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BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM

Division of International Finance

REVIEW OF FOREIGN DEVELOPMENTS

January 21, 1966

Recent Economic Developmentx in the Netherlands:
September-December 1965

21 pages

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Summary

The Netherlands economy continued to expand in the final months of 1965.[1/] A year-end consumer buying wave (in anticipation of higher excise taxes to be imposed at the beginning of 1966) strengthened the demand situation. Exports and investment spending were also expanding. With continuing monetary restraint, conditions in financial markets became tighter as the year ended and interest rates on government and municipal securities advanced further.

Output has continued to rise but limitations of productive capacity and manpower held the growth of industrial production to an annual rate of about 6 per cent for the year--the rate at which output rose during the first half of 1965. Order backlogs rose from September through November. The authorities are trying to hold down wage increases during 1966 to 6 to 7 per cent.

Conditions in the labor market remained strained even after the early onset of cold weather in November reduced activity in weather-sensitive sectors of the economy. The authorities finally drew up an interim wage policy after employers and unions failed to reach an agreement among themselves. Under these arrangements,

1/ For a review of earlier developments see "Recent Economic Developments in the Netherlands, July-September 1965" dated November 16, 1965.

negotiations at the industry, branch or establishment level will be permitted and the government will no longer establish guidelines for permitted wage increases. However, contracts will be reviewed for minimum wage, vacation benefits and related matters by the Labor Foundation and then passed on to the Board of Mediators where the size of the wage increase will be studied. Where the Board finds that the wage increases are dangerously inflationary, the case can be passed to the Minister of Social Affairs who has final authority over the validity of the contract. If the Minister finds a contract inflationary, and if the negotiating parties do not satisfactorily amend the contract, the Minister has the authority to declare the contract null and void; in such a case, the terms of the old contract would continue in effect.

When the Minister of Social Affairs announced these transitional arrangements, he indicated that wage increases in excess of 6 to 7 per cent would be considered dangerously inflationary. It remains to be seen how strict the Government will be in holding down wage increases. Contracts already negotiated for 1966, although not yet formalized, are reported to involve wage increases of 9 to 10 per cent.

Criticism from Parliament and the public forced the government to withdraw certain of the excise taxes proposed in the original budget for 1966. In particular, the tax on shoe repairs was completely withdrawn and excise taxes on textiles and shoes were reduced by one half and postponed for twelve months. To make up part of the revenue lost from these amendments, the government cut back proposed expenditures by fl 70 million and raised proposed capital market borrowings for the year by fl 50 million. In addition, the tax on gasoline was raised from one to two Dutch cents per liter; the income tax on corporate profits exceeding fl 100,000 will also be raised by two percentage points instead of the originally planned one percentage point.

The external position of the Netherlands strengthened in the final months of the year, despite further growth in imports. Exports expanded even more strongly than imports in the October-November period: they covered an average of 85.1 per cent of imports compared with an average of 83.6 per cent for the third quarter. The balance of payments moved into surplus during the third quarter, as it entered the period of seasonal strength. For the first three quarters of the year, the Netherlands over-all balance of payments deficit was fl 484 million ($134 million) compared with the fl 519 million ($143 million) deficit for the same period in 1964.

Between October and December, security yields advanced further. Government bond yields rose from 5.22 per cent to 5.58 per cent. Nonetheless, two public sector loans issued around the beginning of December encountered placement difficulties, in part because of no interest on the part of foreign investors. This lack of response on the part of foreign investors may be the result of the general tightening of European capital markets over the past months, To reduce competition for available funds and thereby to ease upward pressures on interest rates, the authorities declared that all local authority bonds with maturities of more than one year were henceforth to be issued through the Bank for Dutch Municipalities. Previously, the Government had followed the policy of allowing the rise in interest rates to act as the controlling factor in the competition for capital funds. Despite this measure, the Bank for Dutch Municipalities announced in January (1966) an offering of a loan with a coupon rate of 6-1/4 per cent at a price of 98-1/2. This is the first public-sector issue to carry at coupon rate of more than 6 per cent, although industry has for months been offering 6-1/4 to 6-1/2 per cent for funds.

Because rising bond yields have proved attractive to small investors, they have begun to withdraw funds from savings accounts and to place them in the bond market. Such actions have begun to affect the liquidity position of the banks. To improve the competitive attraction of their deposit rates, therefore, many savings banks recently raised the rate of interest which they pay on savings accounts by as much as 1/2 per cent per year. Furthermore two large Dutch banks recently announced that they would now accept funds for deposit in accounts requiring 12 months notice at 5 per cent interest. This is the maximum rate of interest currently available on savings or time deposits in the Netherlands. With government borrowing needs heavier than had been originally anticipated and with increased industrial investment plans for 1966, a continuing demand for funds is expected to exert further upward pressure on interest rates in the coming months.

Continued growth of demand

Continued expansion of demand during the period under review was suggested by the steady growth in backlogs of new orders evident since August. According to a survey conducted by the Central Bureau of Statistics, order backlogs declined from late 1964 to August 1965 and then turned up both for investment and for consumer goods. (See Table 1.) The "all industries" index was four points higher in November than it had been in August.

Table 1. Netherlands: Order Backlog, 1963-November 1965
(orders in terms of months of production, end January 1964=100)

End of month	All Industries 1/			Consumer Goods Sector			Investment Goods & All Other		
	1963	1964	1965	1963	1964	1965	1963	1964	1965
January	100	100	97	96	100	95	101	100	98
March	99	101	95	95	102	95	100	101	95
June	100	99	97	98	103	98	100	99	97
July	103	99	96	96	99	95	105	99	97
August	100	98	96	95	97	94	101	98	96
September	95	99	98	95	97	95	95	100	99
October	100	100	99	98	102	97	101	99	100
November	101	99	100	103	97	98	101	99	100
December	103	99	n.a.	102	96	n.a.	103	99	n.a.

1/ Excluding the chemical industry.
n.a. Not available
Source: Centraal Bureau voor de Statistiek.

The demand for consumer goods was stimulated by substantial purchases in anticipation of the imposition of higher excise taxes on a broad range of goods at the beginning of 1966. This stimulus may have contributed to a further rise of new orders in December. Several other factors contributed to the gains in demand. The running down of inventories apparently stopped during the second half of 1965 and industry once again began to build up its stocks. Foreign demand also appears to be advancing somewhat more rapidly than it did during the summer months, perhaps as a result of the continuing revival of economic activity in France and Italy.

Supply continued to grow in response to the increase in demand. Industrial production expanded strongly in September and October to a level 6.6 per cent over the corresponding months of the previous year. (See Table 2.) Industrial production in the first ten months of 1965 was 6.5 per cent above that of the preceding year, exactly in line with the overall increase in production expected for 1965 as a whole. The chemical industry registered the greatest expansion in the first nine months, when production rose by 13 per cent. Output in the metallurgical industry and in the foodstuffs industry rose by 6 per cent. However, production in the textiles industry declined by 6 per cent; output in the clothing and footwear industries declined also.

Table 2. Netherlands: Industrial Production 1964-October 1965 [a/]
(index numbers 1960=100 and percentage change)

		Index	Percentage change from preceding year
1964	July	111	+ 2.8
	Aug.	113	+ 5.6
	Sept.	124	+ 7.8
	Oct.	135	+10.7
	Nov.	137	+ 8.7
	Dec.	134	+ 8.9
1965	Jan.	126	+ 7.7
	Feb.	129	+ 8.4
	Mar.	128	+ 4.1
1965	Apr.	131	+6.5
	May	134	+5.5
	June	134	+8.9
	July	118	+6.3
	Aug.	118	+4.4
	Sept.	133	+7.3
	Oct.	143	+5.9

a/ Adjusted for number of working days.
Source: Centraal Bureau voor de Statistiek.

Labor market remains strained

The labor market tightened further in September and October, when improved weather conditions allowed increased activity particularly in construction and agriculture. (See Table 3.) The unsatisfied demand for labor was greatest in the building and metallurgical industries. However, the early onset of cold weather in November cut back activity especially in building. Total demand for labor consequently eased somewhat and seasonally-adjusted unemployment reportedly rose slightly.

The tight labor situation and the resulting favorable bargaining position of labor led to an 11 per cent increase in wages in enterprise during 1965. This was substantially greater than the 5 per cent increase originally agreed upon by the Government and the Labor Board as the maximum permissible for the year. In addition to outright wage increases, employers and unions have recently agreed on the establishment of a special fund in each firm for the benefit of union workers. Under the terms of the agreement union members, upon retirement, will receive fl 50 for each year of service from the company fund. The money appropriated to each company's fund will also be used for such activities as training and advanced training courses, leisure activities and other such projects suggested by the union. This is a measure which unions have tried to get for some time as a means of establishing special benefits for their members which will not accrue to non-union workers in a firm.

At the end of December, the Government handed down a provisional wage law for 1966 after unions and employers were unable to reach an agreement on the matter. The law provides for an increase in the minimum weekly wage from the fl 110 in effect in 1965 to fl 120 a week in 1966, a rise of 9 per cent. This is somewhat less than the fl 125 a week which unions had been demanding but it is higher than the increase (based upon the rise in the cost of living) that employers were willing to offer. The Social and Economic Council is expected to present recommendations for a permanent minimum wage law in April 1966.

Transitional wage policy for 1966

Until now, the wage setting process in the Netherlands has been under the close supervision of the Government. Over the past few years, however, there has been growing dissatisfaction on the part of unions and employers alike with the extent of the Government's determination in the wage setting process. During the past year, general acceptance of the idea of a freer wage policy was won; however, unions and employers were unable to agree on the terms which they wished to have incorporated into a new wage policy.

Table 3. Netherlands: Labor Market 1963-October 1965
(in thousands, monthly averages, seasonally adjusted)

		Unemployment	Vacancies	Ratio of vacancies to unemployment
1963	I	38	115	3.0
	II	31	121	3.9
	III	29	123	4.2
	IV	28	126	4.5
1964	I	27	128	4.7
	II	27	130	4.8
	III	28	132	4.7
	IV	30	133	4.4
1965	I	32	132	4.1
	II	33	128	3.9
	III	32	127	4.0
	August	32	127	4.0
	September	32	128	4.0
	October	32	128	4.0

Source: OECD, Main Economic Indicators.

On November 26, agreement was reached on an interim wage policy outlining a contract negotiating procedure which is to remain in effect while employers, unions and the Government take additional time to work out a final plan for a wages policy. Minister of Social Affairs Veldkamp worked out the compromise plan after employers and unions failed to arrive at an agreement themselves. The main provisions of the agreement include:

1. Negotiations will be conducted on an industry, branch or individual firm basis; in this way, the central employer and union organizations will be bypassed.

2. A nationally applicable guideline for permissible wage increases will no longer be set by the Government. Instead of reviewing contracts against such a norm as heretofore, the Labor Foundation will now simply examine the contracts for minimum wage, vacation benefits and related matters and then pass them on to the Board of Mediators where the size of the wage increase will be reviewed.

3. If the Board of Mediators finds the wage increase "dangerously inflationary", it can return the contract to the negotiating parties for reconsideration. The Board has no legal authority to determine the acceptability of the contract. However, if the Board maintains its objections to the contract even after discussions with the contracting parties, it can ask the Minister of Social Affairs to review the contract.

4. The Minister is the ultimate determining authority in cases of contested wage contracts. If the Minister returns a contract for reconsideration, labor and management have two weeks (which may be extended) to revise the contract. If the negotiating parties refuse or if the revised contract still fails to fall within acceptable limits, the Minister has the power to make the final decision whether or not the contract will be allowed to stand.

5. The terms of the old contract will remain in effect in instances in which the new contract is found unacceptable.

This new policy provides a framework within which to carry out wage negotiations until a permanent wage policy is worked out; but questions have arisen about the way the procedures will work. For example, it has been agreed that the Government would no longer issue wage increase guidelines; but when he announced the transitional policy, Minister Veldkamp stated that wage increases of more than 6 or 7 per cent would be considered "dangerously inflationary." This 7 per cent includes the 1-1/4 per cent wage increase which is to granted as compensation for the scheduled increase in controlled rents. This suggested maximum does not have the legal force which the wage guidelines had in the past. Since it has been agreed that a permissible percentage increase will not be indiscriminately applied to all new wage contracts, it is possible that the Government will use this measure with considerable flexibility. Inasmuch as no contracts for 1966 have as yet been written up or registered, it is not clear how strictly the 7 per cent norm will be applied. However contracts currently under negotiation reportedly involve total increases of 9 to 10 per cent.

<u>Prices continue to trend upward</u>

Prices appear to have stabilized in the last few months. By October, wholesale and retail price indices had hardly advanced beyond average second quarter levels. (See Table 4.) However, prices continue under some upward pressure; prices of manufactures apparently inched up again towards the end of the year and the export price index jumped 3 points in the third quarter. The tendency of consumer prices to rise again may reflect rises in food prices as a result of poor fall and summer harvests. The higher excise taxes on a variety of consumer goods and the scheduled increase in controlled rents, both of which became effective on January 1, 1966, should push the consumer price index up again in January.

<u>Budget for 1966 revised</u>

The rise in excise taxes was introduced as a financing item in the Government's budget proposals for 1966 which were presented to the Parliament in September. Despite sever criticism of some of the excise taxes, especially of those on textiles, shoes and shoe repairs, most of the proposed increases went into effect at the beginning of this year. As a result of the criticisms, however, the Minister of Finance modified his budget proposals somewhat. The proposed taxes on shoes and textiles were halved to 2-1/2 per cent and 1-1/2 per cent respectively and postponed until 1967. The tax on shoe repairs was abandoned and a turnover tax was introduced on imported textiles. In order to make up part of the revenue loss in 1966, the excise tax on gasoline was doubled and corporate income tax on profits exceeding fl 100,000 was raised 2 percentage points instead of 1 percentage point as originally planned. In addition, the amount to be borrowed on the capital market was raised by fl 50 million, bringing total proposed capital market borrowing to fl 250 million. However, as originally planned, the largest part of the budget deficit, fl 900 million, will be borrowed from pension and insurance funds so as not to add to the strain on the capital market. Finally, proposed expenditures were cut back by fl 70 million to fl 17.08 billion. (See Table 5.) The budget was approved in this form by both Chambers of the Parliament and took effect January 1.

Financial markets tighten further

Dutch financial markets tightened again between October and December, after easing temporarily in August and September. Rates for day-to-day money moved from an average of 3.35 per cent in October to 4.03 per cent in November and to 4.25 per cent in the last two weeks of December. Rates on three-month Treasury bills also moved from an average of 4.07 per cent in October to 4.30 per cent in December.

Table 4. Netherlands: Selected Price and Wage Indicators, 1964-November, 1965
(Index numbers, 1958=100, monthly averages and month)

		Hourly wages rates	Wholesale Prices Total	Wholesale Prices Manufactures	Cost of living	Export prices	Import prices
1964	I	157	106	107	113	100	98
	II	163	107	109	116	101	98
	III	165	107	109	116	102	98
	IV	166	109	110	116	104	98
1965	I	173	109	111	117	102	99
	II	174	112	112	122	103	99
	III	174	110	112	122	106	99
	July	174	110	112	122	106	100
	Aug.	174	110	112	121	106	99
	Sept.	175	111	112	123	105	99
	Oct.	n.a.	111	112	121	n.a.	n.a.
	Nov.	n.a.	n.a.	n.a.	122	n.a.	n.a.

n.a. Not available.
Source: Centraal Bureau voor de Statistiek, OECD, Main Economic Indicators.

Table 5. Netherlands: Budgets for 1965 and 1966
(millions of guilders)

	1965 As proposed	1965 Estimated results	1966 Original proposal	1966 Revised version
Expenditures	15,006	16,439	18,150	18,080
Revenue	14,090	14,951	17,065	16,945
Deficit	916	1,488	1,085	1,135

During this period, the commercial banks' extensions of new credits each month exceeded the permissible ceiling by increasingly larger amounts. As a result, penalty deposits of commercial banks with the Netherlands Bank rose steadily from fl 70 million in October to fl 107 million in December, and to fl 122 million in January 1966.

The shortage of funds which has been apparent since about the middle of the year is due to the sharp increase in 1965 in both public and private financing demands. Last year Dutch capital market issues totalled fl 2,145 million (fl 2,015 million of bonds and fl 129 million of shares) compared to fl 1,545 million in 1964.

With growing demands for funds, interest rates were under continuous upward pressure. In November, a fl 100 million 6 per cent loan of the Bank for Dutch Municipalities (issued at par) was only 80 per cent subscribed even though the yield was relatively high by previous Dutch standards. Savings banks in particular showed little interest in the loan and foreign interest was notably absent. By contrast, earlier 5-3/4 per cent loans of the Bank for Dutch Municipalities had attracted considerable foreign interest up to the middle of 1965. Rises in interest rates in other European capital markets since mid-year seem to have reduced the relative attractiveness of Dutch issues for foreign investors. In December, a 6 per cent loan of the City of Breda was not placed even though the issue price had been reduced from 99 to 98.5.

Table 6. Netherlands: Selected Interest Rates, January 1964-December 1965
(per cent per annum)

	Call money rate 1/	3-month Treasury Bill rate	Perpetual Government bond yield	Industrial bond yield
Monthly Average				
1965 January	2.43	3.29	4.98	n.a.
April	3.39	3.54	5.02	n.a.
July	3.53	4.13	5.28	n.a.
August	2.68	4.07	5.24	5.73
September	2.66	4.00	5.19	5.67
October	3.35	4.07	5.27	5.94
Week ending				
October 8	4.25	4.06	5.22	5.83
15	3.00	4.06	5.27	5.94
22	2.00	4.06	5.30	5.98
29	4.25	4.13	5.38	6.12
November 5	4.25	4.13	5.44	6.08
12	4.25	4.13	5.44	6.05
19	3.50	4.19	5.46	6.00
26	4.13	4.22	5.50	6.13
December 3	3.50	4.25	5.54	6.13
10	3.00	4.31	5.59	6.01
17	3.00	4.31	5.63	6.03
24	4.25	4.31	5.61	6.03
30	4.25	4.31	5.58	5.89

1/ Unofficial rate.
n.a. Not available.
Source: Netherlands Bank.

Following the failure of this loan, the Government reversed a decision of two years ago and once again made it compulsory for local authorities to take up all loans of over one year through the Bank for Dutch Municipalities. It was hoped thereby to ease the competition among borrowers for funds on the capital market and thus to lessen the pressure on interest rates. Prior to the change in policy, the Netherlands Bank had been depending on the level of interest rates to ration the demand for funds on the capital market.

In January 1966, the Bank for Dutch Municipalities announced a new loan of fl 100-150 million with an interest rate of 6-1/4 per cent and an issue price of 98-1/2. This is the first public issue to carry a coupon of over 6 per cent although private institutions have been paying 6-1/4 - 6-1/2 per cent for privately placed loans for some time.

The attractiveness of higher yields on the bond market has begun to encourage small investors to shift funds from savings accounts. This development began to reduce the liquidity position of the savings banks; it is reported to be one reason for the small purchases of recent bond issues by saving institutions. To prevent a continued switching of funds from savings accounts into bonds, a number of Dutch banks raised interest rates on savings and time deposits by as much as 0.5 percentage points; two large Dutch banks have also announced that they will now accept funds for deposit in accounts requiring 12 months notice at 5 per cent interest.

Since Government borrowing in 1966 will be heavier than originally planned and since industrial investment plans are also substantially larger than they were in 1965, a continuing demand for funds is expected to exert further upward pressure on interest rates in the coming months.

Exports resume expansion

In October-November, exports resumed their growth, once again expanding more rapidly than imports just as they had on average earlier in 1965. The growth of Dutch exports has undoubtedly been simulated by continuing high demand pressures in Germany and the recovery of economic activity in Italy and France. On the whole, exports in October-November were 2.6 per cent higher than the third quarter average. (See Table 7.) Imports rose only slightly over the same period. As a consequence, exports were equivalent to 85.1 per cent of imports in October-November compared to 83.6 per cent in the third quarter. Both the year-end spurt in consummer buying and the rebuilding of industrial inventories may contribute to further gains in imports after November.

Table 7. Netherlands: Merchandise Trade, 1963-November, 1965
(millions of U.S. dollars, monthly averages, seasonally adjusted)

		Exports f.o.b.	Imports c.i.f.	Balance	Exports as % of imports
Year	1963	414	497	- 83	83.3
	1964	484	588	-104	82.3
1964	III	486	586	-100	82.9
	IV	506	595	- 89	85.0
1965	I	513	577	- 64	88.9
	II	530	599	- 69	88.5
	III	529	633	-103	83.6
	July	551	648	- 97	85.0
	August	500	585	- 85	85.4
	September	537	665	-128	80.8
	October	552	668	-117	82.5
	November	534	607	- 73	88.0

Source: OECD, Main Economic Indicators.

Balance of payments moves back in surplus

After two quarters of deficit amounting to fl 491 million, the balance of payments showed an overall surplus of fl 7 million in the third quarter. The Netherlands' period of seasonal strength in the balance of payments is usually in the second half of the year.

Thanks to the small surplus in the third quarter and the unusually favorable balance of payments results in the first quarter of 1965, the external payments deficit for the first nine months of 1965 amounted to fl 484 million compared to fl 519 million a year earlier. These data are on a cash rather than on a transaction basis.

Table 8. Netherlands: Changes in Official Reserves 1963-1965
(In millions of U.S. dollars, end of period figures)

		Gold	Foreign exchange	Total	IMF	Total
Annual change:						
1963		20	136	156	--	156
1964		87	98	185	62	247
1965		68	-62	6	94	76
Quarterly change:						
1964	I	--	-66	-66	20	-46
	II	--	-47	-47	--	-47
	III	--	174	174	25	199
	IV	87	37	124	17	141
1965	I	35	-50	-15	4	-11
	II	33	-92	-59	60	1
	III	--	64	64	30	94
	IV	--	-8	-8	--	-8
Monthly change:						
September		--	12	12	--	12
October		--	23	23	--	23
November		--	32	32	--	32
December		--	-63	-63	--	-63

Source: International Financial Statistics; Netherlands Bank.

The improved payments position contributed to the $67 million rise in Dutch official reserves between September and November. (See Table 8.) During December, however, reserves fell by $63 million and the guilder weakened on foreign exchange markets. The Netherlands Bank used its resources to ease the decline of the rate. By mid-January, the spot guilder was quoted at 27.67 U.S. cents compared with the end-November rate of 27.75 cents. (See Table 9.)

Table 9. Netherlands: Exchange Rate in U.S. Cents per Guilder, January 1965-January 1966 1/

Par value	27.624
Lower limit	27.42
Upper limit	27.84

Monthly average		End of Week		
1965				
January	27.831	October	1	27.798
April	27.780		8	27.779
July	27.761		15	27.770
September	27.791		22	27.757
October	27.772		29	27.750
November	27.756	November	5	27.757
December	27.724		12	27.758
			19	27.751
			26	27.753
		December	3	27.743
			10	27.734
			17	27.726
			24	27.718
			31	27.695
		1966		
		January	7	27.702
			14	27.669

1/ Noon buying rates in New York.
Source: Federal Reserve.