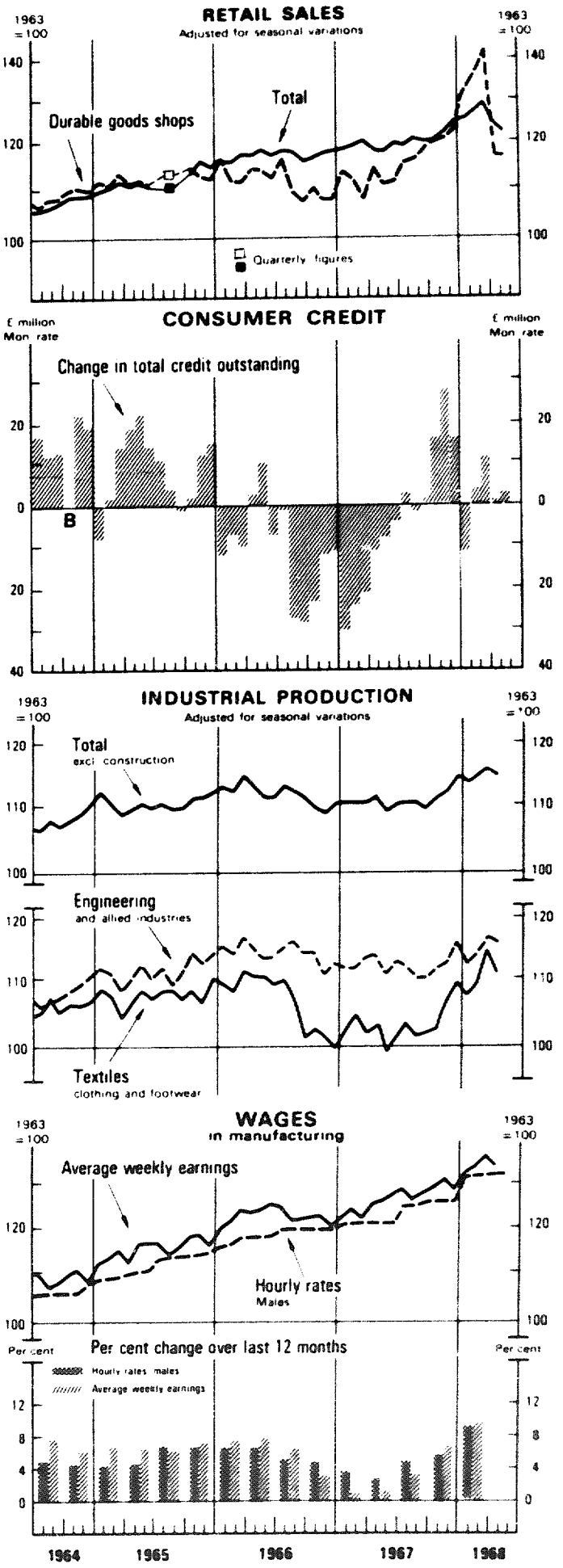
Recent Trends

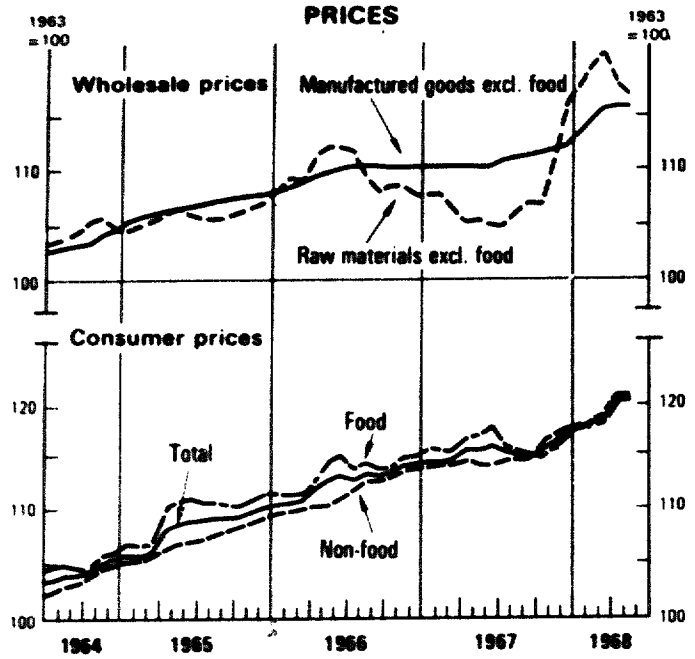
In the course of 1967 there was a marked acceleration of the increase in private consumption. The volume of retail sales was rising at an annual rate of almost 8 per cent between the second and fourth quarters, stimulated by wage increases after the ending in July of the period of severe restraint, and by the relaxation of hire purchase restrictions in June and August. The consumers' boom was, however, offset in the second half of 1967 by a deceleration in the growth of public consumption, fixed investment and stocks and, particularly, by the sharp deterioration of the foreign balance. Private non-residential investment actually fell. The underlying trend in inventory demand was rather weak, but additions to stocks were inflated by export goods held up by the dock strikes.

In the early months of 1968 the rise in consumers' spending accelerated, despite the tightening of hire purchase restrictions on motor cars, in anticipation of further restrictions in the budget. The personal savings ratio, already low in the second half of 1967, fell sharply. Non-residential fixed investment rose in the first quarter, notably in shipbuilding; investment in manufacturing fell. Exports picked up after the dock strike. Industrial production rose by 1 per cent between the fourth and first quarters, and manufacturing output by 1½ per cent. The acceleration of the expansion entailed some increase in the pressure on resources. The number of unfilled vacancies turned up in the second half of last year and continued to rise into 1968. The number of wholly unemployed (excluding school-leavers) fell from a seasonally adjusted rate of 2.4 per cent in September to 2.2 per cent in February.

There are some signs that the production rise has become more gradual since the budget. In April, industrial production remained unchanged and retail sales fell by almost 5 per cent in volume. Car registrations, very high in the first quarter, fell sharply in April and May. The number of wholly unemployed (excluding school-leavers) edged up during the second quarter to 2.4 per cent in June.

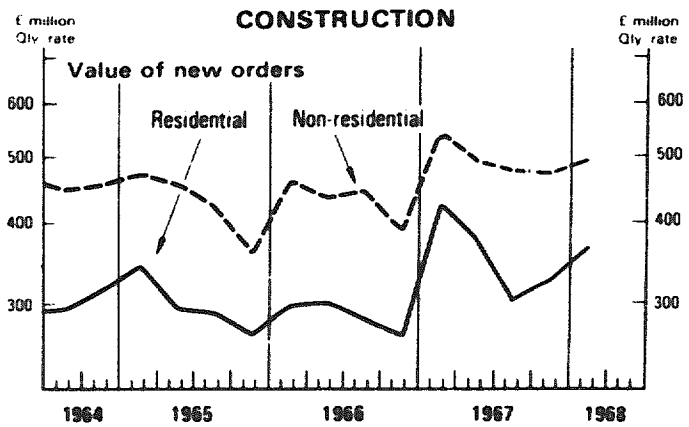
Between the summer of 1967 and the budget, the rise in wages and prices accelerated. The twelve months of standstill and severe restraint up to the middle of 1967 had seen hourly wage rates in all industries rise by only 2.8 per cent. This was followed by an increase of 2 per cent in July when





deferred pay increases took effect. In the six months between August/September and February/March hourly rates were rising at an annual rate of more than 8 per cent, but the increases in April and May were more moderate. Contracts negotiated during the first five months of this year provided for increases of 5 per cent per year. The post-devaluation increase in import prices has begun to work through to the domestic price level. Prices of materials for use in industry rose by 13.3 per cent between October and March: but a fall in imported raw materials prices, especially copper, contributed to a decline in April and May. The retail price index, relatively stable during the first nine months of 1967, increased by 4.3 per cent between October and April, although this was partly attributable to higher charges for electricity, seasonal increases in certain food prices, and higher indirect taxes in the budget.

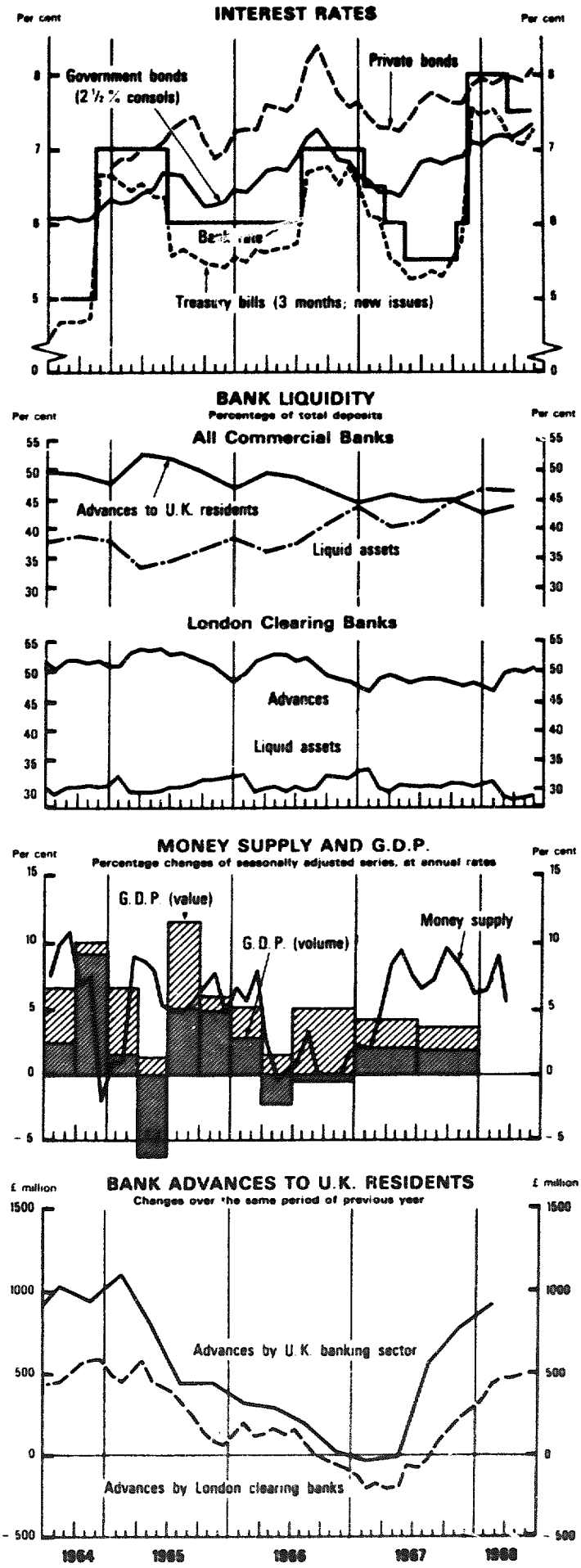
Government borrowing requirements were substantial in 1967, rising to more than £ 1 billion from about £ 0.5 billion in 1966. Private credit demand, weak in the first half of the year, revived in the second; mortgage lending continued to rise, hire purchase and other instalment credit turned up and bank advances rose sharply, particularly to private individuals. The expansion of bank credit continued after the ceiling was imposed at the time of the devaluation, but at a reduced rate; in May, seasonally adjusted outstanding bank advances to customers other than the nationalised industries were 4.7 per cent higher than in mid-November. If loans to the local authorities are excluded, the rise was about 4 per cent, thus reaching the level of the new overall ceiling on bank lending to the private sector and overseas borrowers. The banks' loan-to-deposit ratio, falling during the first half of 1967, turned up in the second; and the tendency remained upwards in the first three months of the present year though there was a slight fall in April. Short-term interest rates rose sharply after the devaluation and the increase in Bank Rate, and have remained high. There was some decline in March with the reduction of Bank Rate to 7.5 per cent after the budget, but by the beginning of June short-term rates had regained the levels at which they stood before the reduction. Long-term rates in the first quarter rose less, and for some time were lower than short-term rates. The rise in interest rates has reduced the attractiveness to investors of building societies' deposit rates, and the net inflow of funds to building societies has been falling since October. Their liquidity position deteriorated in the first quarter, and building societies raised their deposit and mortgage rates in April.



The current deficit of the balance of payments rose sharply to over $ 1 billion in the second half of 1967, after near equilibrium in the previous twelve months. The effects of the Suez and Nigerian situations on oil shipments and the delaying of exports by dock strikes may, together, have accounted for about half the deficit. But there was a clear deterioration of the underlying position. With the position exacerbated by large outflows of banking funds caused by lack of confidence in sterling both before and after the devaluation, the deficit on official settlements rose to $ 2.5 billion in the second half. Gross official reserves (although strengthened by the transfer of the remaining $ 490 million of the dollar portfolio to the reserves) were run down by $ 139 million, and there were substantial drawings on central bank credits.

The trade balance improved in early 1968 as exports picked up sharply after the dock strike. The export improvement was maintained in April and May, pointing to an underlying increase. Imports, however, rose by 5½ per cent in dollar terms and 6 per cent in volume in the first quarter. The buoyancy of domestic demand was an important factor behind this development, and there may have been some carry-over of imports from the dock strike period. A large increase in imports of raw materials and food points to some build-up of stocks. Speculative purchases of silver and precious stones also inflated imports. There was no appreciable fall in imports during April and May, and it is now certain that imports in the first half-year will be appreciably higher than suggested by the official forecasts.

With a marked improvement in the invisible balance during the first quarter, mainly as a consequence of higher earnings on private services and transfers, the current account deficit fell to about $ 300 million—$ 600 million lower than in the previous quarter. There was, however, a sharp deterioration on capital account. The marked jump in the net outflow of long-term capital to $ 350 millions (seasonally adjusted) was due almost entirely to one large transaction, the taking up by the Royal Dutch/Shell Group of its rights in the United States' Shell Oil Company. But there was also a substantial outflow of short-term non-monetary and banking funds. Though partly due to a turnaround in leads and lags in association with the improvement in the current account, it largely reflected the weakness of



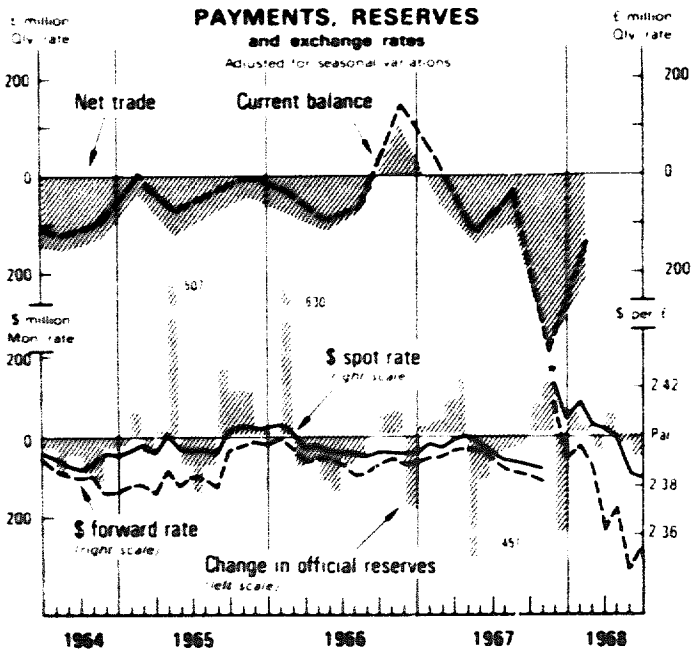
Balance of payments
UNITED KINGDOM

Value, million dollars
Estimates and forecasts

	1967	1968	1967 I	1967 II	1968 I	1968 II
SEASONALLY ADJUSTED						
Exports	13,882	14,450	7,389	6,493	7,030	7,400
Percent change[a]	(-2.0)	(4½)	(1.0)	(-22.4)	(19)	(9½)
Imports*	15,599	15,850	7,921	7,678	8,090	7,750
Percent change[a-b]	(5.5)	(1½)	(14.3)	(-2.0)	(9½)	(-9)
Trade balance	-1,717	-1,400	-532	-1,185	-1,060	-350
Services and transfers, net	378	800	255	123	400	400
Current balance	-1,339	-600	-277	-1,062	-650	50
Long-term capital	-75		8	-83[c]		
Basic balance	-1,414		-269	-1,145		
UNADJUSTED						
Basic balance	-1,414		-163	-1,251		
Short-term capital	489		805	-316[d]		
Balance on non-monetary transactions	-925		642	-1,567[d]		
Change in reserves	-405		-266	-139	-11	
* *Of which:* Progress payments on military aircraft purchases from the US	263	300	145	118	150	150

a) Over previous period at annual rates, customs basis.
b) Excluding US military aircraft.
c) Including an estimate for the dollar value of private long-term capital transactions in the fourth quarter of 1967 which is particularly approximate.
d) Partly estimated by Secretariat.

confidence in face of the continuing high pressure of demand in the economy, and the unsettled condition of the international monetary system. Sentiment remained unfavourable through the second quarter, and there appears to have been further large outflows of short-term funds. Reserves were virtually unchanged over the first half as a whole, but substantial additional assistance was received from Central Banks, and $ 1.4 billion were drawn from the IMF in June.



Prospects

Between the second half of 1967 and the first half of 1968 total output may have been rising at an annual rate of 4 to 4½ per cent. Given the strong advance in the first quarter, this estimate implies a decline in the second, with a reversal of the strong pre-budget increase in consumer purchases. The measures taken since the devaluation, particularly in the budget, may actually reduce total domestic demand slightly in the second half of the year. An improving foreign balance should ensure continued expansion of activity, but at a substantially lower rate than in the first half.

Domestic demand in the second half of the year should only rise in the non-consumption categories —official estimates point to a moderate increase in

public current expenditure on goods and services but a faster rise in total fixed investment than earlier. The public expenditure programme published in January suggests some slowdown of the growth of public sector investment, although significant increases can be expected in certain areas, notably housing. But private fixed investment seems likely to recover. Recent surveys of current business trends point to growing buoyancy of private non-residential investment. Private residential construction, rising in at least the first half of the year, given the very strong increase in housing starts in 1967, may decelerate in the second if relatively tight monetary conditions are maintained. Stockbuilding could be somewhat higher in the second half of the year than in the first, but this may largely be an aftermath of the dock strike (stocks of export products were subject to involuntary accumulation in late 1967 and run down in early 1968).

The rise in domestic non-consumption expenditure in the second half of the year may be more than offset by a decline in private consumption. Wages and salaries have been rising, and government transfer payments to consumers are being increased. But consumer spending will be restrained by price increases following the devaluation, the budget and the increases in public charges. The rise in consumer prices will probably exceed the growth of disposable incomes, so that real incomes may fall. Moreover, the restrictions on hire purchase terms for cars and on bank advances will mean a fall compared with the second half of 1967 in the amount of consumption that can be financed by consumer credit. On these assumptions, the rise in GDP (at constant market prices) between the first and the second halves of 1968 may slow down to an annual rate of little more than 2 per cent and the pressure of demand might, for a time, ease somewhat further.

The rise in exports in the early months of this year, resulting from the reversal of the adverse effects of the 1967 dock strike, should be sustained by the effects of the devaluation. The most recent figures suggest that some of the beneficial effects may already be coming through, and there is evidence of greater buoyancy in export orders. It is assumed here that in the second half of the year the volume of exports of goods and services will be some 15 per cent higher than a year earlier; one-third of this might be due to the elimination of the dock strike effect, and the rest to devaluation and the growth of foreign markets. In addition, there should be some replacement of imports by domestic production, and the volume of imports of goods and services should decline in the second half of the year. On these assumptions, the switch of resources to exports and import replacement between the second halves of 1967 and 1968 might represent some 2.5 per cent of GDP, constituting the main expansionary element in the economy.

The balance of payments is likely to improve substantially this year. Though part of the increase in the volume of net exports may be offset by a deterioration of the terms of trade, a significant improvement of the merchandise balance should be expected. Net invisible earnings should also show some improvement, enhanced by the effects of devaluation, and the deficit on the current account —after a sharp fall in the first half of the year— should be replaced by approximate balance in the second. Given the steps previously taken to restrain private capital exports, the recorded net outflow of long-term capital in the rest of the year should return to a more normal level, despite the possible effect of the measures taken by the United States. Maintenance of relatively tight monetary conditions and high interest rates in the United Kingdom might stimulate both domestic and foreign-based companies operating in the United Kingdom to borrow in European capital markets. Any considerable further tightening of monetary conditions in the United States would probably have adverse effects on the United Kingdom capital account. But assuming that confidence in sterling improves in line with the underlying position, the balance on official settlements might show a significant surplus in the second half of the year.

UNITED STATES

The very substantial acceleration of the growth of demand taking place during the first half of 1968 has been accompanied by faster increases in costs and prices and a marked deterioration of the balance of payments. The passage of the act raising taxes and limiting the rise of Federal government expenditures in fiscal year 1969 should, however, help to produce a much needed " cooling-off " period over the coming months and strengthen the external position.

Demand and Output
UNITED STATES

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

	1966 billion $	From previous year 1967	From previous year 1968	From previous half-year 1967 I	1967 II	1968 I	1968 II
Private consumption	465.9	2.9	4¼	3.4	2.4	6	2½
Public consumption	154.3	11.4	5½	14.9	4.7	7¼	3½
Fixed investment	104.6	–1.0	5	–3.2	6.7	6½	0
Total domestic demand (excluding stocks)	724.8	4.0	4½	4.6	3.5	6½	2¼
*plus change in stock-building	13.4	–1.2	¼	–3.1	0.7	0	0
*plus change in foreign balance	5.1	–0.1	–¼	0.2	–0.3	–½	½
GNP at market prices	743.3	2.6	4½	1.5	4.0	6	2¾
GNP implicit price deflator		3.0	3¾	2.6	3.5	3¾	3¾
Industrial production		1.1	4¼	–2.4	2.2	5¾	3

* In the first column absolute figures are shown for " stock-building " (additions to stocks) and the " foreign balance " (net exports of goods and services). In subsequent columns, changes in stock-building and the foreign balance are expressed as percentages of GNP in the base period. The sum of the changes in domestic demand, stock-building and the foreign balance, will thus equal the change in GNP, although detail may not add because of rounding.

Policies

Federal fiscal policy was highly stimulative in the sluggish first half of 1967, but moved slighty towards restraint in the second. The fiscal plans of the Administration, as revealed in the budget proposed on 29th January, envisaged further restraint in 1968 and the first half of 1969, including a temporary 10 per cent surcharge on personal and corporate income taxes, the former effective on 1st April, the latter on 1st January, both to expire in mid-1969. It was estimated that these measures would augment personal tax revenues by about $ 6¼ billion, and corporate tax revenues by $ 3½ billion (annual rates). The budget also called for the extension, at current rates, of the excise taxes on automobiles and on telephone services which were to have been sharply reduced on 1st April, and an acceleration of the payment of corporate tax liabilities.

The relative budgetary restraint proposed for the first half of 1968 did not, in fact, occur. This resulted from an increase, estimated at $ 2½ billion for fiscal year 1968, in Vietnam-related expenditures, and a further delay in congressional approval of the tax increase which the Administration had first requested as early as August, 1967. Expenditures in the first quarter were already above the rate implied by the budget for the first half of the year, and it seems certain that there was a further substantial increase in the second quarter.

The fiscal package finally enacted in June is stronger than the Administration's proposal since it combines the requested tax increase with a $ 6 billion cut in non-Vietnam spending plans for fiscal 1969.[1] This more than offsets the $ 2.6 billion

1. Also exempt from the expenditure cut are interest payments, social security benefits and veterans' benefits. The President is directed to make expenditure reductions to the extent to which Congress fails to achieve the $ 6 billion goal on appropriation bills. New obligational authority—affecting spending over a longer period—is to be cut back by $ 10 billion, and Federal civilian employment is to be reduced by 250,000 through filling fewer vacancies than occur.

increase in Vietnam expenditures previously announced for the same period. Since the expenditure reductions will take some time to implement, the outlook is for an increasingly restrictive budget in the first half of 1969.

Towards the end of 1967, monetary policy moved towards restraint. Following the sterling devaluation and the United Kingdom bank rate increase in November, the United States discount rate was raised to 4½ per cent. Late in December reserve requirements on demand deposits were raised, absorbing an estimated $ 550 million into required reserves; at the same time open market operations became more restrictive. In the first months of 1968, in the absence of the tax increase, stronger measures were taken. Together with a discount rate increase to 5 per cent in March, open market operations were again used restrictively. In the first three months of 1968, the banks' free reserve position became negative and declined further to a range around -$ 400 million in April-June. On 19th April, the discount rate was increased further to 5½ per cent, the highest since the late 'twenties.

The new balance of payments programme announced by the Administration on 1st January was designed to improve the external account by about $ 3 billion in 1968, of which $ 1.9 billion would be in capital transactions.[1]

a) Voluntary controls on direct investment became mandatory. Outflows to finance direct investment in continental Western Europe were suspended, apart from exceptional cases; earnings could be reinvested up to 35 per cent of the average direct investment made in these countries in 1964-66. For several other countries, including the United Kingdom and Japan, direct investment outflows were sharply reduced, and in less developed countries a limit of 110 per cent of the 1965-66 average was imposed.

b) The Federal Reserve Board issued new guidelines for financial institutions designed to produce a $ 500 million inflow of bank credit, compared with last year's $ 460 million outflow.

c) Additional steps were envisaged to reduce the balance of payments costs of government programmes by $ 500 million.

d) Various measures were proposed to reduce the net deficit on travel expenditure, but the Congress has been reluctant to take action restricting tourism. Legislation to reduce duty-free entry privileges for returning travellers, and extending excise taxes to international airline tickets, has, so far, only been passed by the House of Representatives.

e) A longer-term programme to stimulate exports, with improved financing and promotion, was announced.

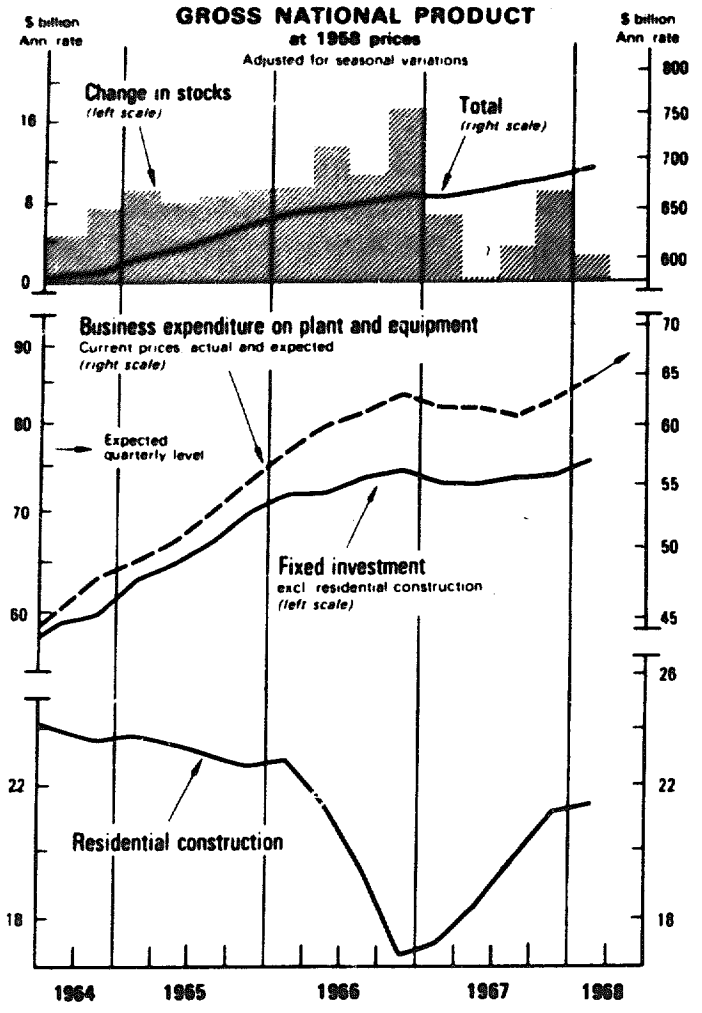
f) Other trade measures were to be considered. However, no action has been taken so far and the Administration has been resisting growing sectoral pressures for protection.

1. Since actual 1967 capital outflows were larger than estimated at the time the programme was announced, the improvement might be about $ 2½ billion.

Recent Trends

A major factor underlying the accelerated rise of GNP in the second half of 1967 was the return of inventory accumulation to normal rates; in volume terms, the increase in inventory accumulation provided more than half the gain in GNP between the second and fourth quarters. The rise in final sales (GNP less inventory accumulation) slowed down in the second half of the year because of weaker trends in government expenditure on goods and services and consumer spending. The volume of purchases of consumer durables remained virtually flat in this period. Personal income rose rapidly, but the savings rate continued the climb begun in 1966, reaching 7.6 per cent in the fourth quarter, in part because the strike limited the availability of automobiles. The revival of residential construction, nourished by the first half-year's expansionary monetary policy, was rapid, and business fixed investment also showed signs of recovery after falling in the first half. Exports of goods and services were flat throughout the year, and a sharp surge in imports reduced the GNP increase significantly in the fourth quarter.

Real GNP rose at an annual rate slightly above 6 per cent in the first quarter of 1968, and the second quarter's increase will probably prove similar. Final sales spurted ahead at a 10 per cent annual rate in the first quarter, but a sharp fall in inventory accumulation cushioned the GNP advance. In the

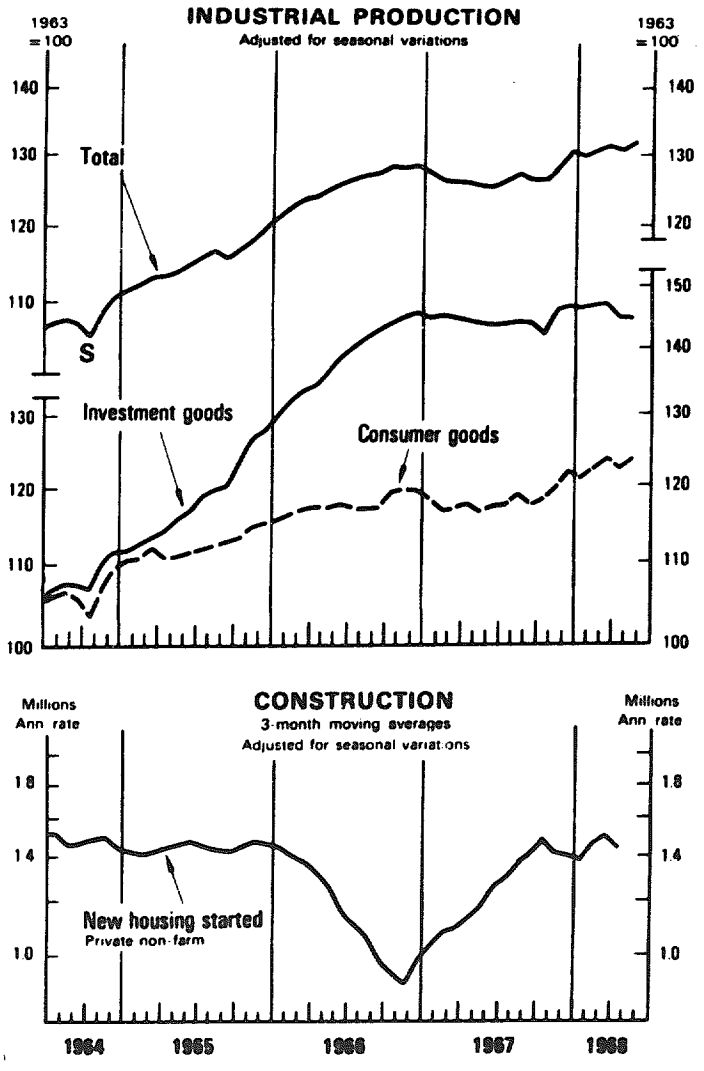


second quarter the increase in final sales has probably been more moderate, but stockbuilding may have rebounded sharply. Growth in the first half (over the preceding half year) should be about 6 per cent at an annual rate.

The first quarter surge in final sales was broadly based among final demand sectors. Consumer spending led the way with a rise substantially exceeding the increase in personal disposable income, and the personal savings ratio fell sharply from its unusually high fourth quarter rate. Federal government purchases climbed rapidly, due, in large measure, to an increase in Vietnam spending. Business fixed investment, stagnant in 1967, turned sharply upwards, whilst residential construction continued its recovery; but net exports fell. The rates of growth of consumers' expenditure, federal government purchases, and business fixed investment will probably prove somewhat lower in the second quarter.

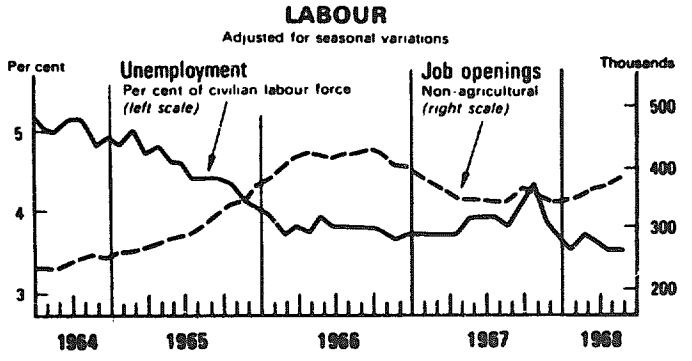
Although the labour market eased somewhat in 1967, overall unemployment climbed only gradually, remaining in the 3.7 - 3.9 per cent range during most of the year. When activity was slowing down, the effect was felt largely in lower average hours worked and labour force participation rates; firms held on to labour, particularly skilled, in anticipation of the speed-up in growth. With the acceleration, labour was more intensively utilised and participation rates rose. At the end of 1967 the unemployment rate stood at 3.7 per cent; the economic surge in the first half of 1968 lowered it to 3.5 per cent in April and May.

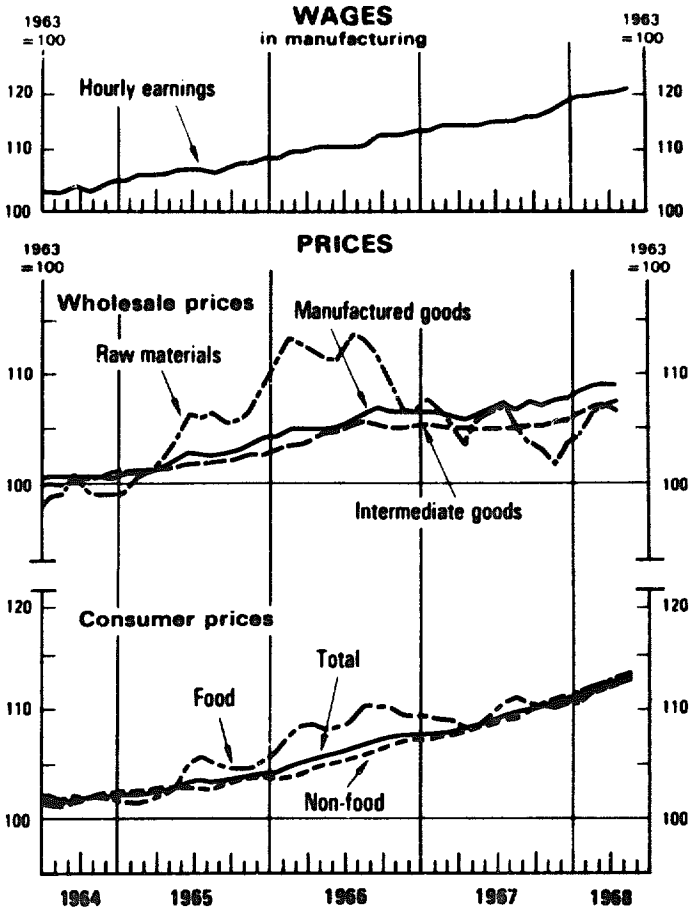
Wage increases generally accelerated in 1967, reflecting substantial collective bargaining gains—about 5½ per cent a year—and an increase and extended coverage in the Federal minimum wage. Gross average hourly earnings in industry increased 4.7 per cent, the rate accelerating towards the end of the year. Average hourly compensation in the private economy rose 6 per cent, while output per man-hour increased at only 1½ per cent, yielding an unusually high 4½ per cent increase in unit labour



cost. For a time, business appeared partly to be absorbing these increases through reduced profit margins; but later in the year, with strengthened demand, cost increases were passed on in higher prices. The key index of industrial wholesale prices, flat in the first half of 1967, rose at an annual rate of 2.7 per cent in the second and about 4 per cent in the first four months of 1968. The rise in the less sensitive, but more broadly based, consumer price index accelerated from an annual rate of 2.2 per cent in the first half to 3.8 per cent in the second, and nearly 4½ per cent in early 1968. The GNP price deflator rose at a 3.8 per cent annual rate in the first quarter.

Most major sectors took advantage of 1967's temporary easing of credit conditions to increase their borrowing and improve their liquidity position. Treasury borrowing, at $ 12.7 billion, was superimposed on strong private demand. Corporations borrowed heavily in the securities market, raising $ 16½ billion—$ 5 billion more than in 1966. State and local governments also stepped up their borrowing, and mortgage financing recovered in the course of the year. Inflows of funds to savings institutions recovered in 1967, providing strength to the mortgage market. Savings and loan associations were acquiring mortgages at a rate of nearly $ 10 billion a year in the second half, compared with less than $ 1 billion in the second half of 1966 (seasonally adjusted). They also managed to build up their liquid reserves and reduce their debt to the Home Loan banks. The expansion of bank lending was small after mid-1967. The banks used their growing reserves to improve their liquidity position through heavy security purchases. Households added to their holdings of money and near-money by nearly $24 billion last year, compared with less than $ 14 billion during 1966, while the money supply rose by 6½ per cent, about three times as fast as in 1966.





Demand on capital markets remained heavy in early 1968, although somewhat less than in the second half of 1967. Federal government borrowing, in particular, continued to be exceptionally heavy. With corporate liquidity positions improved, and reduced needs for external financing, corporate borrowing slackened somewhat from 1967's large volume. Inflows of funds into savings-type accounts began to slow down in late 1967, and savings institutions, facing uncertainty about future inflows, reduced their new mortgage commitments and acquisitions in the first quarter of 1968. Commitments fell further in April, with a new reduction in inflows resulting from higher competing short-term yields. The expansion of commercial banks' credit picked up a little in January and February, but slackened thereafter as their reserve position came under pressure from the restraint applied by the monetary authorities. Banks have also suffered from the loss of funds obtained through certificates of deposit.[1]

1. This resulted from the combination of rising short-term interest rates and the Federal Reserve Regulation Q placing a ceiling on rates payable on certificates of deposit (CD's). The banks' position was eased somewhat when the ceiling on large denomination, negotiable CD's was raised on 19th April.

In order to meet loan demands, government security holdings have been reduced since February.

Short-term interest rates turned up at mid-1967 and rose steeply throughout the second half. They declined a little early in 1968, but have since renewed their upward trend as monetary conditions progressively tightened; 3-month Treasure bill yields reached 5.8 per cent in May, around the 1966 peak levels. Long-term yields had turned up early in 1967 with heavy security borrowing. Yields on high grade corporate issues reached 6.2 per cent in December, well above the 1966 peak, eased somewhat in the early months of 1968 but climbed above the December level by mid-May. In June, as passage of the tax bill became more assured, interest rates eased from their May highs.

The deterioration of the balance of payments on non-monetary transactions, relatively gradual in 1966 and in the first half of 1967, became pronounced in the second half, when the deficit rose to an annual rate of $ 4.6 billion. On the United States liquidity definition, the deficit rose from $ 1.4 billion in 1966 to an annual rate of $ 5 billion in the second half of 1967, but receded to a $ 2.4 billion rate in the first quarter of 1968.

1967 was the third successive year in which the current account deteriorated. By the second half, the surplus had become small. Exports fell, reflecting sluggish growth in Western Europe, lower agricultural exports and stronger demand pressures at home. Merchandise imports turned up steeply in the fourth quarter, partly because of special factors such as strike-induced copper imports, the beginning of steel stock-piling and a substantial rise in petroleum imports, but also because of the faster expansion of domestic demand. Military expenditure abroad rose by $ 600 million last year, but the surplus on other invisibles strengthened in the second half because of higher receipts from direct investment income. Discounting the effects of the New York dock strike in March, the trade surplus declined steadily in the first five months of 1968. The current balance fell into deficit in the first quarter and there was again a trade deficit in May. Export performance improved somewhat but this was more than offset by further sharp increases in imports, partly spurred on by special factors, but increasingly attributable to the rapid advance of domestic demand.

The external position was rendered more difficult in the second half of 1967 by an increased net long-term capital outflow. Direct investment rose from its relatively low first-half level. New issues of foreign securities increased sharply in the third quarter, but subsided to more normal levels in the fourth. Long-term bank loans shifted from a net inflow in the first half to a small net outflow. But private short-term non-monetary capital responded to tighter monetary conditions and higher interest rates, despite a substantial outflow of short-term corporate funds in the fourth quarter. And the second half saw a very sharp change in commercial bank positions from outflow to inflow. In the first quarter of 1968 the impact of tighter money and the Administration's programme was evident on capital flows. US direct investment fell sharply to a $ 1.9 billion annual rate, from $ 3.4 billion in second half of 1967. There were exceptionally large sales to foreigners of US corporate securities to finance direct investments. US banks reported a very substantial inflow from the reduction of holdings of foreign assets.

The 1967 deficit was mainly financed through a $ 3.3 billion accumulation of liabilities held by foreign official agencies. Reserve assets, including the IMF position, fell only slightly as gold losses of $ 1.2 billion, largely in the fourth quarter, were substantially offset by a large increase in convertible currency holdings resulting from sterling support operations. In the first quarter of 1968 gold outflows were substantial—about $1.4 billion—until support for the private gold market was withdrawn in March.

Prospects

The outlook for the second half of 1968 is for a substantial decline in the rate of growth. Fiscal policy has moved towards restraint, and the effects of the recent tightening of monetary conditions will be felt. The increase in consumers' spending should be restricted by the surcharge. Residential construction will probably decline in the face of increased monetary stringency, although the decline is unlikely to be anywhere near so abrupt as in 1966. Present plant and equipment spending plans indicate less buoyancy in the second half than in the first. The rise in Federal government purchases should be much slower. On these

Balance of payments
UNITED STATES
Value, million dollars
Estimates and forecasts

	1967	1968	1967 I	1967 II	1968 I	1968 II
SEASONALLY ADJUSTED						
Exports	30,468	33,100	15,364	15,104	16,150	16,950
Percent change[a]	(5.2)	(8½)	(8.4)	(-1.2)	(12½)	(10)
Imports	26,991	31,300	13,291	13,700	15,750	15,550
Percent change[a]	(5.0)	(16)	(-0.4)	(5.7)	(32)	(-2½)
Trade balance	3,477	1,800	2,073	1,404	400	1,400
Services and transfers, net	-1,786	-1,100	-1,100	-684	-600	-500
Current balance	1,692	700	973	720	-200	900
Long-term capital	-5,153		-2,331	-2,822		
Short-term capital and unrecorded	-544		-248	-297		
Balance on non-monetary transactions	-4,005		-1,606	-2,399		
Change in reserves	-146		-649	503	-768	

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

assumptions, the rise in real output might slow down to an annual rate of about 2¾ per cent (well below 2 per cent between the second and fourth quarters), with some easing of the pressure on resources beginning. By the end of the year unemployment might have risen to around 4 per cent. In the early months of 1969, when the full impact of the tax increase and Federal spending cuts will be being felt, the rate of expansion might be even slower, even if some relaxation of monetary conditions were encouraged in the interest of residential construction; unemployment would therefore be likely to rise somewhat above 4 per cent.

With demand increasing less rapidly, it would seem reasonable to expect some deceleration of the rise in prices to begin in the second half of 1968. But the slowdown may be moderated by the strong upward movement of labour costs. The increase in the consumer price index and the GNP price deflator may still be around 4 per cent a year. The rise of wholesale prices might, however, slow down more sharply, promising a better general price performance in 1969.

For 1968 as a whole, the current account of the balance of payments seems certain to show another deterioration. In the first half, it will probably show a deficit, for the first time in almost a decade. In the second half, both the disappearance of the special factors and the slower domestic growth will restrain imports, and the current account should return to surplus. But for the year as a whole, this is likely to be small. Exports should rise rather faster than in 1967, with more buoyant demand in Western Europe. Travel expenditures abroad will probably decline with the ending of Expo '67 and the Administration's efforts to discourage US tourism in Western Europe. Investment income receipts should respond to improved profits in Western Europe, and the Administration's programme. Capital outflows should be sharply curtailed by the programme. But the rise of imports will certainly turn out to have been very large, and the overall result for the year as a whole seems likely to be a substantial deficit on non-monetary transactions—subject to the many uncertainties concerning the direct and indirect effects of domestic policy measures and developments in Vietnam. The major part of the deficit will have been incurred in the first half-year, with a marked improvement during the second; but further progress towards balance will need to be made next year, and the slow growth of domestic demand at present envisaged will be an important factor contributing to such progress.

CANADA

Despite rather modest expansion of activity, a more satisfactory cost/price performance has continued to be a main preoccupation of Canadian policy. Some progress should be achieved in this respect with the further easing of demand pressures being experienced in 1968.

Policies

The 1968-69 Federal budget[1] has not yet been presented to Parliament, but last November the Minister of Finance announced that the increase in Federal budgetary expenditure would be held to 4.5 per cent, a much smaller increase than in the last three years, and that additional costs resulting from the national medicare programme—if introduced as planned from 1st July 1968—would be met by higher taxes or further reductions in existing programmes. Thus, at the end of November, new temporary fiscal measures were proposed, including:

a) A personal income surtax of 5 per cent of the basic income tax, effective as from January 1st 1968 and yielding $ 185 million in fiscal 1968-69;

b) Higher excise taxes on liquor and tobacco from December 1st 1967, to yield $ 95 million in fiscal 1968-69;

c) Acceleration by two months of corporate tax payments, which would increase cash receipts by about $ 290 million in fiscal 1968-69;

d) To reduce the impact on corporations of *c*) above, repayment of the refundable tax on cash flow collected between May 1966 and April 1967—about $ 230 million—would begin in June; some $ 105 million would be repaid in fiscal 1968-69.

On the basis of these measures the Government expected to reduce its net cash requirements and its consequent demands on the capital market to less than half the $ 1.6 billion experienced in fiscal 1967-68.

In February, when Parliament withheld approval of the 5 per cent surtax, the Government proposed, and Parliament adopted, a 3 per cent surtax on both individuals and corporations for the years 1968 and 1969, yielding $ 150 million in fiscal 1968-69—somewhat less than the defeated proposal. Simultaneously, the Government announced additional cuts in Federal expenditures totalling about $ 75 million, and an immediate freeze on the total numbers employed in the Civil Service. It also announced its intention to set up a Board of Review on prices and wages which would act by means of persuasion and co-operation.

The easy posture of monetary policy was changed last autumn. With the prospect of reviving demand,

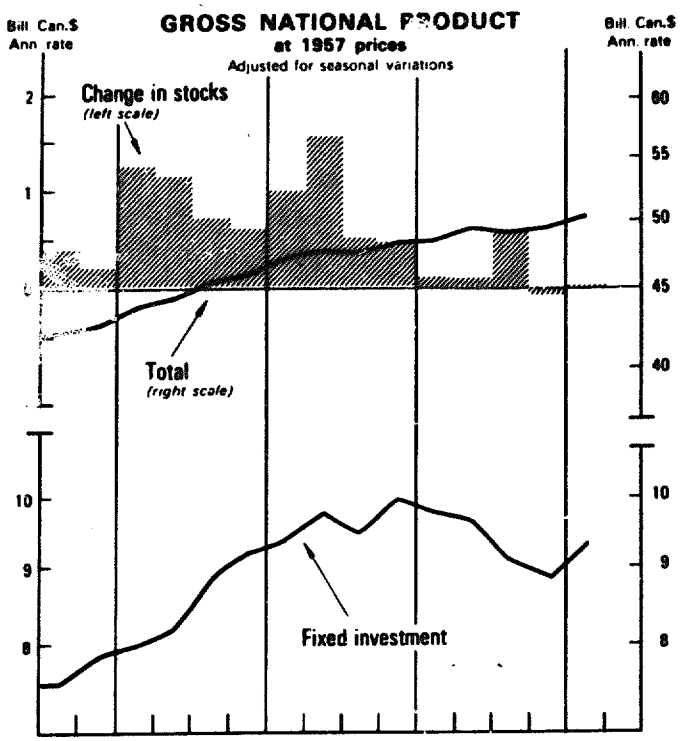
1. The fiscal year runs from 1st April to 31st March.

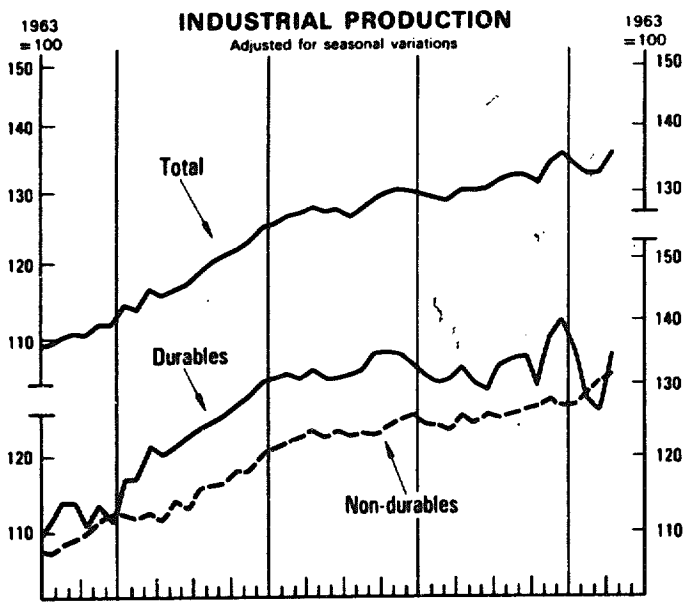
Demand and Output
CANADA

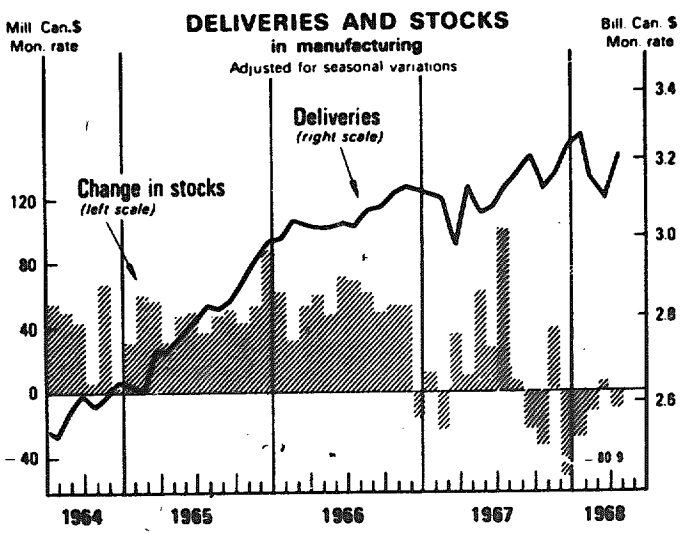
Percentage changes, volume
Seasonally adjusted, at annual rates
Estimates and forecasts

	1966 billion $ Cd.	From previous year 1967	From previous year 1968	From previous half-year 1967 I	1967 II	1968 I	1968 II
Private consumption	34.8	4.8	4	4.0	4.2	4½	3½
Public consumption	11.3	3.3	3	0.6	–0.8	4	4¾
Fixed investment	12.5	–3.3	–½	–0.4	–14.9	3½	7½
Total domestic demand (excluding stocks)	58.6	2.9	3¼	2.5	–0.6	4¼	4½
*plus change in stock-building	0.9	–1.5	½	–1.6	0.6	½	½
*plus change in foreign balance	1.2	1.1	–¼	2.6	0.8	0	–1½
GNP at market prices	58.3	2.8	3½	4.3	0.8	4¾	3½
GNP implicit price deflator		3.9	3½	4.0	3.1	3¼	3¾
Industrial production		2.7	4½	1.0	5.0	5½	2¼

* In the first column absolute figures are shown for "stock-building" (additions to stocks) and the "foreign balance" (net exports of goods and services). In subsequent columns, changes in stock-building and the foreign balance are expressed as percentages of GNP in the base period. The sum of the changes in domestic demand, stock-building and the foreign balance, will thus equal the change in GNP, although detail may not add because of rounding and because of the residual error of estimate.







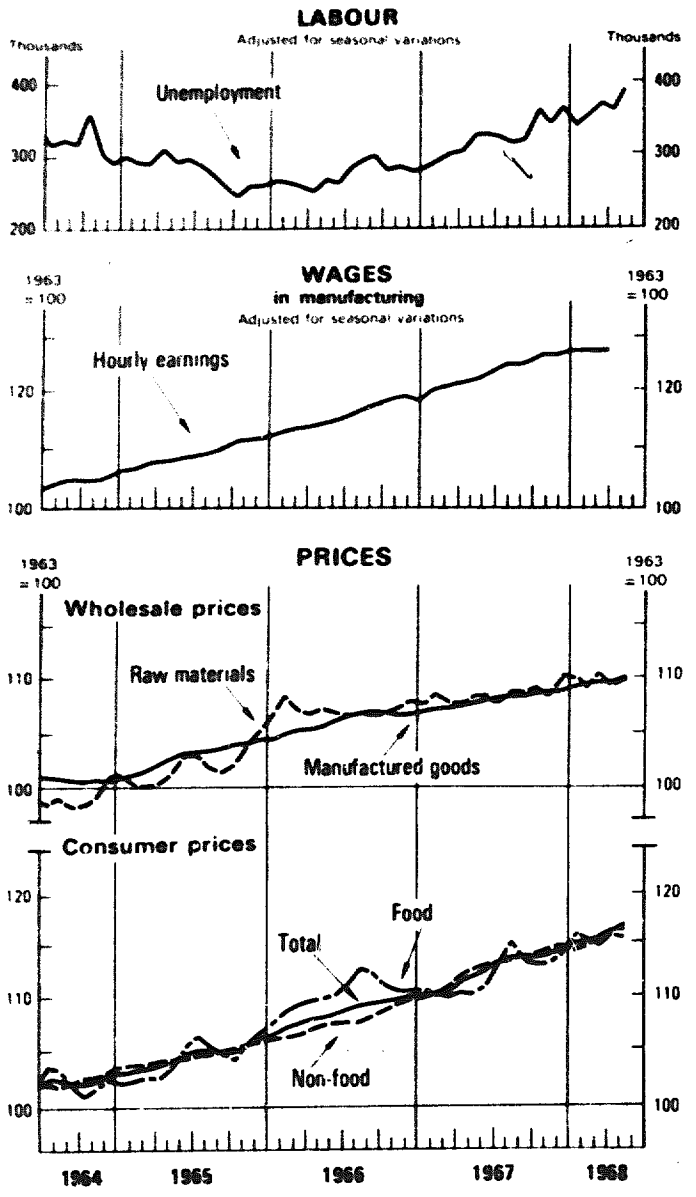
and with continuing strong pressures on costs and prices, the Bank of Canada began to exert pressure on bank liquidity in September and raised Bank rate from 4.5 to 5 per cent. In the closing months of 1967 and the first months of 1968 external developments also played an important role in the formulation of monetary policy. In November, following the devaluation of sterling and the rises in British Bank rate and the US Federal Reserve discount rate, Canadian Bank rate was raised to 6 per cent; it was increased to 7 per cent in January in response to pressure on the Canadian dollar, and to 7.5 per cent in March following the rise in the Federal Reserve rate to 5 per cent. A further rise in the Federal Reserve discount rate to 5½ per cent in April was not followed by the Bank of Canada.

Recent Trends

In line with the pattern in the United States, some strengthening of economic activity could have been expected in Canada in the second half of last year. In fact, the indicators were rather mixed. The rise in industrial production accelerated from 1 per cent in the first half to 5 per cent in the second (seasonally adjusted, at annual rates) despite a decline in October due to shutdowns in the car industry. Residential construction recovered strongly in the wake of earlier monetary easing and special government measures,[1] and consumers' expenditure continued to rise with the rapid increase in wages and salaries. The volume of business investment, however, fell sharply, and real expenditure on goods and services by all levels of government showed little change from the first half-year. A decline in wheat shipments in the second half of the year was largely responsible for a fall in merchandise exports.

Real domestic product as estimated from the production side grew at an annual rate of about 2½ per cent in the second half, slightly more rapidly than previously, but GNP as estimated from the demand side was rising at an annual rate of less

1. In addition to the special lending programme by the Government to builders for the spring months, a number of measures began to stimulate the flow of funds into the mortgage market. The new Bank Act in effect since May 1967 authorised chartered banks to make conventional mortgage loans, and in October the spread between the maximum permissible interest rate on National Housing Act insured mortgage loans and the long-term government bond average was raised to 2.25 per cent, from 1.5 per cent.



than 1 per cent—considerably less than in the first half. In the course of the year, the unemployment ratio rose by almost 1 percentage point, to 4.6 per cent in the last quarter. In the first quarter of 1968 industrial activity was adversely affected by labour disputes in the automobile industry and the production index declined.[1] After settlement was achieved, industrial production rose sharply in April; nevertheless, the production index was virtually unchanged in the first four months of 1968 as compared with the preceding four-month period. But housing starts rose strongly in the January-April period and exports of goods continued the upward trend in response to brisk demand conditions in the United States. After a decline in January, the unemployment ratio resumed its rising tendency and reached 4.9 per cent in May.

The average annual increase of wage rates in new settlements in private industries (excluding agriculture) increased to nearly 9 per cent in 1967, though there seems to have been some slight moderation in wage demands in the latter part of the year and early 1968. With productivity rising very slowly, unit labour costs in manufacturing increased by some 5 per cent between 1966 and 1967. Nevertheless, the deterioration, if any, in Canada's labour cost position in manufacturing vis-à-vis the United States was small.

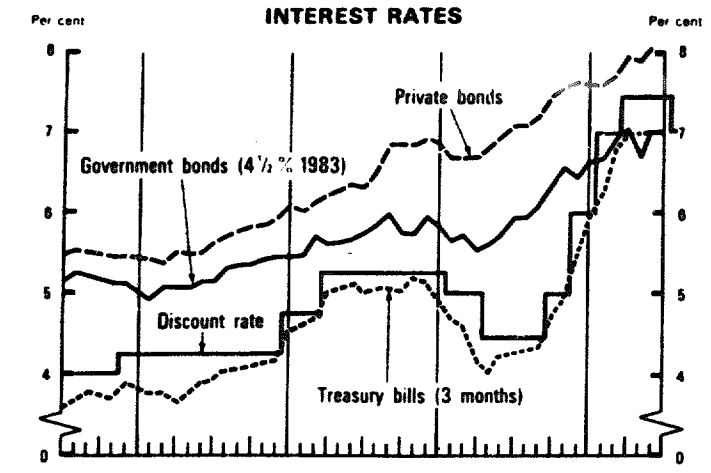
Price increases remained strong in 1967, but slowed down after mid-year. During the ten months from June 1967 to April 1968, non-food consumer prices rose by 3.6 per cent, partly owing to higher indirect taxes, compared with an increase of 4.7 per cent during the previous ten months.

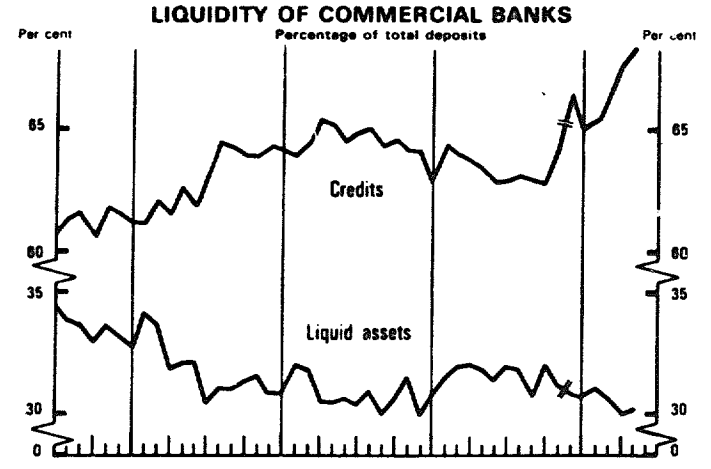
With the business sector rebuilding its liquidity following the decline in 1966, net issues of corporate bonds were high in the first three quarters of 1967 but more moderate towards the end of the year. Net issues by the Federal Government more than doubled compared with 1966 and net issues of provincial and municipal bonds also increased significantly. There was a substantial recovery in mortgage lending. The expansion of chartered bank credit, rather weak in the first half of 1967, strengthened in the second when a higher rate of inventory accumulation was resumed, and the stronger trend continued in the first four months of 1968.

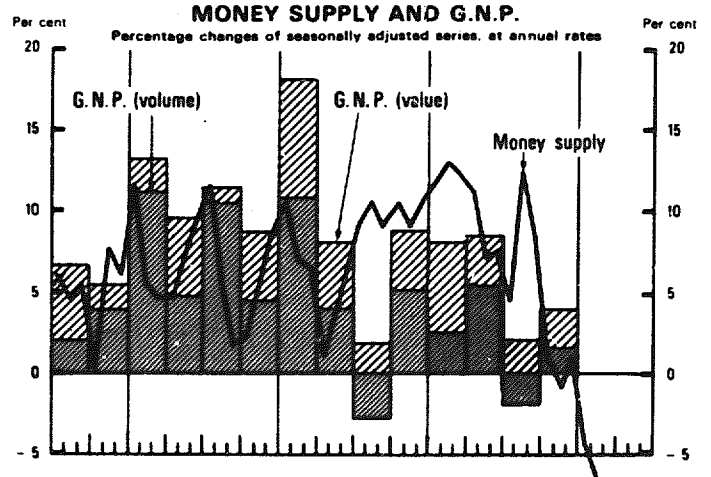
In the last months of the year and early in 1968, the rate of monetary expansion slowed down markedly as policy became tighter. The rise of interest rates accelerated, especially at the shorter end of the market. By the end of May the yield on 3-month treasury bills was 6.95 per cent compared with about 5 per cent in early November, and the government long-term bond yield had risen from 6.3 per cent to nearly 7 per cent. Subsequently, interest rates eased somewhat and by mid-June the yield on 3-month treasury bills had declined to 6.84 per cent and the government long-term bond yield to 6.82 per cent.

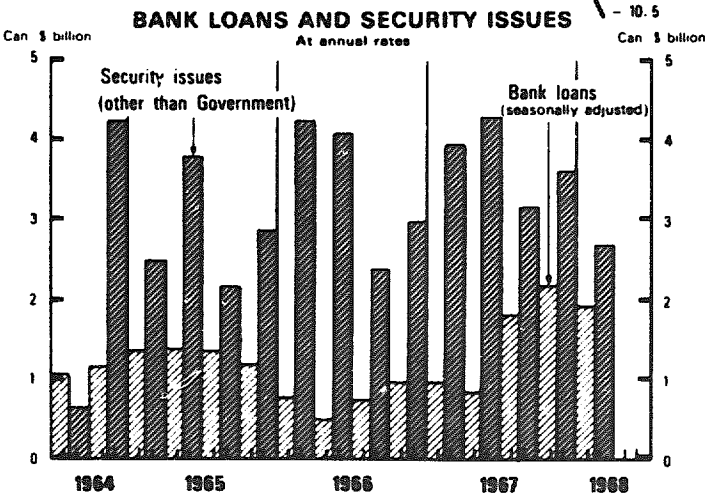
The current external deficit fell sharply in 1967. Merchandise exports, on a seasonally adjusted basis, rose strongly in the first half of the year. When

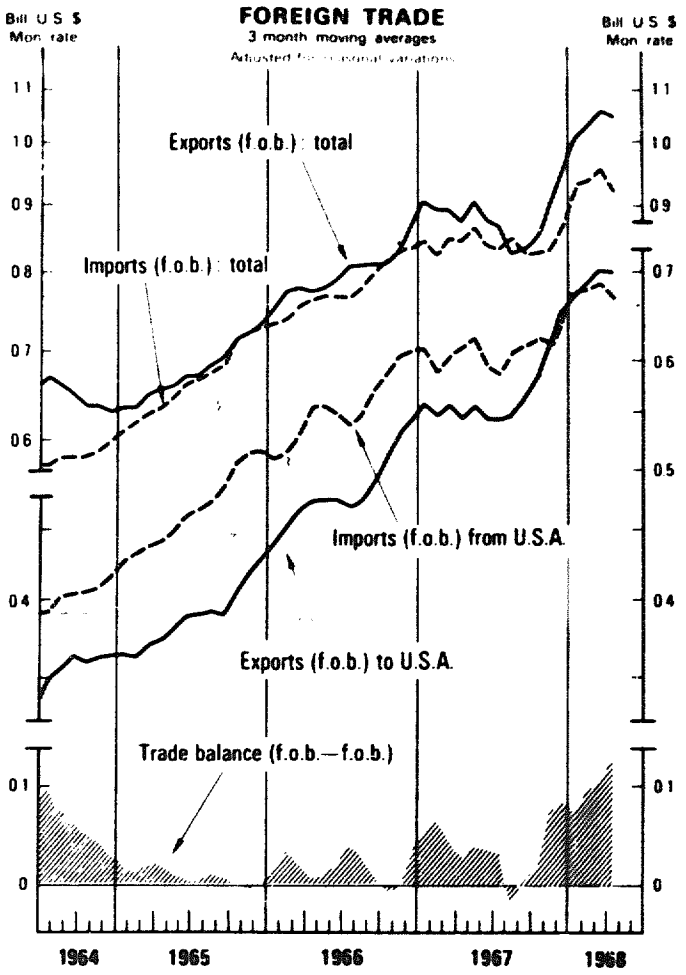
1. Nevertheless, provisional figures for the first quarter show a substantially higher rate of growth of private investment than incorporated in the present forecast.











exports fell in the second half (mainly because of reduced wheat shipments), the current account received strong support from travel receipts associated with Expo '67 and other centennial year celebrations. The net inflow of long-term capital increased despite a decline of direct investment in Canada. But capital movements in short-term form led to a larger outflow, concentrated mainly in the second half of the year when Canadian residents increased their holdings of bank balances and other short-term funds abroad and foreign currency bank loans were repaid. Official holdings of gold and foreign exchange reserves (including the net IMF position) increased very slightly in 1967. The Government of Canada bought $ 40 million of its own outstanding bonds and $ 19 million World Bank bonds from US residents in accordance with the agreement with the US to keep Canadian reserves near $ 2,550 million. In response to pressures on the Canadian dollar in January, the Bank of Canada activated $ 250 million of its reciprocal facility with the Federal Reserve System; and in February $ 426 million was drawn from the IMF.

Balance of payments
CANADA
Value, million dollars
Estimates and forecasts

	1967	1968	1967 I	1967 II	1968 I	1968 II
SEASONALLY ADJUSTED						
Exports	11,095	12,700	5,631	5,464	6,400	6,300
Percent change[a]	(10.6)	(14½)	(20.6)	(-6.1)	(36½)	(-4)
Imports	10,249	11,450	5,186	5,063	5,700	5,750
Percent change[a]	(8.1)	(12)	(10.0)	(0.0)	(25)	(1)
Trade balance	846	1,250	445	401	700	550
Services and transfers, net	-1,239	-1,800	-699	-540	-800	-1,000
Current balance	-393	-550	-254	-139	-100	-450
UNADJUSTED						
Current balance	-393	-550	-525	132	-400	-150
Long-term capital	1,282		523	759		
Short-term capital and unrecorded	-558		-256	-302		
Balance on non-monetary transactions	331		-258	589		
Change in reserves	29		-68	97	306	

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

By the end of March, official reserves had declined to $ 2,244 million, well below the end-year level. The reserves rose to $ 2,695 million in May, helped by loans raised in Italy ($ 100 million) and West Germany ($ 62 million). [All figures in United States dollars.]

Prospects

Demand conditions in the United States point to a more buoyant picture in Canada in 1968. But the more moderate nature of the inventory adjustment that occurred in Canada last year. and the absence of other special factors influencing the United States (e.g. the post-strike boom in car production and the build-up of inventories to guard against a possible steel strike) suggest that the resurgence of activity will be less marked. In addition, Federal expenditure will rise more slowly than last year and both direct and indirect taxes have recently been increased. Some reversal of the recent tightening of monetary policy in Canada may take place. On these assumptions, real GNP may rise by some 3½ per cent in 1968. This would still be less rapid than capacity growth (estimated at some 5 per cent a year) and unemployment could rise above 5 per cent in the course of the year. The pattern of growth within 1968 is likely to be influenced by developments in the United States, with the first half stronger than the second.

The official end-1967 investment survey suggested that business fixed investment in current prices would not rise in 1968, which would imply a decline in volume. Given the sharp decline in business investment in the second half of last year this might be consistent with a revival of investment activity in the course of 1968. Housing activity should continue to grow, although much less rapidly than during the recovery last year. Private consumption should be fairly buoyant, as the rise in wages and salaries may remain strong even if there is some slowdown in response to lower demand pressures. The personal savings ratio has been high for some quarters and a decline would seem likely. But the rise in employment will probably be less than last year, when it was large in relation to the advance in output, and higher taxes will moderate the growth of consumption.

Net exports may be less of a stimulative factor than in 1967. Exports are likely to benefit, especially in the first half of the year, from the rapid expansion in the United States; but the rise in imports may also quicken in line with the trend of domestic activity. Both exports and imports of automobiles

and parts are expected to expand by less than the exceptionally fast advances realised in recent years. There may be some improvement in the trade balance, but tourist earnings are likely to fall back to more normal levels after the sharp increase related to Expo '67, so the current external deficit may rise. With the complete exemption of Canada from the United States balance of payments measures, the deficit is likely to be financed by an inflow of capital, mainly from the United States.

JAPAN

After two years of rapid internal expansion and deterioration of the foreign balance, the Japanese economy has now entered a phase of readjustment, with the external basic account swinging back into surplus. If these new trends are confirmed some relaxation of monetary restraint may be desirable to prevent too sharp a check to private fixed investment.

Policies

The budget for the 1968 financial year [1] is less expansionary than its predecessor. Government expenditure on goods and services is foreseen to increase by 11.7 per cent and transfer payments by 13.3 per cent as compared with probable increases of more than 15.5 and 16.5 per cent respectively in FY 1967. Central government bond issues are expected to decline from 713 billion to 640 billion yen. The overall deficit of general government may, however, increase slightly if, as expected, the growth of total current receipts slows down substantially.

Monetary conditions have been tightened further since the beginning of the year. The official discount rate was raised by another 0.365 per cent to 6.21 per cent in January and city banks were requested to keep their credit expansion during January-March below 71 per cent of that recorded a year earlier. The ceiling fixed for April-June implied some further tightening.

1. From April 1968 to March 1969.

Demand and Output
JAPAN

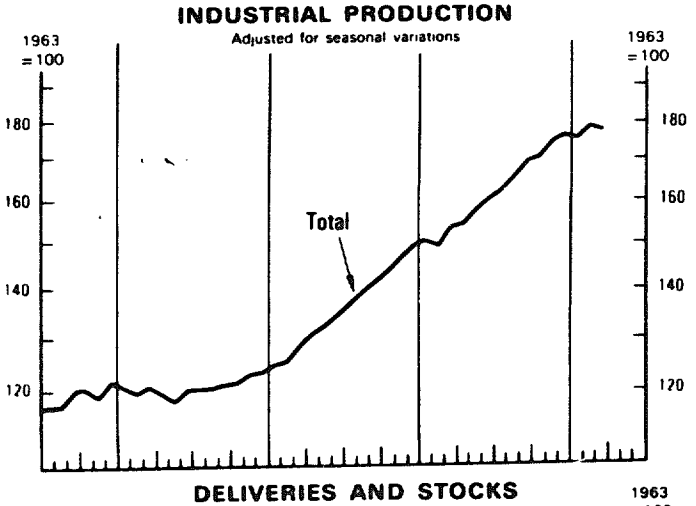
Percentage changes, volume
Seasonally adjusted,
at annual rates
Estimates and forecasts

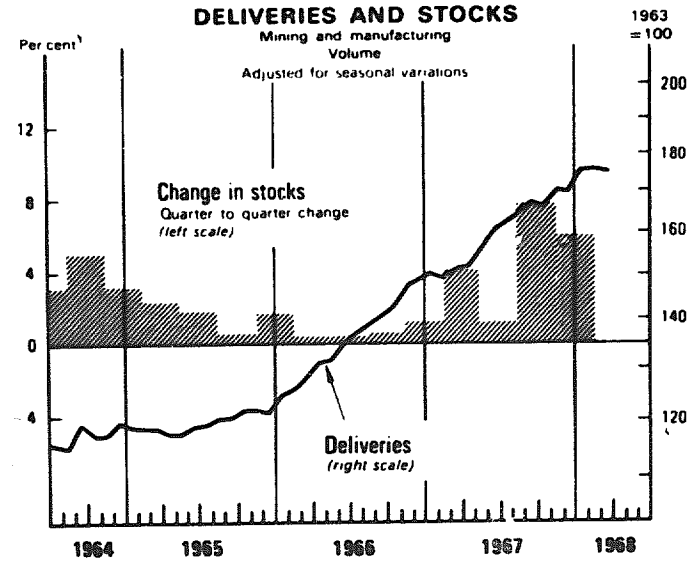
	1966 billion Yen	From previous year 1967	From previous year 1968	From previous half-year 1967 I	1967 II	1968 I	1968 II
Private consumption	19.2	9.2	9	6.4	13.6	8	6
Public consumption	3.4	5.4	5	5.2	7.0	5	3
Fixed investment	11.0	16.8	12	19.2	18.0	13	3
Total domestic demand (excluding stocks)	33.7	10.8	9	10.0	13.7	9	4½
*plus change in stock-building	0.9	3.8	-2½	4.4	2.3	4½	-2½
*plus change in foreign balance	0.5	-1.7	1	-1.7	-2.2	2½	½
GNP at market prices	35.1	13.1	7½	12.7	13.9	7	2½
GNP implicit price deflator		4.4	4½	2.9	5.2	5	2½
Industrial production		19.1	12	16.0	20.4	12	3

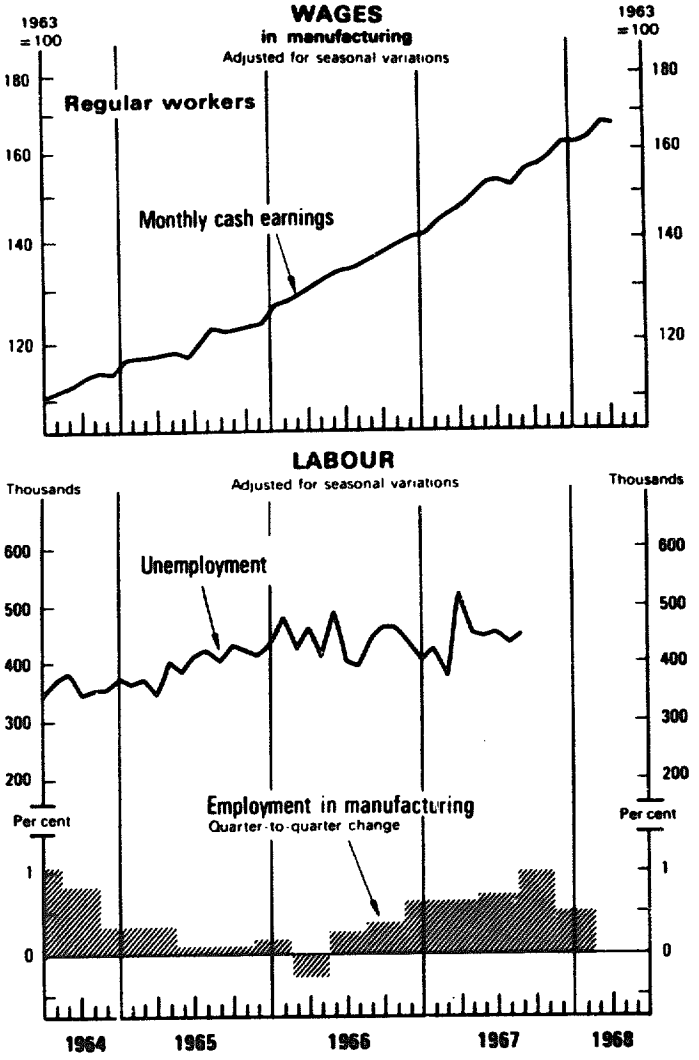
In the first column absolute figures are shown for "stock-building" (additions to stocks) and the "foreign balance" (net exports of goods and services). In subsequent columns, changes in stock-building and the foreign balance are expressed as percentages of GNP in the base period. The sum of the changes in domestic demand, stock-building and the foreign balance, will thus equal the change in GNP, although detail may not add because of rounding.

Recent Trends

The weakening of the boom in recent months probably reflects the effect of financial restraint on the corporate sector. Moreover, business expectations have deteriorated in response to the measures taken by other countries to improve their balances of payments. New orders for machinery and equipment have become more hesitant since the end of last year. Inventories of finished goods are now rising faster than shipments and voluntary stock-building seems to be tailing-off. Recent indicators suggest that, in the first quarter of 1968, real private investment in housing and machinery and equipment was rising less sharply than previously, and that total stock accumulation had fallen significantly. By contrast, the upward trends of private and public consumption and government fixed investment may have strengthened. With weaker imports and a sharp acceleration of exports the growth of GNP was probably kept at an annual rate of about 10 per cent in the first quarter.







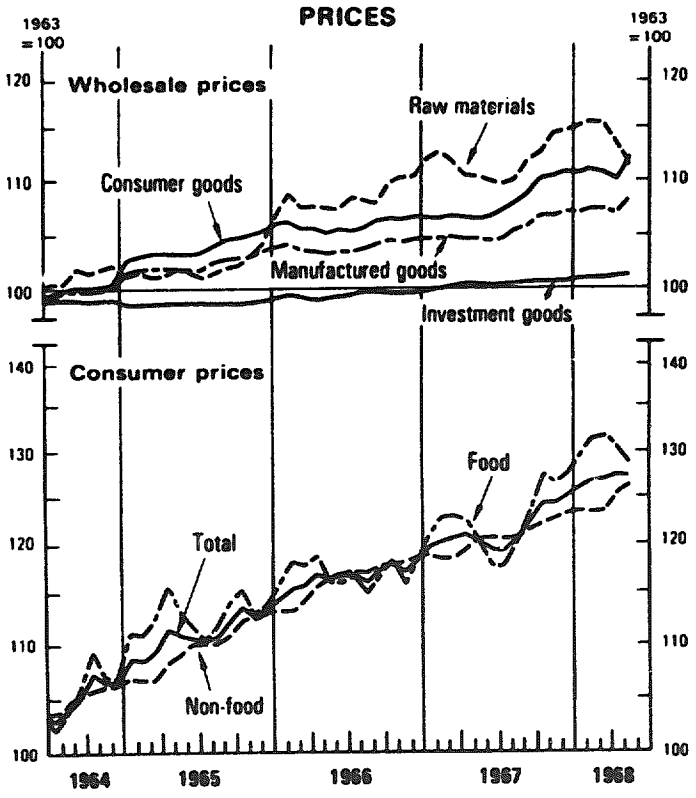
A less buoyant picture is reflected in recent output and employment statistics. Although the seasonally adjusted index of industrial production rose strongly in April and May, the December/May increase was only 6.6 per cent as against 9 per cent during the preceding five months. The rise of operating ratios in manufacturing levelled off in the first quarter and the increase of employment slowed down. Labour market conditions continued to tighten up to the beginning of this year, but have since shown some easing with the ratio of job vacancies to job seekers declining from 1.18 in January to 1.01 in April.

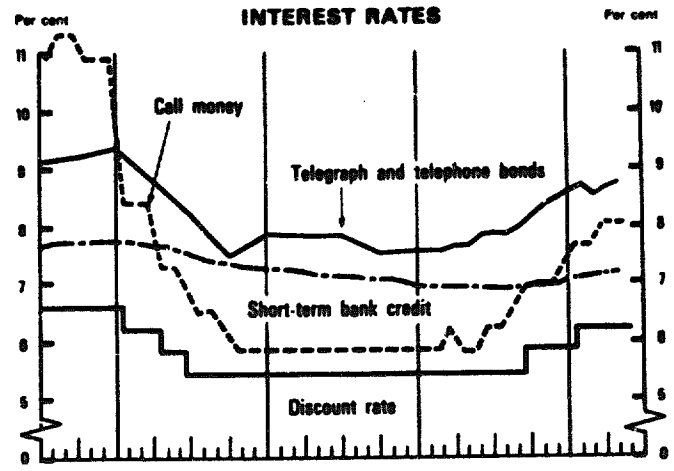
The index of monthly earnings of regular workers in manufacturing has risen steadily; in April it exceeded the level of a year earlier by about 12 per cent, compared to an average rise of 13.5 per cent in 1967. Wholesale prices, however, have remained virtually stable in recent months. The rise of consumer prices has also become more moderate since last October, though in April the index still showed an increase of over 5 per cent on a year-to-year basis, with food prices 6 per cent up on the year.

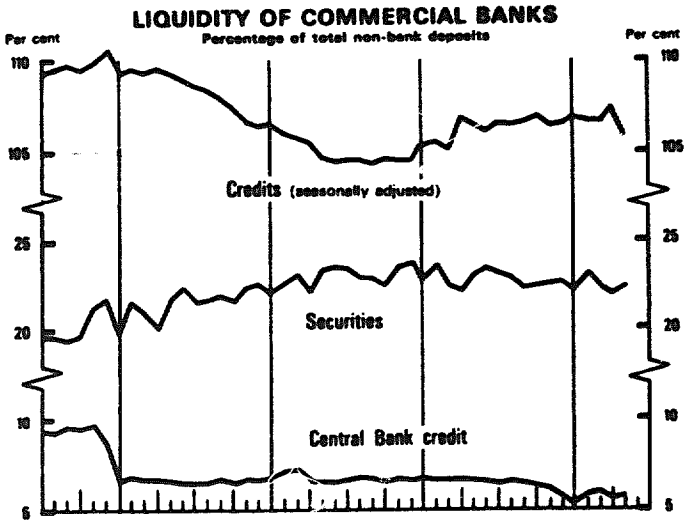
An important improvement in the pattern of the balance of payments has taken place in recent months. Merchandise exports have moved sharply upwards since January, and the steep rise of imports has been arrested. The current balance of payments (seasonally adjusted) improved from a deficit of $ 225 million in the fourth quarter of 1967 to a surplus of about $ 300 million (quarterly rate) in April-May. At the same time, the outflow of long-term capital has been substantially reduced by heavier borrowing abroad, with the placing of important loans in European markets. The basic balance (current transactions seasonally adjusted) has swung back into growing surplus since April, but the inflow of monetary and non-monetary short-term capital has been slightly reversed.

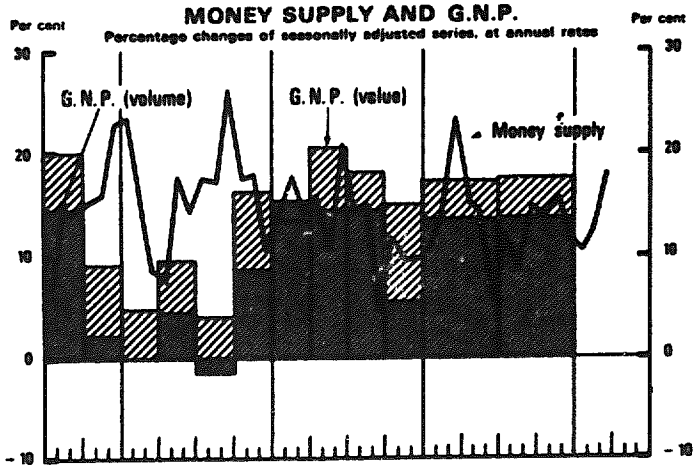
Prospects

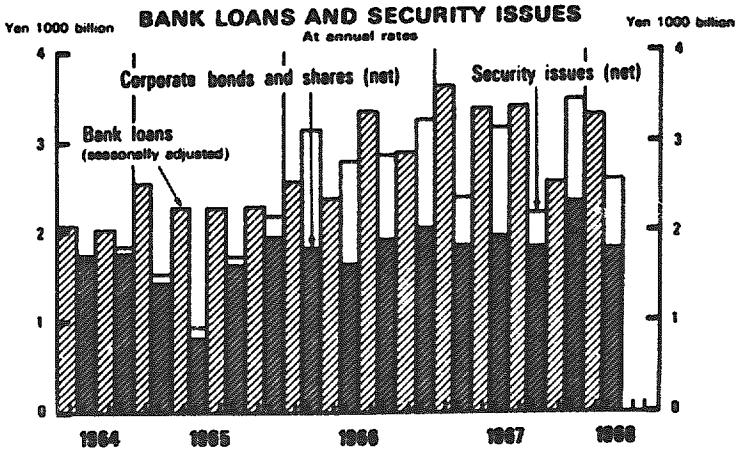
The coming months are likely to see a further slowdown of economic activity. The decline in stock formation may continue. With sales prospects deteriorating, private productive investment may further lose momentum and could even level off by the end of the year. Investment activity of small and medium-sized firms had already started declining in the fourth quarter of last year and the ambitious investment plans of larger firms announced











Balance of payments
JAPAN
Value, million dollars
Estimates and forecasts

	1967	1968	1967 I	1967 II	1968 I	1968 II
SEASONALLY ADJUSTED						
Exports	10,229	12,100	5,018	5,211	5,900	6,200
Percent change[a]	(6.8)	(17½)	(5.1)	(6.9)	(26½)	(9½)
Imports	9,068	9,850	4,272	4,796	4,850	5,000
Percent change[a]	(22.4)	(9)	(23.4)	(21.0)	(3)	(9½)
Trade balance	1,161	2,250	746	415	1,050	1,200
Services and transfers. net	-1,351	-1,450	-648	-703	-750	-700
Current balance	-190	800	98	-288	300	500
UNADJUSTED						
Current balance	-190	800	-347	157	-150	950
Long-term capital	-799		-364	-435		
Short-term capital and unrecorded	419		222	197		
Balance on non-monetary transactions	-570		-489	-81		
Change in reserves	-7		39	-46	-61	

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

in February for FY 1968 are not likely to be fully implemented.[1] Government expenditure, on the other hand, is not expected to decelerate much. The same may be true for private consumption since past experience shows that wage and employment movements are relatively little affected by changes in the business situation.

The slackening of internal demand pressure, coupled with some further expansion of exports, should make for a continued strengthening of the current balance. Although the net long-term capital outflow may pick up again, the basic external account should remain in surplus in the latter part of the year.

1. On a payments basis, the forecast rates of growth ranged between 12.9 per cent (Bank of Japan enquiry covering 503 corporations) and 30.9 per cent (survey of the Ministry of International Trade and Industry covering 1,800 corporations); the latter was subsequently adjusted downwards to 17 per cent.

ECONOMIC PERFORMANCE OF OECD COUNTRIES AS REVEALED IN NATIONAL ACCOUNTS STATISTICS

The basic features of a country's economic performance are best illustrated through its national accounts statistics, whilst a comparison of the national accounts of various countries reveals much about their different situations. The present article summarises some of the more significant facts tabulated in the latest OECD national accounts yearbook, which covers the years 1957-66. [1]

Rate of growth

Table I shows the rate of growth of real GNP, both in total and in per capita terms, between 1957 and 1966. Even excluding Japan (with a 9.6 per cent annual rate of expansion over the period) considerable diversity in growth rates persisted—though the diversity was probably less marked than in the preceding quinquennium, 1950-55. Recorded rates of expansion do not coincide exactly with the growth of different countries' economic potential. In the United States there was greater under-utilisation of resources in 1957 than in 1966, so that some of the recorded expansion represents absorption of resources initially unemployed. Some European countries, on the other hand, slowed down their rate of expansion towards the end of the decade and thus progressed at an overall rate below that which could be considered their capacity growth rate.

Table I also shows the average rate of price increase, as measured by the GNP price deflators. The diversity of experience was somewhat more marked than with rates of real expansion. There appears little inverse correlation between rates of price increase and rates of real expansion.

Level of real GNP

Chart O attempts to show the progression of real national product per capita in the different countries. One approach to answering this question would be to convert the value of GNP in different countries at the base date into terms of a common currency (e.g. dollars) by use of the official exchange rates ruling at this date. As is generally recognised, there are grave shortcomings in such a procedure—stemming from the fact that the price weights implied in estimating real GNP in different countries are dissimilar. An earlier OEEC study estimated comparative national products in certain countries in 1950 and 1955 by applying a common set of price weights—those ruling in the United States in 1950. [2]

TABLE I.
Increases in real GNP and in prices, 1957-1966
Average annual rate of change in per cent

Rank	GNP, real terms		GNP, real terms per capita		GNP price deflator	
1	Japan	9.6	Japan	8.5	Iceland	12.0
2	Greece	(6.5)	Greece	(5.8)	Turkey	6.8
3	Spain	(6.5)	Spain	(5.7)	Spain	(5.8)
4	Italy	5.4	Italy	4.7	Denmark	4.8
5	Portugal	5.4	Germany	4.6	France	4.8
6	Iceland	5.2	Portugal	4.5	Netherlands	3.9
7	Germany	5.1	Denmark	4.1	Sweden	3.9
8	Denmark	4.9	Austria	3.9	Switzerland	3.9
9	France	4.9	France	3.8	Italy	3.8
10	Turkey	4.9	Ireland	3.7[a]	Japan	3.7
11	Netherlands	4.7	Sweden	3.6	Ireland	3.6[a]
12	Canada	4.5	Norway	3.4	Austria	3.3
13	Austria	4.5	Belgium	3.3	Germany	3.2
14	Switzerland	4.5	Netherlands	3.3	Norway	2.9
15	Norway	4.3	Iceland	3.2	U.K.	2.8
16	Sweden	4.3	Luxembourg	(2.8)[b]	Belgium	2.4
17	United States	4.2	Switzerland	2.7	Luxembourg	(2.4)[b]
18	Belgium	3.9	United States	2.6	Canada	2.2
19	Luxembourg	(3.9)[b]	U.K.	2.5	Portugal	2.2
20	Ireland	3.7[a]	Canada	2.4	Greece	(2.1)
21	U.K.	3.2	Turkey	2.2	United States	1.8
	TOTAL OCDE	4.6	TOTAL OECD	3.3	TOTAL OECD	2.4

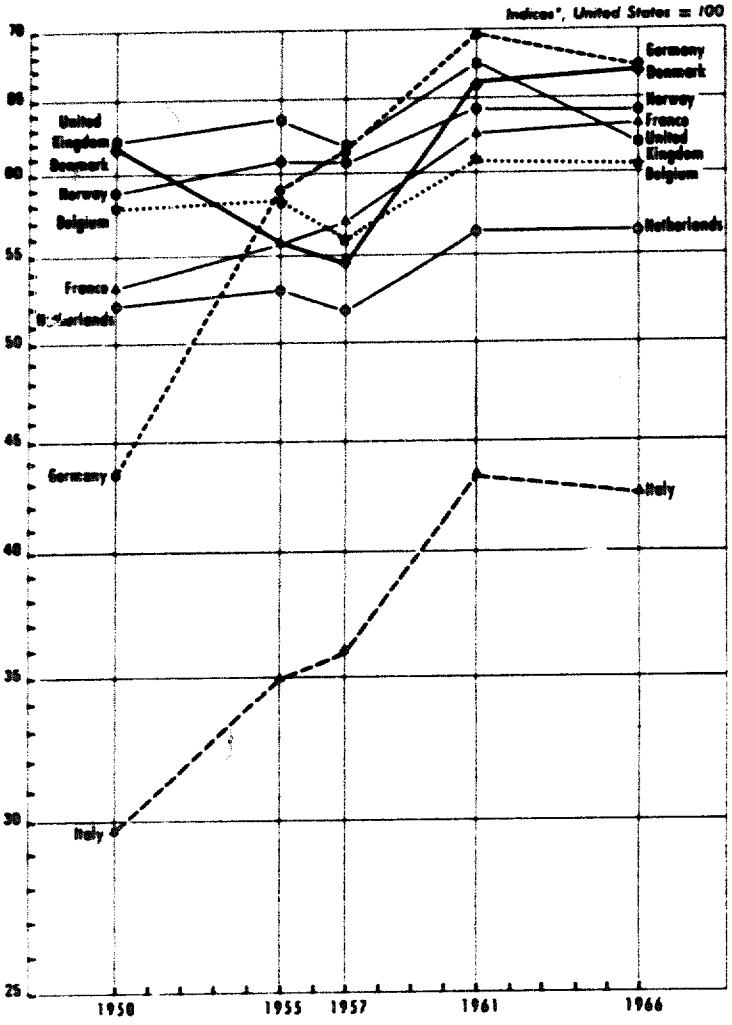
a) 1958-1966. *b)* 1960-1964. ( ) Estimated.

1. *National Accounts of OECD countries, 1957-66* (OECD, Paris 1968). Statistics for all countries have been adjusted so as to follow standard international definitions.

2. M. GILBERT and associates, *Comparative National Products and Price Levels*, OEEC, Paris, 1956. Relative levels of GNP as compared with the US were also estimated for each country using that country's own relative price structure, and, as with any index number estimation, the results in some cases differed appreciably. For a multilateral comparison of the sort made here, it is convenient to work with a single set of price relatives throughout. But this may to some extent misstate the comparisons and certainly gives a misleading impression of accuracy.

CHART O

REAL GNP PER CAPITA AT UNITED STATES PRICES IN SELECTED OECD COUNTRIES 1950-1966



* For absolute values, see Table 2

The levels of national product thus estimated for 1955 were extrapolated to 1957, 1961 and 1966 by use of the volume indices of the major expenditure components of each country and the corresponding price indices for the United States.[1] In view of the extended period of extrapolation (and for other reasons) such estimates need to be treated with caution: a re-estimate of comparative national products for 1966 would not necessarily coincide exactly with the extrapolated figures. But in the absence of any such recalculation, the present estimates are the best available.

As will be seen, there is a general tendency for levels of per capita national product to become more equal in the nine countries shown. The

1. For further details see note at the end of Table II.

TABLE II.

Comparative national product per capita in nine countries, 1950-1966, at US relative prices

US dollars

Countries	1950	1955	1957	1961	1966
United States	**1,823**	**2,301**	**2,618**	**2,877**	**3,842**
Germany	**791**	**1,354**	**1,610**	**2,003**	**2,581**
Denmark	**1,124**	**1,284**	**1,426**	**1,902**	**2,571**
Norway	**1,072**	**1,400**	**1,588**	**1,848**	**2,459**
France	**970**	**1,283**	**1,493**	**1,798**	**2,426**
United Kingdom	**1,134**	**1,462**	**1,617**	**1,942**	**2,377**
Belgium	**1,053**	**1,342**	**1,466**	**1,747**	**2,322**
Netherlands	**949**	**1,218**	**1,356**	**1,621**	**2,165**
Italy	**541**	**803**	**939**	**1,247**	**1,632**

SOURCES AND METHOD

The data for the years 1950 and 1955 were taken from Milton GILBERT and associates. *Comparative National Products and Price Levels*. The countries' GNP at US relative prices for any other year shown were obtained by extrapolation of component expenditure items of GNP by means of the following formula:

$$GNP^{E}_{i} = \sum_{i} GNP^{E}_{i,50} \quad Q^{E}_{i,50-t} \quad I^{US}_{i,50-t} + \text{Net exports in year } t \text{ at official exchange rate.}$$

where

$GNP^{E}_{i,50}$ is the i-th category of expenditure excluding net exports of the relevant European country valued at 1950 US relative prices. (The coverage of the expenditure items used is the same as that given in the *OECD National Accounts Yearbooks*)

$Q^{E}_{i,50-t}$ is the respective volume indice for the period 1950 to year t for the i-th category of expenditure. and

$I^{US}_{i,50-t}$ is the implicit price indice for the i-th category of expenditure (change in stocks excluded) in United States for the period 1950 to year t. For change in stocks the wholesale price index in US for the relevant period was used.

Corresponding population data were taken from *OEEC General Statistics Bulletin* and *OECD Main Economic Indicators*.

TABLE III.

Relation between level and rate of change of GNP

Countries	Per capital GNP: Level 1957 US dollars[a]	Per capital GNP: Rate of change 1957-66 volume	Rate of change ranking
Japan	**340**	**8.5**	**1**
Greece	375	(5.8)	2
Spain	415	(5.7)	3
Italy	**560**	**4.7**	**4**
Germany	**1,020**	**4.6**	**5**
Portugal	240	4.5	6
Denmark	1,060	4.1	7
Austria	720	3.9	8
France	**1,270**	**3.8**	**9**
Ireland	580	3.7[b]	10
Sweden	1,410	3.6	11
Norway	1,150	3.4	12
Belgium	1,150	3.3	13
Netherlands	840	3.3	14
Iceland	2,020	3.2	15
Luxembourg	1,490	(2.8)[c]	16
Switzerland	1,400	2.7	17
United States	**2,600**	**2.6**	**18**
United Kingdom	**1,200**	**2.5**	**19**
Canada	**2,000**	**2.4**	**20**
Turkey	320	2.2	21
TOTAL OECD	1,320	3.3	

a) National values converted at 1957 exchange rates.

b) 1958-1966.

c) 1960-1964.

( ) Estimated.

European countries have tended to catch up with the United States; and in general the countries which were initially poorest have tended to advance most rapidly. Thus Italy, though still the lowest of the countries shown, increased its per capita national product threefold whereas that of the United States increased only twofold. Both France and Germany now appear to have overtaken the United Kingdom, so that the three major European countries all now appear to have a per capita national product about two thirds that of the United States.

A cruder calculation based on 1957 current exchange rates (Table III) suggests that the levelling tendency was fairly general among OECD countries, so that with some important exceptions, the poorer countries have tended to catch up.

Composition of National Expenditure

Tables IV, V and VI show the proportion of national product taken respectively by consumers' expenditure, government current expenditure and fixed investment. To minimise the effect of cyclical influences, the ratios are shown for the average of the last three available years, 1964-66—and, for comparison, the average for the first three years of the decade here covered, 1956-58.

The share of consumption [1] has continued to vary widely, ranging from three-quarters of GNP to a little over half (Table IV). There was some tendency—not however shared by all countries—for its share to fall. [2]

In interpreting Table V, it has to be remembered that the coverage of the public sector varies widely between different countries. This is part of the explanation for the differing shares of GNP taken by government current expenditure—varying from 18 per cent in the case of Sweden to 7½ per cent in the case of Japan. In some countries the share fell largely because of a decline in the relative importance of defence expenditure, while in others, the share rose without increasing importance of defence expenditure. (Figures for total government expenditure, including transfer payments, are given in *National Accounts of OECD countries.*)

Table VI shows the ratio of gross fixed investment for the same periods. The ratio varies from as much as one third of national product in the case of Japan to one sixth in the case of the United States. In most countries there was an appreciable increase in the share of GNP going to investment (in Norway, Italy and the United States there was little change; and in Canada, over this period, a fall).

To show the relative importance of foreign trade, Table VII gives the average of exports and imports

1. Measured at current prices.
2. The change in the share of different expenditure components is best measured in terms of constant prices and it is this comparison that is referred to here and in later paragraphs.

TABLE IV.
Consumers' expenditure, in per cent of GNP, in selected OECD countries, 1956-1966

Countries	At 1958 prices				At current prices	
	Ratio		Rank		Ratio	Rank
	1956-58	1964-66	1956-58	1964-66	1964-66	
Portugal	80.7	74.6	1	1	74.0	1
Denmark	67.7	66.5	3	2	63.1	5
Italy	66.3	65.1	5	3	62.9	6
United Kingdom	65.7	65.0	6	4	64.2	3
France	66.4	64.9	4	5	63.7	4
Switzerland	64.4	64.8	8	6	58.8	11
Canada	63.4	64.2	9	7	61.6	9
Iceland	64.5	63.8	7	8	62.8	7
Belgium	68.0	63.7	2	9	64.8	2
United States	63.1	63.6	10	10	62.4	8
Austria	61.5	63.3	12	11	60.0	10
Netherlands	59.0	61.1	14	12	57.7	12
Germany	58.9	59.4	15	13	56.7	13
Sweden	61.3	58.3	11	14	56.6	14
Norway	58.2	56.1	16	15	55.6	15
Japan	60.4	54.7	13	16	55.1	16
Average:						
Unweighted	64.3	63.1			61.3	
Weighted	63.7	63.1			61.7	

TABLE V.
Government current expenditure, in per cent of GNP, of selected OECD countries 1956-1966

Countries	At 1958 prices				At current prices	
	Ratio		Rank		Ratio	Rank
	1956-58	1964-66	1956-58	1964-66	1964-66	
Sweden	17.6	17.8	2	1	19.7	1
United States	18.1	17.2	1	2	18.5	2
Norway	13.5	14.9	8	3	16.3	4
United Kingdom	16,5	14.8	3	4	16.7	3
Germany	13.0	14.3	10	5	15.4	7
Denmark	13.4	13.4	9	6	15.5	6
Belgium	11.0	13.1	13	7	13.0	12
Netherlands	15.1	12.6	4	8/9	15.8	5
Canada	14.5	12.6	5	8/9	14.3	8/9
France	14.4	12.2	6	10	13.4	11
Portugal	10.6	12.1	14	11	12.3	13
Austria	13.7	11.9	7	12	13.6	10
Italy	12.4	11.3	11	13	14.3	8/9
Switzerland	11.1	11.0	12	14	11.6	14
Iceland	9.4	9.8	16	15	9.1	16
Japan	9.8	7.4	15	16	9.5	15
Average:						
Unweighted	13.4	12.9			14.3	
Weighted	16.1	15.0			16.4	

TABLE VI.
Fixed investment, in per cent of GNP, in selected OECD countries 1956-66

Countries	At 1958 prices				At current prices	
	Ratio		Rank		Ratio	Rank
	1956-58	1964-66	1956-58	1964-66	1964-66	
Japan	25.8	34.4	3/4	1	31.8	1
Norway	31.3	31.1	1	2	28.7	2
Iceland	27.4	30.7	2	3	28.1	3
Netherlands	24.5	27.3	5	4	25.0	7
Switzerland	20.6	26.7	8/9	5	27.9	4
Germany	21.8	25.7	6	6	26.1	5
Austria	21.7	25.3	7	7	25.9	6
Denmark	16.7	23.7	14	8	21.7	10
Canada	25.8	23.3	3/4	9	24.5	8
Sweden	19.8	22.9	10	10	23.0	9
France	18.5	22.1	11	11	21.5	11
Italy	20.6	20.5	8/9	12	19.7	13
Belgium	17.6	20.2	12	13	21.2	15
Portugal	14.4	18.6	16	14	17.4	12
United Kingdom	15.0	18.5	15	15	17.6	14
United States	17.5	17.0	13	16	17.0	16
Average:						
Unweighted	21.2	24.3			23.6	
Weighted	20.1	20.2			18.6	

of goods and services as a ratio of GNP. The ratio is of course highest for small countries; and lowest for the largest country, the United States. In general the ratios show an appreciable increase over the decade, the average ratio for OECD countries increasing from 11 to 14 per cent of GNP. The increase has tended to be proportionately bigger for the small countries: among the larger countries, the United Kingdom showed little increase in the ratio over this period, and the United States a relatively small increase. The trade ratio for EEC countries increased from 19 to 25 per cent; that for EFTA countries from 25 to 28 per cent.

In some respects different countries appear to be becoming more similar. Not only has there been, as noted above, a general reduction of differences between countries in the level of national output per head, but expenditure patterns appear to be getting less diverse. Table VIII attempts to summarise the information on the points contained in Tables IV-VII. It shows the third highest and third lowest ratios of the aggregates considered, thus excluding extreme values, more likely to have been influenced by conjunctural or special factors. (Since, in general, the highest and lowest ratios are attained by different countries for the different aggregates, the ratios of sub-items in this table are not additive.)

TABLE VII.
Foreign trade[a] in per cent of GNP, of selected OECD countries 1956-66

Countries	At 1958 prices				At current prices	
	Ratio		Rank		Ratio	Rank
	1956-58	1964-66	1956-58	1964-66	1964-66	
Netherlands	47.4	62.9	1	1	48.3	1
Norway	42.4	54.4	2	2	42.4	2
Belgium	32.5	41.5	3	3	38.4	4
Denmark	31.7	40.5	4	4	31.0	6
Switzerland	29.7	37.9	5	5	32.2	5
Iceland	24.9	32.1	6	6	40.5	3
Austria	22.7	30.6	8/9	7	25.9	8
Sweden	24.8	29.8	7	8	24.9	9
Portugal	21.0	28.5	11	9	28.8	7
Germany	20.3	24.3	12	10	20.2	12
Canada	21.6	23.4	10	11/12	23.0	10
United Kingdom	22.7	23.4	8/9	11/12	21.4	11
Italy	12.4	22.8	14	13	17.0	13
France	14.1	16.9	13	14	14.7	14
Japan	11.4	15.1	15	15	11.0	15
United States	4.9	5.6	16	16	5.2	16
Average:						
Unweighted	24.0	30.6			26.6	
Weighted						
EEC	18.5	24.9			20.8	
EFTA	24.6	28.1			24.7	
TOTAL OECD	11.1	13.9			12.3	
of which:						
7 major countr.	9.4	11.6			10.4	
Other	25.4	33.7			29.2	

a) Exports plus imports of goods and services divided by two.

Taxes in relation to GNP

Table IX shows total taxes (direct and indirect, plus social security contributions) as a percentage of GNP. In the years 1964-66, total taxes, so defined, amounted on average to over one-fourth of GNP, taking all OECD countries together; the ratio was

TABLE VIII.
Extreme structural ratios, in per cent of GNP, of OECD countries 1956-1966[a]

	1956-58 Average	1964-66 Average
A. *Highest ratio* (excl. two top countries)		
Consumers' expenditure	67.7	65.1
Government current expenditure	16.5	14.9
Gross fixed investment	25.8	30.7
Foreign trade	32.5	41.5
B. *Lowest ratio* (excl. two last countries)		
Consumers' expenditure	59.0	58.3
Government current expenditure	10.6	11.0
Gross fixed investment	16.7	18.6
Foreign trade	12.4	16.9
C. *Spread* (A — B)		
Consumer' expenditure	8.7	6.8
Government current expenditure	5.9	3.9
Gross fixed investment	9.1	12.1
Foreign trade	20.1	24.6

a) In 1958 prices.

TABLE IX.
Total taxation in per cent of GNP, at current prices, of selected OECD countries 1956-1966

Countries	Ratio 1956-58	Ratio 1964-66	Rank 1956-58	Rank 1964-66
Sweden	29.6	38.8	6	1
France	33.5	38.2	1	2
Austria	30.7	35.1	5	3/4
Norway	31.3	35.1	4	3/4
Germany	32.6	34.7	3	5
Netherlands	29.5	34.0	7	6
United Kingdom	27.9	29.7	8	7/8
Denmark	24.5	29.7	11	7/8
Belgium	23.7	29.5	12/13	9/10
Italy	26.0	29.5	9	9/10
Iceland	32.8	29.1	2	11
United States	25.5	27.5	10	12
Canada	23.7	27.4	12/13	13
Switzerland	19.0	21.5	14	14
Japan	17.9	19.4	15	15
Average:				
Unweighted	27.2	30.6		
Weighted	26.6	28.7		

TABLE X.
Direct taxes in per cent of GNP, at current prices, of selected OECD countries 1956-1966

Countries	Ratio 1956-58	Ratio 1964-66	Rank 1956-58	Rank 1964-66
Sweden	17.2	19.2	1	1
United States	13.9	13.8	3	2
Denmark	11.7	13.5	5	3
Norway	14.0	13.1	2	4
Netherlands	12.6	12.8	4	5
Austria	10.9	12.2	7	6
United Kingdom	11.3	11.0	6	7
Germany	9.1	10.6	9	8
Canada	9.3	10.5	8	9
Switzerland	8.2	9.5	11	10
Belgium	7.4	8.6	12	11
Japan	7.0	8.2	13	12
France	5.7	6.5	14	13/14
Italy	5.3	6.5	15	13/14
Iceland	8.5	6.1	10	15
Average:				
Unweighted	10.1	10.8		
Weighted	11.8	11.8		

highest in Sweden and France (39/38 per cent), lowest in Switzerland and Japan (21/19 per cent). It increased in all the countries shown with the exception of Iceland. For OECD as a whole the ratio rose from 27 per cent of GNP in 1956-58 to 29 per cent in 1964-66.

Comparable figures for the separate categories of taxation were, for OECD countries taken together: no increase for direct taxation; 1 percentage point for indirect taxes (from 10 to 11 per cent of GNP); and 1½ percentage points for social security contributions (from 4½ to 6 per cent of GNP). In the Netherlands, the United Kingdom and the United States there was no increase in the direct tax ratio, and in Iceland and Norway it fell (Table X). In Germany and the Netherlands there was no increase in the ratio of indirect taxes to GNP, and in Iceland and Japan it fell (Table XI). In all the countries shown social security contributions increased in relation to GNP (Table XII), the increases being particularly marked in the case of the Netherlands (5 percentage points), Sweden and Norway (3½ percentage points), France (3 percentage points), and Belgium and Italy (2½ percentage points).

TABLE XI.
Indirect taxes in per cent of GNP, at current prices, in selected OECD countries 1956-1966

Countries	Ratio 1956-58	Ratio 1964-66	Rank 1956-58	Rank 1964
Iceland	21.9	20.6	1	1
France	16.7	17.7	2	2
Austria	13.7	15.3	5	3
Norway	14.1	15.0	4	4
Canada	12.5	14.5	8	5
Denmark	11.5	14,3	9	6
Germany	14.4	14.2	3	7
United Kingdom	13.3	14.1	6	8
Sweden	9.9	13.4	12	9
Italy	12.8	12.6	7	10
Belgium	10.5	12.4	10	11
Netherlands	10.1	10.1	11	12
United States	8.5	9.2	14	13
Japan	8.7	7.8	13	14
Switzerland	6.6	7.2	15	15
Average:				
Unweighted	12.3	13.2		
Weighted	10.4	11.1		

TABLE XII.
Social security contributions in per cent of GNP, at current prices, of selected OECD countries 1956-1966

Countries	Ratio 1956-58	Ratio 1964-66	Rank 1956-58	Rank 1964-66
France	11.1	14.1	1	1
Netherlands	6.9	11.1	4	2
Italy	7.9	10.4	3	3
Germany	9.1	9.9	2	4
Belgium	5.9	8.5	6	5
Austria	6.1	7.5	5	6
Norway	3.2	6.9	9/10	7
Sweden	2.5	6.1	11	8
Switzerland	4.2	4.7	7	9
United States	3.2	4.6	9/10	10/11
United Kingdom	3.3	4.6	8	10/11
Japan	2.4	3.5	12/13	12
Iceland	2.4	2.5	12/13	13
Canada	1.8	2.3	14	14
Denmark	1.4	1.9	15	15
Average:				
Unweighted	4.8	6.6		
Weighted	4.3	5.8		

New Foreign Bond Issues
$ million

Markets	1965	1966	1967	1967 I	1968 I
United States	1,317	1,321	..	..	..
of which:					
Sold in the US	1,206	1,210	1,597	352[a]	366[a]
Canada	23	19	19	19	14
Europe	1,337	1,464	2,336	1,120	2,106
National markets	231	347	370	75	398
Belgium	12	10	21	—	15
France	25	41	41	—	—
Germany	—	—	10	—	171
Italy	24	139	24	—	49
Luxembourg	1	—	—	—	—
Netherlands	29	—	—	—	22
Sweden	—	—	20	5	10
Switzerland	77	101	152	70	124
United Kingdom	63	56	102	—	7
Euro-issue market	1,106	1,117	1,966	1,045	1,707
of which:					
DM-issues	331	146	159	94	189

QUARTERLY DATA

Markets	1966 Q1	Q2	Q3	Q4	1967 Q1	Q2	Q3	Q4	1968 Q1	Q2
United States[b]	466	305	241	198	352	412	473	361	366	..
Canada	19	–	–	–	19	–	–	–	14	–
Europe	542	233	330	359	569	551	544	672	991	1,114
National markets	98	39	126	84	30	45	123	172	182	216
of which:										
Belgium	–	–	–	10	–	–	–	21	15	–
France	–	–	41	–	–	–	41	–	–	–
Germany	–	–	–	–	–	–	–	10	65	106
Italy	67	24	28	–	–	–	–	24	49	–
Netherlands	–	–	–	–	–	–	–	–	–	22
Sweden	–	–	–	–	–	5	–	15	–	10
Switzerland	31	15	23	32	30	40	43	39	46	78
United Kingdom	–	–	14	42	–	–	39	63	7	–
Euro-issue market	444	194	204	275	539	506	421	500	809	898
of which:										
DM issues	65	–	25	56	79	15	15	50	46	143

For sources and methods see " Technical Notes ".

a) First quarter only.
b) Foreign issues sold in the United States.
c) Including European institutions and European and US special finance companies.
d) Issues by foreign special finance companies (incorporated in Luxembourg) are allocated to the countries concerned or to European and US special finance companies respectively.
e) Special finance companies which cannot be allocated to a single country.
f) Excluding direct investment issues.

New Issues on the Euro-bond Market
$ million

Borrowers	1965	1966	1967	1967 I	1968 I
OECD area[c]	923	997	1,637	836	1,580
Nordic countries	233	101	198	92	65
Denmark	35	48	72	37	51
Iceland	—	—	18	—	—
Norway	116	19	78	40	14
Sweden	82	34	30	15	—
EEC countries[d]	181	168	405	290	72
Belgium	20	10	50	40	—
France	30	—	157	80	22
Germany	20	65	45	45	—
Italy	45	60	65	50	30
Luxembourg	—	—	10	10	—
Netherlands	66	33	78	65	20
United Kingdom	25	40	71	36	—
Japan	35	—	—	—	95
Other OECD countries	32	86	171	68	226
Austria	12	37	72	36	161
Ireland	—	20	—	—	—
Portugal	20	29	34	—	5
Spain	—	—	65	32	60
European institutions	71	101	120	75	25
European special finance cos.[e]	15	62	140	50	—
US special finance cos.[f]	331	439	532	225	1,097
Non-OECD countries	120	120	329	209	127
Argentine	—	—	25	—	—
Australia	50	25	50	25	—
Finland	11	—	39	24	10
Israel	—	—	15	—	—
Mexico	27	45	85	65	72
New Zealand	20	25	40	20	15
Peru	—	—	13	13	—
South Africa	12	25	62	62	30
International institutions	63	—	—	—	—
All borrowers	1,106	1,117	1,966	1,045	1,707

QUARTERLY DATA

Borrowers	1966 Q1	Q2	Q3	Q4	1967 Q1	Q2	Q3	Q4	1968 Q1	Q2
OECD area[c]	404	174	179	240	474	362	366	435	759	821
Nordic countries	41	31	14	15	52	40	43	63	36	29
EEC countries[d]	90	–	50	28	155	135	55	60	20	52
United Kingdom	–	–	15	25	36	–	20	15	–	–
Japan	–	–	–	–	–	–	–	–	35	60
Other OECD countries	20	–	30	36	36	32	53	50	121	105
European institutions	20	46	15	20	50	25	45	–	25	–
European special finance companies[e]	27	–	20	15	50	–	40	50	–	–
US special finance companies[f]	206	97	35	101	95	130	110	197	522	575
Non-OECD countries and international institutions	40	20	25	35	65	144	55	65	50	77
All borrowers	444	194	204	275	539	506	421	500	809	898

TECHNICAL NOTES

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

FORECASTING TECHNIQUES

Tables 1, 2, 4, 5, 8 to 11, 33 and 34, as well as 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 smaller industrialised countries forecasts are made only of the likely development of GDP and of foreign trade; and for the developing countries the forecasts are confined to foreign trade. 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.

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. In order to obtain this forecast, it is necessary to transpose the import figure in national accounting terms (goods and services at constant prices) into current trade statistics (customs basis, goods only, at current prices): this involves a good deal of approximation. The figures thus 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 Tables 9 and 10. 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.

The consistency check imposed by the foreign trade matrix 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 alsewhere.

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 National Account 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 page 112.

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 the "Gross Domestic Production" which has a more restrictive definition of the border of production. It excludes the services provided by the General Government, financial institutions and domestic servants. The figures shown in the *Economic Outlook* are adjusted to the definitions of the Standardized System, on the basis of data supplied by the French Authorities. In the five years to 1965 the volume changes in the two series were as follows (percentages):

GDP	1961	1962	1963	1964	1965
French definition	4.6	6.8	5.6	6.2	3.5
Standardized definition	4.5	6.5	5.2	5.9	3.4

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.

All these differences are, in principle, taken into account, but the adjustments used, particularly for the most recent period, are bound to be somewhat arbitrary. There are not, as yet, official French quarterly national accounts.

(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 (e.g. in 1967 the rate of increase of GNP is here shown at –0.3 per cent, against –0.1 per cent in German official publications.) This discrepancy results from the use of a 1954 price base in the official calculations, whereas the OECD figures are estimates expressed in terms of 1966 prices.

Official half-yearly accounts, going back to 1960, have been published by the Federal Statistical Office starting in December 1965; the seasonal adjustment used in *Economic Outlook* is made by the Department of Economics and Statistics.

(c) *Italy*

The definitions used are those of the *Standardized System.* The half-yearly aggregates shown for the past are based on quarterly figures at 1963 prices published for some categories of expenditure and output in *Relazione Generale Sulla Situazione Economica Del Paese.*

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

(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.*

(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 of 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.

(g) *Japan*

"Public expenditure" includes expenditure by some public enterprises and "Fixed investment in Machinery and Equipment" 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 on 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.

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 and the United States, 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 onto 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 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, 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 and Italy.

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, 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 Treasury bills, 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.* In the case of the United States, the balance on "official reserve transactions" —apart from the treatment of special transactions—differs from the balance on official settlements mainly by the exclusion of liquid liabilities to international lending institutions, which are treated as financing items in *Economic Outlook.*

UNITED STATES

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

	BALANCE ON NON-MONETARY TRANSACTIONS (OECD BASIS)	SOURCE [a]
Less:	Waiver of U.K. debt obligations	As announced by U.K. government
Plus:	Debt prepayments received	*SCB* Table 1, line 45, plus *SCB* Table 5, line C.2
	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*, Financial statistics, Table 8
Equals:	Balance on liquidity basis	*SCB* Table 3, line 1

a) SCB refers to the United States *Survey of Current Business* March, 1967.

(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:

i) 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 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 these inconsistencies cancel out at the current balance level.

ii) 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.

iii) 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:

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

b) 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

All tables, excepts Nos. 19, 23 and 24, are based on the financial accounts (flow of funds statistics) of the United States and Germany as published in the *Federal Reserve Bulletin* and the *Monthly Bulletin of the German Bundesbank*.

The notes on the individual countries contain a certain number of graphs illustrating monetary phenomena. The data chosen are intended to give an indication of developments in the field of interest rates, liquidity and institutional lending and security issues. To the extent that the institutional differences between countries and the very uneven quality and availability of data permits, an effort has been made to prepare the statistics in such a way as to facilitate international comparison.

The interest rates shown are mainly representative of yields to the lenders rather than cost to the borrower. They give an indication of the movement, of the level and of the time structure of interest rates in a given country, but the international comparability of absolute levels is difficult because of differences in fiscal treatment, statistical coverage, etc.

The sections on *liquidity* consist of graphs of commercial bank liquidity and of changes in the money supply. Commercial bank liquidity is shown as the ratio of certain assets to deposits. Fos some countries the ratio of borrowing from the central bank to deposits is also shown. Developments in the liquidity of the economy as a whole illustrated by a graph comparing changes in the money supply to those in the volume and value of GNP/GDP. Changes in the money supply are shown in the form of changes in a three-month moving average of a seasonally adjusted series, at annual rates.

The graphs of *borrowing and lending* are based, wherever possible, on flow of funds statistics. They show selective types of borrowing, such as bank lending, lending by non-bank financial intermediaries and security issues.

Canada

Money supply includes currency in circulation and Chartered Banks' demand deposits.

Source: Bank of Canada *Statistical Summary*.

France

Interest rates. From February 1965 the series on government and private bonds yields take into account the tax credit.

Money supply. Seasonal adjustment by Department of Economics and Statistics.

The series on *institutional lending* are seasonally adjusted by the Department of Economics and Statistics.

Sources: Conseil National de Crédit, *Annual and Quarterly Reports*.

Germany

Interest rates. German short-term interest rates show strong seasonal movements connected with end-year window dressing. The amplitude of these movements varies somewhat from year-to-year but, nevertheless, appears to be sufficiently regular to make seasonal adjustment worthwhile, and hence the three-months money rate in Frankfurt has been seasonally adjusted by the Department of Economics and Statistics.

Money supply. Seasonal adjustment by Department of Economics and Statistics.

Bank liquidity. Banks comprise deposit money banks (including savings banks), specialised credit institutions (including mortgage and communal banks) and postal cheque and savings bank offices.

Bank credit to the economy comprises all credits granted to the private and public sector by the banking system (excluding Bundesbank). Seasonal adjustment by Department of Economics and Statistics.

Source: Deutsche Bundesbank *Monthly Reports*.

Italy

Liquidity of commercial banks. The credit-to-deposit ratio and the excess reserves-to-deposit ratio is shown as defined in the Italian banking statistics (liquidita/depositi; imphieghi sull'interno/depositi).

Money supply. Seasonal adjustment by the Department of Economics and Statistics.

The series of *credits to the economy* are seasonally adjusted by the Department of Economics and Statistics.

Sources: Banca d'Italia, *Bollettino* and *Supplemento*.

Japan

Liquidity of commercial banks. The credit-to-deposit ratio is calculated on the basis of seasonally adjusted series for both credits and deposits.

Source: Bank of Japan, *Economic Statistics Monthly.*

United Kingdom

Bank liquidity. For purposes of international comparison figures are shown for the liquid assets held by *all* commercial banks (including merchant banks and branches of foreign banks) and covering boh domestic liquid assets (including British governement securities maturing in five years or less) *and* short-term foreign exchange assets (including credits). Figures are also shown for the domestic liquid assets held by the London clearing banks as defined in United Kingdom banking statistics.

Money supply includes currency in circulation and deposits with domestic banks. Seasonal adjustment by the Department of Economics and Statistics.

Source: Central Statistical Office, *Financial Statistics.*

United States

Liquidity of commercial banks. Free reserves are defined as holdings of central bank money in excess of required reserves minus liabilities to central bank. Monthly data are averages, of daily figures.

Source: Federal Reserve System, *Federal Reserve Bulletin.*

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 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,[2] 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.[3] 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 U.K. Ministry of Labour. There is usually a difference of about one-fifth between the two figures. The figures for Austria, France and Ireland relate to *registered job applicants.* These figures depend very much on the proportion of unemployed who usually register. In France this proportion is estimated to be slightly more than one-half of the total number of unemployed according to the census definitions. The figures for France exclude throughout repatriates from Algeria who inflated registered unemployment in 1962/63, but count for only a few thousand in the most recent period. In Belgium and Denmark 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 employment).

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.

Price indices (Tables 2 and 3)

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., France and Italy and on commodity groupings by *end-use* in Japan. Diffe-

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.

2. 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. In the Economic Outlook these are used in calculating OECD aggregates.

3. More detailed Labour force statistics, on an annual basis, can be found in *Manpower Statistics 1954-1964*, OECD, 1965.

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.

rences 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.

Wages (Tables 3 and country charts)

The wage indices are also net 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.

Index of industrial production (Chart A, 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. The new Italian index, introduced in January 1966, has not yet been seasonally adjusted by the Italian Statistical Office: the adjusted figures are therefore rough OECD estimates. [1]

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.

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

" New Foreign Bond Issues " and " New Issues on the Euro-bond Market "

These tables are designed to give comprehensive information on new foreign bond issues placed on both national security markets of the OECD area and the Euro-bond market. Foreign issues are considered to be floated on a national security market if they are handled by a national banking consortium and if they are denominated in the currency of the lending country. In some cases dollar-denominated foreign issues placed in Europe have also been allocated to a national market if it was known that the issue was underwritten by a national banking consortium and entirely placed in that market.

Euro-bonds are essentially defined as bond issues (with maturities of five years and more) handled by international banking consortia and simultaneously offered in more than one national market. Accordingly, IET-exempt foreign dollar issues underwritten by international banking consortia are also considered as Euro-bonds, even if they are partly placed in the United States. However, Euro-bonds also comprise certain other issues such as: (*a*) dollar-denominated private placements and certificates of deposits (with maturities of five years and more) issued outside the United States and placed in more than one national market; (*b*) foreign DM issues handled by German banking consortia but with yields lower than the yield level prevailing on the German domestic bond market; (*c*) tranches of domestic bond issues placed by an international banking consortium outside the country concerned.

Sources: Figures for foreign bond issues floated on national security markets in Europe and Canada and on the Euro-bond market are based on listings of single issues compiled by the Secretariat. Information on new issues is obtained from the financial press, commercial banks, the Fédération Bancaire de la Communauté Économique Européenne, published and unpublished records of central banks and issue prospectuses. Figures on foreign issues in the United States are taken from special articles (on international investments of the United States and the US balance of payments) regularly published by the US Department of Commerce in *Survey of Current Business*. The figures on new foreign issues offered in the United States as shown in this publication are, wherever possible, adjusted to exclude issues which are considered as Euro-issues.

OTHER SELECTED PUBLICATIONS OF THE DEPARTMENT OF ECONOMICS AND STATISTICS

BASIC STATISTICS

The Department publishes a series of annual year-books of statistical information in different fields. Those which have recently appeared are:

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