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BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM

Division of International Finance

REVIEW OF FOREIGN DEVELOPMENTS

November 27, 1962

Recent Economic Developments in France:
January to October 1962

13 pages

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Recent Economic Developments in the
Netherlands: July to October 1962

4 pages

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Recent Economic Developments in France: January to October 1962

Summary

During the period under review, the French balance-of-payments surplus may have topped out and, with the trade surplus now declining, may have begun to diminish somewhat. Nonetheless, the over-all surplus remains extremely large--almost \$700 million in the first half of 1962--and official reserves are at the high level of over \$3.6 billion. Internally, there is no sign of a slowing of economic activity, and official estimates are for an even more rapid pace of business expansion during 1963. The settlement in Algeria and recent political developments in France favorable to President de Gaulle should help to reduce materially in 1963 the political uncertainty which has continued to be an adverse factor in the French business situation in recent years.

France's main problems are in the price and wage field. Retail prices have risen 5.3 per cent in the past 15 months, and officials expect prices will be higher in 1963. The rise in wages has accelerated this year, and amounted to 8.4 per cent in the year ended last July. However, the export unit value index has changed little since late 1960. The wage trend, and competition from imports, has reduced profit margins and thus the generation of internal funds for reinvestment. However, releases from the armed forces, demographic changes, and repatriates from Algeria should materially augment labor supplies during 1963. Monetary expansion has continued to be rapid.

Payments surplus may have recently topped out

France's balance-of-payments surplus may have reached a peak. The surplus on non-trade transactions was slightly lower in the first half

of 1962 than in the same period last year. On trade account, export shipments which earn foreign currencies (that is, sales outside the overseas franc area) this year have shown progressively smaller increases over the same period last year: 14 per cent in the first quarter, 10 per cent in the second quarter, and only 5.6 per cent in the third. (See Table 1.) Nearly 80 per cent of all non-franc area exports are sold to the OECD countries. On a seasonally-adjusted basis, French exports to the OECD countries declined 1.5 per cent between the first and second quarters of this year, and in July-August still averaged slightly less than in the first quarter. (See Table 2.)

TABLE 1. France: Trade with Foreign Countries, Unadjusted

(in millions of dollars; monthly average or month)

	<u>Exports</u>	<u>Imports c.i.f.</u>	<u>Balance</u>
1960 - Year	401	405	- 4
Qtr. I	426	425	+ 1
II	450	450	--
III	426	391	+ 35
1962 - Qtr. I	487	471	+ 16
II	496	479	+ 17
III	450	458	- 8

TABLE 2: France: Trade with OECD Countries, Seasonally-Adjusted

(in millions of dollars; monthly average or month)

	<u>Exports</u>	<u>Imports c.i.f.</u>	<u>Balance</u>
1960 - Year	304	278	+ 26
1961 - Qtr. I	332	291	+ 41
II	353	318	+ 35
III	354	312	+ 42
IV	356	335	+ 21
1962 - Qtr. I	387	354	+ 33
II	381	337	+ 44
July-Aug.	385	362	+ 23

Imports from foreign countries, on the other hand, have been rising rapidly, and in the first nine months of this year were 11 per cent above the same period a year previous. (See Table 1.) As shown by the seasonally-adjusted data in Table 2, imports from the OECD area have risen markedly since the third quarter of last year, averaging 16 per cent above the third quarter of 1961 in July-August 1962. As a result, trade with foreign countries (imports valued c.i.f.) showed a monthly average deficit of \$8 million in the third quarter of 1962 compared with a monthly average surplus of \$135 million in the third quarter of 1961, for a net deterioration of \$43 million.

Trade statistics appear to indicate that the failure of exports to expand since the first quarter is due to internal factors rather than to a stagnation of import demand in France's main export markets. Rapid rises in French wage rates and retail prices this year suggest that to some extent French exports have been diverted from export to domestic markets. The upsurge of imports, which reflects increases in almost all categories of goods, has been conditioned by both price factors and a vigorous expansion of income and output. The stability of non-food wholesale prices has been partly attributed to competition from imports.

Official expectations are for further price increases in France and for a somewhat larger rise in real GNP in 1963 than in 1962. In conjunction with France's 1962 trade trends, these expectations make some deterioration in France's trade balance appear likely.

But over-all surplus is still very large

However, there is still a very large surplus in the French balance of payments, and official reserves of gold and convertible currencies at the end of October were at the high level of \$3,616 million. The balance

of payments surplus was \$1,234 million in 1961. (See Table 3.) The first half of 1962 showed a surplus of \$698 million compared with \$659 million in the first half of 1961. Official reserves (adjusted for debt prepayments and IMF transactions) rose \$488 million in the four months July-October 1962 compared with a balance-of-payments surplus of \$575 million in the six months July-December 1961. The trade surplus on an f.o.b. basis has accounted for a good deal less than half of the total surplus. Taking together all items other than trade payments, there were surpluses of \$493 million in the first half of 1961, \$345 million in the second half of 1961, and \$473 million in the first half of 1962.

TABLE 3. Balance of Payments of French Franc Area
(In millions of dollars)

	<u>Year</u> <u>1961</u>	<u>First Half</u>	
		<u>1961</u>	<u>1962</u>
Trade f.o.b. (payments basis)	396	166	225
Current invisibles	532	299	258
Private capital movements <u>a/</u>	242	130	139
Official long-term capital movements <u>b/</u>	-119	-14	-51
Net balance of overseas franc area with foreign countries	72	51	57
Net errors and omissions	<u>111</u>	<u>27</u>	<u>70</u>
Total of above	1,234	659	698
Advance debt repayments	-320	-40	-120
Increases in official reserves, IMF position, and net foreign assets of commercial banks	914	619	578

a/ Excluding short-term assets and liabilities of commercial banks.

b/ Excluding advance debt repayments.

During this period the French franc has almost without interruption remained at the upper level of its exchange-rate margin against the dollar.

Internal expansion still vigorous

There are no signs that economic activity in France is slackening. Following a very rapid increase in the last quarter of 1961, seasonally-adjusted industrial production was unchanged between December and March. Subsequently, however, output rose 1.6 per cent from March to June and 2.0 per cent from June to September, at which time it was 8.7 per cent above a year previous. Recent quarter-to-quarter percentage changes in seasonally-adjusted industrial production have been:

	<u>1961</u>	<u>1962</u>
Qtr. I	-0.6	+1.0
II	+1.1	+1.6
III	+1.1	+1.5
IV	+3.8	

The expansion this year has occurred without the benefit of a rising trend of exports. Seasonally-adjusted exports rose 3 per cent in the first quarter; but they fell 3 per cent in the second, and rose only 0.7 per cent in the third. Exports to Algeria and other parts of the overseas franc area have fallen, and exports to the OECD area have changed little since the first quarter. According to a recent OECD report, private consumption is currently the main driving force in the economy, partly in reflection of the transfer this year from Algeria to France of 600,000 persons and \$400 million of liquid funds. For this year, France's National Accounts Commission recently forecast gross domestic product (in real terms) at 5.6 per cent above 1961; consumption and gross investment were both estimated at 5.8 per cent above last year.

French officials expect the economy to show somewhat greater, rather than less, expansion in 1963. Projections for 1963 prepared recently by the National Accounts Commission show increases over 1962 (in real terms) of 6.1 per cent in gross domestic product; 6 per cent in private consumption; 6.8 per cent in government consumption; and 6.3 per cent in exports. The exports projection apparently implies an end to the decline in sales to the franc area and further expansion of sales to foreign countries, despite the recent slowing of the latter. Whether this source of strength--which hinges on developments outside as well as inside France--will materialize is open to question. But the 1963 budget should certainly raise the level of public expenditures in the economy. The proposed 1963 budget outlays drawn up in September are 9-1/2 per cent above the level shown in the Budget Law for the calendar year 1962. Compared with the amended 1962 budget, the 1963 outlays are up only 6.3 per cent, but in 1963 there will probably again be supplementary appropriations. Because 1963 revenues are expected to be up 10-1/2 per cent over the initial 1962 estimates, the Finance Ministry says the deficit should not exceed the level of 7 billion francs (\$1.4 billion) which it maintains can be raised by noninflationary borrowing. The revenue estimate is predicated on a 6.1 per cent increase in real gross domestic product over 1962 and a 2 per cent rise in the GNP deflator.

Upward price and wage trends cause concern

As the OECD pointed out in its mid-1962 annual review of the French economy, price and wage movements are the main source of concern at the present time. Official sources expect that the uptrend of prices

will continue in 1963, as evidenced by the anticipated 2 per cent rise in the GNP deflator. The government's prognostications have in fact underestimated eventual price increases in the past two years. The GNP deflator was officially expected to rise 1.4 per cent in 1961, but the rise turned out to be 3.1 per cent. For 1962, the increase was again estimated at 1.4 per cent. But over the first nine months of this year, monthly price indexes have been above the corresponding month of last year by an average of 5.4 per cent for retail prices and 2.1 per cent for wholesale prices.

Retail prices have shown a nearly unbroken advance for 15 months, and in September the general consumer price index was 5.3 per cent above a year earlier (see Table 4). Although food prices led the advance, the indexes for all other main categories also rose between 2 and 4 per cent in this period. The wholesale price index increased only 1.6 per cent in the year ending September 1962. Prices of industrial raw materials and semi-manufactures have been steady because of increasing international competition. The rise in food prices in late 1961 reflected mainly higher agricultural price supports and reductions in some crop yields. However, the export unit value index was changed little since late 1960.

TABLE 4. France: Price and Wage Indexes for Specified Periods

(1958 = 100)

	1960	1961				1962		
	III	I	II	III	IV	I	II	III
<u>Wholesale prices^{a/}</u>								
General index	107.1	108.9	107.2	110.1	113.2	112.8	112.0	111.9
Foodstuffs	101.7	102.0	98.2	104.2	111.0	110.9	110.2	108.5
Ind. raw materials and semi-manufactures	110.9	113.9	114.3	115.0	115.0	114.7	114.6	115.5
<u>Consumer prices^{a/d/}</u>								
General index	111.1	111.9	111.4	113.5	116.3	117.5	118.7	119.4
Food	107.2	108.6	107.5	110.8	115.0	116.6	118.9	119.3
All other excluding beverages	116.6	116.9	116.8	118.0	119.7	120.8	121.1	n.a.
<u>Export unit value^{b/}</u>	112	112	113	112	114	113	113	n.a.
<u>Hourly wages^{c/}</u>	115.3	117.5	119.6	122.2	124.1	126.9	129.3	132.5

a/ Last month of quarter indicated.

b/ Quarterly average.

c/ Beginning of quarter indicated.

d/ 250-Articles index for Paris region.

Strong upward pressure on prices and downward pressure on profits have resulted from rapidly rising labor earnings. The tightness of the labor market has contributed strongly to the wage rise. Average hourly wages rose 8 per cent in 1961; including fringe benefits, hourly earnings were up about 9 per cent. This year, the upward push of wages has accelerated; the wage index rose 4.4 per cent between January and July of this year, to a level 8.4 per cent above July 1961. Labor earnings have been rising considerably faster than productivity, and have been cutting into profit margins. The recent report of the National Accounts Commission states that operating profits,

at current prices, rose only 2.8 per cent in 1961 compared with 11 per cent in 1960. The French four-year "plan" for 1962-65 envisages an increase in share of investment in GNP, the realization of which will depend on the generation of internal funds. Because of concern over wage trends, the Government initiated last month the first of a series of three-sided conferences with business and labor to aid in the formulation of a more satisfactory "wage policy."

In a recent newspaper article (La Vie Francaise, November 1, 1962), a French columnist, Adrien Duffau, summarized the principal factors which are likely to affect French prices in the coming year:

1. Factors making for stability:

a. Agricultural prices should now rise at the more modest annual rate of 1-2 per cent, as compared with the big increase in 1961; and

b. Neither industrial prices nor freight rates should show an appreciable rise, owing to the influence of vigorous international competition.

2. Factors tending to reduce prices:

a. World raw materials prices have been declining;

b. The labor force will be increased by the reduction in military personnel made possible by the Algerian solution, by the postwar "baby boom," 1/ and by repatriates from Algeria; and

c. The contemplated Common Market energy policy should

1/ Live births per year ranged from 520,000 to 643,000 in 1941-45, jumped to 840,000 in 1946, and ranged between 858,000 and 869,000 in 1947-50.

bring lower prices of coal and petroleum products.

3. Factors tending to raise prices:

a. The rapidly-rising wage trend, which in particular affects the prices of services;

b. The profit squeeze, which makes self-financing of investments increasingly difficult, and puts pressure on the Planning Commission to allow price increases in the interests of the fulfillment of the Plan; and

c. Wage increases granted in the public sector exert pressure for compensating price increases in the nationalized industries in order to avert mounting deficits and lagging investments. One solution being considered is to raise prices of nationalized goods and services to consumers without raising prices to industrial users.

Monetary expansion continues at rapid rate

The balance-of-payments surplus and an expansion of bank credit to private borrowers have produced further large additions to the money supply during 1962. Monetary ease has probably helped to dull employers' resistance to wage demands and facilitated price increases.

The French inflation of 1956-58 appreciably reduced the liquidity of the economy as measured by the ratio of money supply to GNP. There were very large additions to money supply in 1959-61, and the economy regained the 1956 level of liquidity in the latter part of 1961, a development which coincided with a sharp upsurge of prices in the second half of last year. Because of their concern over this upsurge, the French monetary authorities advised the banks in November 1961 to exercise caution in extending credit.

Subsequently, effective February 28, 1962, the Bank of France increased from 30 to 32 per cent the banks' required minimum liquidity ratio, i.e., the percentage of deposit liabilities that must be held in cash, deposits with the Bank of France and the Treasury, Treasury bills, medium-term credits, and export paper.

In the first eight months of 1962, money supply increased 9 per cent, or by a little more than the 8 per cent rise in the same period last year. The raising of the compulsory liquidity ratio has had only a slight braking effect on bank credit to the private sector, which rose 6 per cent in January-August 1962 as against 7.5 per cent in January-August 1961. Because of the balance-of-payments surplus, the banking system has been able to expand its loans without any increase in its recourse to credit from the Bank of France.

The French authorities considered monetary expansion to have been somewhat excessive in 1961. No further credit-tightening measures have been taken since last February, although expansion this year has been slightly faster.

If the budget deficit is held to no more than 7 billion francs in 1963, it should not be a source of inflationary pressure. In 1959-61, realized cash deficits were substantially less than the deficits estimated in the Budget Law because of systematic underestimation of revenues, and in 1961 the actual deficit was only 4.38 billion francs. In covering this deficit, together with 3.09 billion francs of debt amortization, the Treasury raised 10.05 billion francs by noninflationary borrowing, mainly sales of medium-term Treasury "bills" to individuals and non-bank institutions (5.04 billion francs) and increases in deposits with the Treasury owned by

state and para-statal institutions and agencies (3.86 billion francs). These receipts allowed the Treasury to reduce its indebtedness to the banking system, and build up its cash balances, by 2.58 billion francs, so that budget operations in 1961 were in fact slightly deflationary. The 1961 experience indicates that a cash deficit of 7 billion francs in 1963 could well be covered without resort to bank credit.

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November 27, 1962.

Recent economic developments in the Netherlands: July to October 1962

Summary and conclusions

The domestic economic situation in the Netherlands remains generally favorable. Mid-September forecasts issued by the Central Planning Bureau envisage increases of 4 per cent in industrial output both in 1962 and in the coming year, and a somewhat easier domestic labor market and a small improvement in the country's balance of payments in 1963. The Netherlands Bank has slightly relaxed its generally restrictive monetary policies.

Recent foreign trade and exchange developments

Following the 5 per cent revaluation of the currency in March 1961, the foreign trade of the Netherlands continued to develop favorably during the first half of 1962. Because exports have not risen as fast as imports, however, the trade deficit was somewhat higher in 1962 than in 1960 and 1961:

Table 1. Netherlands: Exports and Imports, seasonally adjusted
(in millions of U. S. dollars, monthly or monthly average)

		<u>Exports</u>	<u>Imports</u>	<u>Trade Balance</u>
1960:	I	326	363	- 37
	II	337	371	- 34
	III	336	380	- 44
	IV	339	391	- 52
1961:	I	365	430	- 65
	II	352	419	- 67
	III	360	420	- 54
	IV	357	440	- 83
1962:	I	375	453	- 78
	II	390	441	- 51
	July	377	456	- 79

Source: O.E.C.D.

The favorable trade position in part reflects the stabilization of export prices because of the willingness of Dutch exporters to accept lower profit margins on sales abroad. In addition, import prices have continued their gradual decline (see Table 2). As a result of these price movements, the terms of trade moved in favor of the Netherlands from an index of 100 in the first half of 1960 to 104 in the same period in 1962.

Table 2. Netherlands: Export and import price indexes (1953=100)

		<u>Price indexes</u>		<u>Terms of trade</u>
		<u>Imports</u>	<u>Exports</u>	<u>Export prices/ Import prices</u>
1960:	I (Jan. to June)	99	99	100
	II	99	100	101
1961:	I	98	100	102
	II	97	98	101
1962:	I	96	100	104

The Netherlands had a continuing payments surplus during 1961 although the current-account surplus (comprising a deficit on trade and a surplus on invisibles account) declined from Fl. 1.3 billion in 1960 to Fl. 0.7 billion in 1961. The capital account deficit declined from Fl. 1.1 billion in 1960 to only Fl. 0.3 billion in 1961 (including government debt prepayments). Projections for 1962 called for a trade deficit of Fl. 3.0 billion as an upper limit. The current-account surplus, presently estimated at Fl. 0.3 to 0.4 billion, is below the Fl. 0.5 billion surplus regarded by the authorities as desirable. In view of the large reserve build-up in 1959 and 1960, however, a somewhat lower current-account surplus for 1962 can hardly be considered an unsatisfactory development.

Favorable foreign trade and balance of payments trends have helped keep the Dutch guilder near the top of its range against the U. S. dollar

for many months. Between mid-August and mid-November, the rate for the guilder eased slightly below its official selling limit; both a moderate easing of credit availabilities in the domestic money market and a rise in Euro-dollar market interest rates encouraged some "covered" outflow by private banks. But since early November, a temporary tightening of the domestic money market has led to some reflow of funds to the Netherlands, and the guilder rate has strengthened. (See Table 3.)

Table 3. Spot Dutch Guilder rate against the U. S. dollar
(In U. S. cents per guilder)

Official limits:		Buying	27.42		
		Selling	27.84		
July	13	27.83	Sept.	7	27.75
	27	27.80		14	27.75
				28	27.80
Aug.	3	27.78	Oct.	15	27.75
	17	27.74		22	27.72
	31	27.74		31	27.70
			Nov.	2	27.70
				13	27.74
				20	27.76

Dutch reserves, adjusted for special transactions (including debt prepayments and changes in Fund holdings of guilders) apparently dropped only slightly in October. (See Table 4.)

Table 4. Netherlands: Changes in official reserves
(In millions of U. S. dollars)

	<u>1961</u>	<u>1962</u>			<u>October</u>
		I	II	III	
Reported figures	-27	+30	+50	-14	-6 ^{a/}
Adjusted for special transactions	+119	-15	+30	-45	+14

^{a/} Preliminary estimate based on weekly balance sheet of the central bank.

Continued stabilization effort

Since the Dutch authorities regard tendencies toward overspending and inflation as the country's major economic problem, they are firmly committed to a continuation of stabilization efforts. In mid-September a request was made to the Social and Economic Council for urgent advice on steps which might be taken to hold down rising wage costs in 1963.

The authorities continue to follow restrictive monetary and fiscal policies but minor relaxations have taken place in monetary restraints. On August 22, the cash reserve requirements of the banks were reduced from 8 to 7 per cent primarily to facilitate the assumption by a Dutch banking syndicate of promissory notes issued by KLM (Royal Dutch Airlines) to repay dollar loans in New York. A second transaction involving a shift in KLM financing from the United States to the Netherlands took place about November 13. These two transactions involved a reflux of funds to the U. S. of approximately \$70 million.

On September 10, the Netherlands Bank and the commercial banks agreed to extend the credit agreement of July 1961 until the end of 1962. To meet seasonal needs, however, the authorized monthly credit expansion for November and December was raised from 1/2 to 1 per cent. In addition, the authorities, anticipating a tightening on the money market, reduced the banks' minimum cash reserve requirement from 7 to 6 per cent on September 20.

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