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Recent Economic Developments in the Netherlands:
April-July 1964

17 pages

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Summary

Expanding consumer demand, freshly charged with higher wages from the recent general wage increase, continued to supply industry with a steady stream of new orders in the first five months and industrial production grew strongly and steadily.[1/] Tight labor market conditions limited the ability of Dutch industry to satisfy domestic demand and imports were an average of 22 per cent higher than in the first half of 1963.

Inflationary pressure continued strong in the Dutch economy. The cost of living index rose 4.4 per cent from December to June, reflecting in part higher excise taxes to mop up producing power. However, results of the increased wages are as yet barely noticeable in the export price index, and exports in the January-June period were 15 per cent higher than they had been at the same time last year.

The authorities continued to take steps to contain inflationary pressure. In June the discount rate was raised for the second time this year, on this occasion from 4 to 4-1/2 per cent. Furthermore, having announced previously that no expansion in bank lending would be allowed during the May-August period, the central bank warned commercial banks that penalty deposits would be increased if bank lending continued to exceed the established ceiling. At the end of July, the Netherlands Bank moved to limit credit expansion by placing a ceiling on short-term foreign indebtedness of Dutch commercial banks.

1/ See "Recent Economic Developments in the Netherlands, February to April 1964," dated May 27, 1964.

The deficit in the Dutch external accounts in the period under review was reflected in a decline of $37 million in official reserves in the second quarter. In July, however, reserves rose by $55 million (on an adjusted basis), largely because commercial banks repatriated foreign assets in order to meet domestic demands for cash and tighter penalty deposit requirements. Hence, Netherlands reserves at the end of July were again slightly larger than they had been in September 1963, when the breakdown of wage contracts started the deterioration in the country's internal and external financial position.

The guilder weakened on exchange markets in the period following the June 4 discount rate increase but strengthened in July as a result of the repatriation of banking funds and of seasonal factors connected with the tourist trade.

Output continues steady growth

Industrial production exhibited a strong and steady growth through April. The year-to-year increase of more than 8 per cent in the first four months of 1964 partly reflects recovery from the low levels of output caused by last year's severe winter weather, but it also clearly indicates a continuing strong expansion in the Dutch economy. The advance halted in May--and the index fell 3.4 per cent below the favorable May 1963 level--probably because of tighter labor market conditions but also because of fewer working days during the month.[1/] (See Table 1.)

1/ The Dutch index of industrial production has been revised and seasonally adjusted data are not yet available.

Table 1. Netherlands: Industrial Production, 1963-May 1964[a/]
(index numbers, 1958=100 and percentage changes)

		Index	Percentage Change from preceding year			Index	Percentage Change from preceding year
1963	Year	139	+ 4.5				
1963	Jan.	132	+ 0.8	1963	Oct.	159	+ 6.7
	Feb.	123	+ 0.8		Nov.	151	+ 3.4
	Mar.	135	+ 0.7		Dec.	144	+11.6
	Apr.	138	+10.4	1964	Jan.	144	+ 9.1
	May	145	+ 5.8		Feb.	135	+ 8.9
	June	132	+ 0.8		Mar.	147	+ 8.8
	July	140	+ 9.4		Apr.	149	+ 8.0
	Aug.	134	+ 1.5		May	140	- 3.4
	Sept.	138	+ 7.8				

a/ The industrial production index has been revised; seasonally adjusted data have not yet been released.

Source: Central Bureau voor de Statistiek.

Industrial expansion should continue under the impact of lively domestic and foreign demand. Domestic and foreign orders continued to flow into industry, and order backlogs remained at a high level. (See Table 2.) Backlogs in the consumer goods sector continued to lengthen, in part as a result of recent wage and salary increases. On the other hand, order books for investment goods shortened slightly.

Table 2. Netherlands: Order Backlog, 1962-June 1964[1/]
(Orders in terms of months of production, January 1963=100)

End of Month	All industries excl. chemical industry			Consumer goods sector			Investment goods and all other		
	1962	1963	1964	1962	1963	1964	1962	1963	1964
January	109	100	96	106	100	107	110	100	94
February	107	99	100	103	97	107	107	100	99
March	105	97	100	100	98	108	106	97	98
April	106	97	98	101	100	107	107	97	97
May	104	98	98	102	104	109	105	97	96
June	102	97	n.a.	102	103	n.a.	103	96	n.a.

1/ Based on sample survey.

Source: Central Bureau voor de Statistiek.

Labor market extremely tight

The continued strained condition of the labor market mirrored the severe tensions in the Dutch economy, as the labor market tightened further during the first half of 1964 and the ratio of registered vacancies per unemployed worker hovered in the vicinity of five to one. (See Table 3.) Expectations that demand for labor would ease because the recent sizable rise in wages would lead employers to dishoard labor proved vain. Arrangements to recruit additional foreign workers continued; in addition, 3,000 men were released from military service between May and July in advance of schedule in order to help relieve the labor market tension during the season of peak strain. However, the limited preparatory measures which were taken did not prevent the demand for labor from adding to the total of job vacancies during 1964.

Table 3. Netherlands: Labor Market 1962-June 1964
(in thousands, monthly averages or month, seasonally adjusted)

	Unemployment	Vacancies
1963		
I	37	115
II	31	121
III	30	123
IV	28	126
1964		
I	27	128

	Unemployment	Vacancies
1963		
July	30	124
August	30	123
September	29	123
October	29	124
November	28	126
December	28	128
1964		
January	27	128
February	26	130
March	28	127
April	28	128
May	27	129
June	27	133

Source: OECD, Main Economic Indicators.

Inflationary pressure remains strong

Increased workers' income continued to act as the strongest contributor to the rise in consumer expenditures and in prices. The government-approved wage agreement which took effect on January 1, 1964, resulted in a general round of wage increases throughout the economy. Wage rates rose 7.9 per cent from the fourth to the first quarter and continued their rise in April. (See Table 4.)

The negotiation and processing of outstanding wage contracts was largely completed during the second quarter. Even though many contracts provided for wage increases of more than the agreed 10 per cent maximum, the Labor Foundation rejected none of them. Contracts still awaiting approval at the end of June allowed for an average wage increase of roughly 13 per cent.

Table 4. Netherlands: Selected Wage and Price Indices, 1962-June 1964
(Index numbers, 1958=100, monthly averages and month)

	Hourly Wage Rates	Wholesale Prices	Manufactured Product Prices	Cost of Living	Export Prices	Import Prices
1963						
I	137	100	102	112	100	95
II	139	99	102	114	98	96
III	140	100	102	112	99	97
IV	140	104	104	113	99	96
1964						
I	151			116	101	99
1964						
Jan.	149	106	107	116	101	98
Feb.	150	106	107	116	101	99
Mar.	156	n.a.	n.a.	117	101	99
Apr.	157	n.a.	n.a.	122 a/	101	99
May	n.a.	n.a.	n.a.	119 a/	n.a.	n.a.
June	n.a.	n.a.	n.a.	119 a/	n.a.	n.a.

a/ Based on preliminary information.

Source: International Financial Statistics; Central Bureau voor de Statistiek

Although wage increases have exceeded the 10 per cent limit, the earlier pessimistic predictions of observers have not quite been realized. The actual average increase of about 14 per cent (including social benefits) is considerably below the 16 to 18 per cent increases which were predicted. When account is taken of price increases and of the high degree of progressiveness in the lower end of the Netherlands income tax structure, the 13.8 average increase in wages this year reduces to a real average increase of 5 to 6 per cent.

Price levels trend upward

The double effect of increased cost and consumer demand connected with the rise in wages was reflected by rising prices. By the end of February, wholesale prices had risen 1.9 per cent, and prices for manufactured goods 2.8 per cent above their fourth quarter levels. (See Table 4.) Export prices rose 2 per cent in January but thereafter remained unchanged through April.

The cost of living index registered the most marked advance, rising 2.6 per cent during the first quarter and an additional 4.2 per cent in April; however, the April rise was partially offset by a 3 point decline in May and June. Netherlands officials have attributed part of the April increase to a statistical exaggeration caused by price movements in the base period. However, the immediate causative factors included seasonal rises in prices of fresh foods and the imposition of higher gasoline and cigarette taxes.

The April rise in the consumer price index drew strong public and union criticism; but renewed union demands for wage increases and greater price control measures were momentarily lessened when the lower index for May and the first quarter balance of payments deficit were published. However, the unions remain clearly dissatisfied with the price situation and will undoubtedly vigorously renew their demands if prices rise further. According to initial reports, the cost of living index remained at the May level in June; however, it is expected that the index will rise in July when announced increases of 10-12-1/2 per cent in rents and the accompanying 1.3 per cent compensatory wage increase go into effect. Union spokesmen point out that the 1963 wage agreement was reached with the understanding that prices would rise no more than 5 per cent during 1964; that limit has already been reached. A further increase in prices will make it difficult for the government to ignore union demands.

Social-economic policy for 1965-1966 announced

The government's proposed social-economic policy for 1965, announced on June 1, has been carefully designed around the long and short-term economic goals currently being pursued. The proposed program envisages a reduction in income taxes, higher old age pensions and pensions for widows and orphans, and a further rent increase. Only very limited wage increases are considered possible and producers will not be permitted to pass on increased wage costs in the form of higher prices.

A reduction in income taxes has been under consideration for some time. However, the measures now advanced by the government go considerably beyond the tax reform proposed last year. The program envisages a 10 per cent or 1 billion guilder reduction in total tax revenue. Reforms in the tax structure are designed to modify the high degree of progressiveness in the lower income brackets. Though originally planned to go into effect in January 1966, the government may implement the reduction in two steps: in July 1965 and January 1967. Such an action would offer important advantages. The promise of the early date of the tax cut is intended to help hold down wage demand. Thus workers' disposable incomes would be increased by fiscal means, rather than increasing wage rises, and production costs would not be affected. The second part of the tax cut could be effected on schedule or held in abeyance depending upon whether an expected slow down in economic activity as develops at that time or not.

As of January 1, 1965, old age pensions and pensions for widows and orphans are to be raised. The increased cost of the pensions will be divided between the Treasury and employers and employees.

The further increase in rents is part of the continued government program to eliminate the large difference between rent on existing and on new housing.

The expansionary effects which some of these measures will produce are to be counterbalanced by the restrictive effects of other government policies--especially in the field of government expenditures. The government has already announced its intent to restrict the increase in public expenditures in 1965 to 5 per cent in accordance with the recommendations of the European Economic Commission. Despite a cutback in public investment this year, the increase in government expenditures will exceed the 5 per cent level and will probably approach 10 per cent. However, increased expenditures have been offset by increased taxes. In fact, new indirect taxes and increased income tax receipts (from higher incomes, including wage incomes, and the high degree of progressiveness in the Dutch tax structure) have swelled government receipts and resulted in a reduction of the 1964 budget deficit from the expected one billion to 400 million guilders.

Trade balance improves in second quarter.

The deterioration in the trade balance, following the expansion of domestic demand, appears to have stopped since April. Trade returns for May and June indicate a further steady rise in exports and a leveling off in imports. Consequently, the export coverage of imports rose from a low of 76.9 per cent in April to 84.4 per cent in June and the trade deficit dropped from $143 million in April to $94 million in June. (See Table 5.)

There had already been indications of an improvement in the trade balance in the first quarter.[1/] These improvements, which are based on customs figures, are not as yet apparent in the Netherlands Bank balance of payments returns which are based on money flows.

1/ See "Recent Economic Developments in the Netherlands, February to April 1964" dated May 27, 1964.

Table 5. Netherlands: Merchandise Trade, 1962-June 1964
(Millions of U.S. dollars, monthly averages, seasonally adjusted)

		Exports f.o.b.	Imports c.i.f.	Balance	Exports as % of Imports
1962	III	381	448	- 68	85.0
	IV	386	444	- 58	86.9
1963	I	386	461	- 75	83.7
	II	438	496	- 59	88.3
	III	426	502	- 76	84.9
	IV	407	532	-125	76.5
1964	I	460	570	-110	80.7
	II	489	602	-113	81.2
	Jan.	463	553	- 90	83.7
	Feb.	478	600	-123	79.7
	Mar.	439	555	-116	79.1
	Apr.	478	621	-143	76.9
	May	483	583	-100	82.8
	June	507	601	- 94	84.4

Source: OECD, Main Economic Indicators.

For the first six months, imports rose by 22 per cent while exports increased by 15 per cent and the half yearly trade deficit rose to $774 million from the $480 million in the January-June period last year.

First quarter balance of payments moves into deficit

The Netherlands balance of payments, on a cash basis, moved into deficit in the first quarter after having shown a surplus throughout 1963. The overall payments balance showed a deficit of fl 484 million compared to a fl 23 million surplus in the first quarter last year.

The shift from surplus to deficit in the balance of payments was entirely the result of a deterioration in the trade account. (See Table 6.) On a balance of payments basis, the first-quarter trade deficit of 793 million guilders was three times larger than the 217 million guilder trade deficit registered in

January-March last year. To some extent, the deterioration is exaggerated because last year's severe winter held back imports and led to unusually favorable trade results. Nevertheless, because the first quarter has customarily been a favorable one for the current account, this year's poor results have added weight to the government's pessimistic predictions about the effects of the higher wages on the balance of payments. The authorities made immediate use of this new ammunition: they publicized the first-quarter results with considerable fanfare and used them to counter new union wage proposals.

The capital account improved slightly in the first quarter as compared with 1963; the deficit shrank from fl 227 million to fl 184 million. The improvement was primarily attributable to a large reduction in the outflow of commercial bank capital, particularly on short-term account. Net exports of bank funds totaled only 110 million guilders in the first three months of the year compared to 310 million guilders last year. The attractiveness of rising interest rates in the Netherlands is tending to hold funds at home. (See Table 7.) The substantial improvement in this sector was, however, almost completely offset by a swing from a surplus of 115 million guilders to a net outflow of 65 million guilders of private nonbank capital.

The balance of payments deficit was financed, in almost equal portion, by reductions in commercial bank foreign exchange holdings and in reserves of the central bank.

Table 6. Netherlands: Balance of Payments, First Quarter 1964 1/
(in millions of Dutch guilders)

	1964 I a/	1963 I	1963 II	1963 III	1963 IV	1963 Year
Goods and Services						
Merchandise	-793	-217	-302	-267	-389	-1175
Investment income	195	214	-155	229	338	626
Other Services	298	253	399	391	430	1473
Total	-300	250	- 58	353	379	924
Private Capital						
Transactions in domestic securities	- 62	199	194	163	- 40	516
Transactions in foreign securities	- 36	8	- 59	- 74	- 73	- 198
Direct investment	-139	-159	22	- 13	- 91	- 241
Long-term credits	158	- 74	89	- 90	- 26	- 101
Other	14	141	41	55	-160	77
Total	- 65	115	287	41	-390	53
Commercial Banks Capital						
Long-term	- 18	- 7	- 50	8	32	- 17
Short-term	- 92	-303	- 77	79	165	- 136
Total	-110	-310	-127	87	197	- 153
Official Payments						
Debt repayments	- 1	- 1	- 27	- 1	- 20	- 49
Other	- 8	- 31	- 19	64	- 32	- 18
Total	- 9	- 32	- 46	63	- 52	- 67
Surplus or Deficit (-)	-484	23	56	544	134	757
Financed by:						
Special transactions						
Debt prepayments	--	--	--	-253	--	- 253
Commercial banks						
Foreign exchange, net (increase-)	261	25	208	-247	114	100
Central bank						
Drawing rights on IMF (increase-)	- 72	--	18	- 18	--	--
Consolidated credits (receipts-)	3	4	1	5	2	12
Gold & foreign exchange (increase-)	292	- 52	-283	- 31	-250	- 616
Total	223	- 48	-264	- 44	-248	- 604
Total financing	484	- 23	- 56	-544	-134	- 757

1/ Data are shown on a cash rather than a transactions basis. This affects primarily the current account balance and the commercial banks' capital flows.

a/ Preliminary

Source: Netherlands Ministry of Finance

Interest rates continue to climb

The Dutch money market continued to tighten, as it has since late last year, and rates rose on papers of all maturities. The three-month Treasury bill rate moved from 3.00 per cent at the beginning of April to 3.13 per cent at the end of May and--following the June 4 discount rate--rose to 4.38 per cent in mid-July. (See Table 7.) At the same time, the official call money rate rose from 2.50 per cent to 4.00 per cent and the yield on long-term government bonds increased from 4.69 to 5.06 per cent.

Table 7. Netherlands: Selected Interest Rates, September 1963-July 1964
(per cent per year)

Monthly Average		Official Call Money Rate	Three Month Treasury Bill Rate	Government Bond Yield
1963	September	1.24	1.89	4.33
	October	1.11	1.95	4.43
	November	1.14	2.10	4.61
	December	1.56	2.25	4.77
1964	January	1.67	2.31	4.83
	February	2.00	2.36	4.73
	March	2.56	2.94	4.67
	April	2.50	3.00	4.71
	May	2.85	3.13	4.78
	June	1.88	3.89	4.87
Week ending				
	April 3	2.50	3.00	4.69
	10	1.75	3.00	4.69
	17	2.75	3.00	4.72
	24	3.00	3.00	4.75
	May 1	2.75	3.13	4.74
	8	2.75	3.13	4.75
	15	3.00	3.13	4.76
	22	2.75	3.13	4.80
	29	3.00	3.13	4.86
	June 5	1.50	3.63	4.86
	12	1.50	3.94	4.86
	19	2.00	4.00	4.85
	26	2.50	4.00	4.90
	July 3	3.50	4.00	4.89
	10	3.50	4.25	5.10
	17	4.00	4.38	5.06

Source: Netherlands Bank

The upward trend of interest rates and the increased tightness of the Dutch capital market was well illustrated on the occasion of the new State loan in July. Despite the fact that the new issue carried a coupon rate of 5.36 per cent, the highest on any State loan since the war, authorities were not able to place the entire issue in the market largely because competition for scarce capital market funds had already driven rates on privately issued bonds to an average of 6 per cent.

The poorest response came from large institutional investors. Public subscriptions, mostly domestic but some foreign, took up 93 per cent of the loan and the Minister of Finance was forced to draw on government pension funds to place the remainder of the issue. This contrasts markedly with the reception given the State loan floated in March this year, when the issue was eight times oversubscribed at par although it carried a coupon of only 5 per cent.

To contain the inflationary pressure arising from increased consumer demand and limited capacity, the Netherlands Bank raised its discount rate from 4 to 4-1/2 per cent on June 4. This was the second raise this year: on January 6 the rate was increased from 3-1/2 to 4 per cent. The discount action was prompted by the repeated failure of commercial banks to respect credit ceilings and by the unfavorable balance of payments development. The increase in the discount rate seemed intended as a general notice that the authorities are determined to restore equilibrium in the Netherlands economy as soon as possible.

In a further move, the Netherlands Bank declared in the first part of July that penalty deposits would be increased and the scope of credit restrictions would be broadened if commercial banks continued to ignore the prescribed credit ceilings. Although credit expansion was to be limited to 5 per cent from January through April and to be held unchanged from May through August, banks increased their short-term loans to the private domestic sector by an average of 10 per cent during the first half of the year.

In order to meet large domestic demands, Dutch commercial banks have been taking up loans abroad, enabling them to exceed credit expansion ceilings despite the increasingly larger penalty deposits which they have been obliged to hold with the Central Bank. At the end of July, the Netherlands Bank moved once again to limit the domestic credit expansion by placing a ceiling on the permissible level of short-term foreign indebtedness of commercial banks. After July 31, a bank may not allow its short-term foreign liabilities to exceed its foreign assets by more than 5 million guilders without the express approval of the Central Bank. Furthermore, a bank whose foreign liabilities exceed this amount on July 31 must bring its accounts into line with the new regulation by December 31.

Official reserves decline during second quarter

Official gold and foreign exchange reserves of the Netherlands Bank fell by the equivalent of $47 million in the second quarter. (See Table 8.) This fall in reserves reflects the continued surplus of imports over exports.

In July, however, the Bank's reserves rose by $77 million; some $22 million represented a special payment by Germany, making an adjusted reserve increase of $55 million. Repatriations by commercial banks of their foreign exchange assets are largely responsible for the July increase in reserves. Banks have had to bring funds back from abroad to meet large domestic demands for cash in the vacation season and also to meet their increased penalty deposits with the Central Bank. It is also thought that commercial banks repatriated some funds in response to the increasingly attractive returns available on money market paper at home after the June 4 increase in the discount rate.

Table 8. Netherlands: Changes in Official Reserves 1962-July 1964
(in millions of U.S. dollars, end of period figures)

	Gold	Foreign Exchange	Total
Annual Change:			
1962	--	28	28
1963	20	136	156
Quarterly Change:			
1963 I	--	7	7
II	--	88	88
III	--	15	15
IV	20	26	46
1964 I	--	-66	-66
II	--	-47	-47
Monthly Change:			
1964 April	--	-31	-31
May	--	15	15
June	--	-31	-31
July e/	- 7	84	77
Actual Amounts July e/	1,594	269	1,863

e/ Estimated

Source: International Financial Statistics; Netherlands Bank.

Dutch guilder weaker on foreign exchange markets

The exchange rate for the Dutch guilder dropped off considerably following the June 4 discount rate increase, after having strengthened somewhat in May. (See Table 9.) The rate dropped to a low of 27.596 U.S. cents in the last week of June but strengthened in July, rising to 27.668 cents on July 24. The general tendency to weaken was probably the result of the Dutch import surplus and the cessation of speculative interest after the discount rate had been changed. The strengthening in July, on the other hand, is probably attributable to the repatriation of banking funds and to seasonal factors connected with the tourist trade.

Table 9. Netherlands: Exchange Rate in U.S. Cents per Guilder[1/]
July 1963-July 1964

Par Value 27.624; Lower Limit 27.42; Upper Limit 27.84

Monthly Average			End of Week		
1963	July	27.755	May	8	27.667
	August	27.712		15	27.681
	September	27.721		22	27.693
	October	27.749		29	27.670
	November	27.765	June	5	27.645
	December	27.765		12	27.613
1964	January	27.753		19	27.617
	February	27.733		26	27.596
	March	27.731	July	3	27.640
	April	27.711		10	27.660
	May	27.681		17	27.675
	June	27.627		24	27.668

1/ Noon Buying Rate

Source: Federal Reserve Board