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Recent Economic Developments in the Netherlands:
March-July 1965

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Summary

Through mid-1965 the Netherlands economy performed more favorably than had been anticipated in Government projections.[1/] With output expanding faster than forecast, there was a further improvement in the strained relationship between supply and demand.

The movement towards better internal balance was accompanied by further favorable developments on the external side. It now appears that external equilibrium has virtually been restored: exports are expanding at a year-to-year rate of growth of about 13 per cent, while imports are no longer rising. These developments support the view that Dutch products, despite large price increases, continue to be competitive on both foreign and domestic markets.

The favorable trade returns have caused the Government to revise its forecast of the current account balance for 1965 from a deficit of fl 100 million ($28 million) to a surplus of fl 300 million ($83 million). In 1964, the current account deficit amounted to fl 650 million ($180 million). The improvement in the trade position, higher earnings on service account, and a swing from private capital outflows to inflows brought about a $129 million improvement in the balance of payments between the first quarters of 1964 and 1965.

1/ See "Recent Economic Developments in the Netherlands, January-March, 1965" dated May 12, 1965.

The inflows of foreign capital reflected largely tight capital market conditions in the Netherlands. Continuing fast economic expansion, combined with the restrictive policy of the monetary authorities, have put strong upward pressures on interest rates. Long-term rates on new issues moved from around 5.25 per cent early in 1965 to over 6 per cent at mid-year; these yields apparently are sufficiently attractive to draw foreign funds into the Dutch market. However, the authorities believe that tightening credit conditions in other financial centers will prevent capital inflows from reaching any appreciable volume and thus defeating anti-inflationary policies.

The success of these policies may be put to a further test in the second half of the year when demand pressures are expected to intensify. A number of fiscal measures undoubtedly added to effective demand in July; in addition, the new Cabinet has taken a number of decisions which are raising expenditures of both the central government and the local authorities.

Furthermore, the favorable performance of the economy has forced the Government to honor the promise made at the conclusion of the wage agreement in December 1964 that a lump-sum bonus payment to workers would be considered at mid-year if economic conditions allowed. It was recently agreed that this bonus payment would amount to 2 per cent of wages and would be paid in two instalments: in July and December. It was estimated that this would add about fl 600 million to the wage bill.

In view of these large additions to disposable incomes and of continued high consumption and investment demand of public authorities, aggregate demand may well grow faster in the second half of 1965 than it did in the first half of the year, with intensified pressures on prices.

Continued expansion of output and demand

With supply elasticity greater than had been expected, the easing of pressures on productive capacity in the Netherlands economy, which became apparent during the second half of 1964, continued in the first half of 1965. During the year, industrial output expanded faster than expected: for the first five months, industrial production averaged about 7 per cent above the preceding year, compared with a 6 per cent annual rate of increase projected by the Central Planning Bureau. (See Table 1).

Domestic capacities were sufficient to accomodate rising demands from both domestic and foreign sources. During the first half of 1965, order backlogs were almost consistently below both 1964 and 1963 levels, according to a survey conducted by the Central Bureau of Statistics. (See Table 2.) This easing of order backlogs was found only in the capital goods sector, however: order backlogs in the consumer goods sector, which had been worked down in late 1964 and early 1965, rose again in the second quarter. The easing of demand for capital goods is thought to reflect largely the tightening credit situation which has begun to affect the investment activity of smaller companies; rising disposable incomes, which are giving further impetus to private consumption, account for the pick-up of activity in the consumer goods sector.

Table 1. Netherlands: Industrial Production 1964-May 1965 [a/]
(Index numbers 1960=100 and percentage change)

Year		Index	Percentage change from preceding year	Month		Index	Percentage change from preceding year
1964		124	+ 8.4	1965	Jan.	126	+7.7
1964	Jan.-Mar.	120	+12.1		Feb.	129	+8.4
	Apr.-June	124	+ 6.9		Mar.	129	+4.0
	July-Sept.	116	+ 5.5		Apr.	132	+7.3
	Oct.-Dec.	135	+ 8.9		May	135	+6.5
1965	Jan.-Mar.	128	+ 6.7				

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

Industry judged its overall order position in recent months somewhat less favorably than in the first quarter of 1965. According to the latest survey by the Central Bureau of Statistics, the June order position was judged normal by 80 per cent of the respondents, large by 5 per cent and small by 15 per cent; compared with the assessments reported in March (1965), the June judgment represented a shift of 5 per cent from those considering their order position normal to those considering it small.

Labor market tensions unrelieved

Any moderation in demand pressures so far has had little effect on the tight labor market situation. The expansion in output has been achieved mainly because of increases in labor productivity; the number of workers employed in industry has risen only fractionally.

Table 2. Netherlands: Order Backlog, 1963-June 1965
(Orders in terms of months of production, end January 1964=100)

End of month	All industries 1/			Consumer goods sector			Investment goods & all othe		
	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
April	98	101	98	96	104	97	99	100	98
May	101	100	97	100	105	99	101	99	97
June	100	99	97	98	103	98	100	99	97
September	95	99		95	97		95	100	
December	103	99		102	96		103	99	

1/ Excluding chemical industry.
Source: Centraal Bureau voor de Statistiek.

Unemployment, although rising slightly since the end of 1964, still remains at less than 1 per cent of the labor force. Furthermore, the slight upward tendency of the unemployment level is in large measure attributable to the bad weather conditions which impeded construction and agricultural activity in the first and second quarters of 1965, respectively.

The continued reduction in the number of job openings reported, which brought the ratio of vacancies to unemployment down from 4.8 in mid-1964 to 3.0 in May (1965) would suggest some easing of labor market tensions; but on the whole, shortages appear to remain acute. (See Table 3.) In fact, the Social-Economic Council in its mid-year assessment of the economic situation foresaw no appreciable easing of the labor situation for the rest of 1965, in contrast with earlier projections of the Central Planning Bureau.

Table 3. Netherlands: Labor Market 1963-May 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	126	4.7
	II	27	130	4.8
	III	28	135	4.8
	IV	30	134	4.5
1965	I	32	127	4.0
	Apr.	33	120	3.6
	May	34	115	3.0

Source: OECD.

Wage incomes rise

The expectation of continuing labor shortages was in part based upon the stimulus to the expansion of private consumption demand, which can be expected from the fast growth of disposable incomes projected for the second half of 1965. First, one-half of the fl 1 billion tax cut passed early this year became effective on July 1, 1965.

Secondly, the Government promised at the conclusion of the compromise wage agreement of 1964 that a lump-sum "bonus" payment, in addition to the 5 per cent wage increase, would be considered around mid-year if economic conditions permitted. The improvement in the balance of payments position and in the general business situation made it clear early in 1965 that this promise would have to be honored. After lengthy negotiations, the unions and employers finally agreed on a "bonus" of 2 per cent to be paid in two instalments of 1 per cent each in July and December. Thus the unions achieved their original demand of a 7 per cent wage increase in 1965, which had been rejected by the Government in December 1964.

Wage settlements in general have remained within the 5 per cent guidelines agreed upon in December (1964). However, the approval of the controversial wage contract for the Philips Company by the Board of Government Mediators suggests a major change in Dutch wage setting procedures. The contract is to run for three years, rather than the customary one year for which the Central Planning Bureau estimates provide guidelines; but, the introduction of an escalator clause, which permits a maximum 2 per cent per annum compensation for increases in living costs, may make it more difficult to contain inflationary tendencies.

Although the Board of Mediators has stated that the approval of the Philips contract should not be taken as a precedent, the agreement may well furnish the basic pattern for future contracts. The important metal industry recently reached an agreement which contains all the major provisions of the Philips contract. Approval of this contract is still pending, however.

Prices trend upward

The inclusion of the escalator clause in current wage contracts is particularly important since the cost of living in recent months has again begun to rise. Between the second quarter of 1964 and the first quarter of 1965, living costs had remained virtually stable; but in June 1965 consumer prices were 4.2 per cent above the March (1965) and 7.0 per cent above the June 1964 figure.

The recent price increases have mainly been attributable to the effects of bad weather on the potato and vegetable crops. In addition, there were some increases in charges for Government services among the fiscal measures aimed at reducing deficits of Government enterprises. In contrast, increases in prices for consumer goods other than food continued to be moderate. Accordingly, there appeared to be little concern about the inflationary implication of the fact that increases in the cost of living were outstripping the projected rate of 4.5 per cent for the year.

The accelerated rise in the wholesale price index also reflected primarily increased costs of foodstuffs. Wholesale prices, which had held steady between the fourth quarter of 1964 and the first quarter of 1965, rose by 3.6 per cent between March and May 1965. This rise reflected the combined effect of a steep increase in foodstuff prices and the continued moderate upward tendency of finished manufactured product prices, partly offset by a reduction in the cost of raw materials.

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

	Hourly wages rates	Wholesale prices	Manufactured product prices	Cost of living	Export prices	Import prices
1964						
I	157	106	107	113	100	98
II	163	107	109	117	101	98
III	165	107	109	116	102	98
IV	166	109	110	117	104	98
1965						
I	173	109	111	117	102	99
March	173	110	111	118	103	100
April	174	111	112	122	103	99
May	174	114	112	122	n.a.	n.a.
June	n.a.	n.a.	n.a.	123	n.a.	n.a.

n.a. Not available.
Source: Centraal Bureau voor de Statistiek; OECD.

Export prices, which had fallen from November 1964 to February 1965, also resumed their upward drift. However, in April 1965 they were only 2 per cent above their April 1964 level, a smaller increase than that registered in a number of competing countries. This relative price movement and the continued strong export performance has led the Social-Economic Council to conclude that the Dutch competitive position in international markets has not deteriorated.

Continued improvement in trade position

The Council's judgment of the strength of the Dutch trade position was supported by the recent trade returns. The Netherlands balance of trade improved further in the first half of 1965, continuing a tendency which has been apparent since mid-1964. Exports expanded strongly--rising by 7.2 per cent between the fourth quarter of 1964 and the second quarter of 1965 (after seasonal adjustment), while imports tapered off and in June were actually slightly below end-of-year levels. As a consequence, the percentage of imports covered by exports rose from 84.5 per cent in the fourth quarter of 1964 to 89 per cent in the second quarter of 1965, which was appreciably above the low of 80 per cent recorded in the first half of 1964. The trade deficit (after seasonal adjustment) was accordingly reduced from $683 million in the first half of 1964 to $394 million in the first six months of 1965.

Exports in the first half year of 1965 were 12.7 per cent higher than during the comparable period of 1964. (See Table 5.) The continuing export expansion was primarily the result of rising demand from industrial countries, particularly from within the EEC. The Netherlands benefited primarily from the expansion of import demand in Germany and the revival of Italian import demand. Exports to the United States and the EFTA countries also expanded strongly. The resumption of trade relations with Indonesia was reflected by the fact that exports for the first five months of 1965 already exceeded the (rather small) 1964 total.

Table 5. Netherlands: Merchandise Trade, 1963-June 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	1st half	466	579	-113	80.4
1965	1st half	525	590	- 65	89.0
1964	III	486	585	- 99	83.1
	IV	500	592	- 92	84.5
1965	I	513	577	- 64	88.9
	II	536	603	- 67	88.8
	March	489	584	- 95	83.7
	April	530	624	- 94	84.9
	May e/	536	596	- 60	89.9
	June e/	542	589	- 47	92.0

e/ Estimated.
Source: OECD.

Imports, on the other hand, were in the first six months of 1965 only 1.9 per cent higher than in the first half of 1964. The slower growth of imports is largely a return to more normal rates of expansion following the import upsurge of last year. The slight downward tendency of imports apparent in the second quarter and the reduction in the relative importance of capital goods in total imports may indicate some slackening in the growth of investment demand. This tendency may not continue, however, since the recent tax cut and the lump-sum wage bonus will undoubtedly stimulate economic activity further. In addition, investment expenditures in connection with the exploitation of the natural gas finds are continuing to rise.

The relative development of imports and exports would seem to dispel earlier official expectations that wage and price increases at home would have unfavorable repercussions on the trade balance. While imports have risen as expected in view of increases in disposable income and economic activity, exports have continued to surge ahead. Furthermore, the fact that import growth has slowed or, as recently, ceased may well indicate that domestic producers still can compete effectively with foreign producers in the home market.

First quarter balance of payments in equilibrium

The favorable developments in the Netherlands trade position, together with other factors producing a surplus on the current and private capital accounts, brought the balance of payments for the first quarter close to equilibrium. The over-all balance recorded a deficit of only fl 17 million ($4.7 million), an improvement of fl 466 million ($128.7 million) over the first quarter of 1964. (See Table 6.) The strength of the Netherlands' external position is emphasized by the fact that the seasonal payments pattern normally is adverse during the first half of the year.

The favorable development in the balance of payments resulted in large part from an improvement of fl 307 million in the current account, which moved to a surplus of fl 8 million, as compared with a deficit of fl 299 million in the first quarter of last year. The trade deficit shrank by fl 169 million from fl 792 million to fl 623 million, and income from services increased by fl 138 million.

Table 6. Netherlands: Balance of Payments, 1963-First Quarter 1965 1/
(in millions of Dutch guilders)

	Year 1963	Year 1964	1964 a/ I	1964 a/ II	1964 a/ III	1964 a/ IV	1965 I a/
Goods and Services							
Merchandise	-1,325	-2,776	-792	-898	-683	-403	-623
Investment income	645	734	195	-135	291	383	223
Other services	1,592	1,585	298	438	419	430	408
Total	912	- 457	-299	-595	27	410	8
(on transaction basis)	(367)	(-658)	(-542)	(-820)	(284)	(420)	(100)
Private Capital							
Transactions in domestic securities	524	325	- 62	44	190	153	183
Transactions in foreign securities	- 203	65	- 36	16	73	12	- 84
Direct investment	- 238	- 201	-139	- 32	- 44	14	- 87
Long-term credits	- 124	307	158	56	34	78	139
Other	101	233	14	- 83	152	131	18
Total	60	729	- 65	1	405	388	169
Commercial Banks Capital							
Total	- 148	18	-110	45	110	- 27	-168
Official Payments							
Debt repayments	- 49	- 42	- 1	- 20	--	- 21	- 1
Other	- 18	- 35	- 8	- 30	21	- 18	- 25
Total	- 67	- 77	- 9	- 50	21	- 39	- 26
(Errors and omissions)	(- 545)	(201)	(243)	(225)	(-257)	(- 10)	(- 92)
Surplus or Deficit (-)	757	213	-483	-599	563	732	- 17
Financed by:							
Special transactions							
Debt prepayments	- 253	--	--	--	--	--	--
Commercial banks							
Foreign exchange, net (Increase-)	100	682	260	496	59	-133	- 19
Central bank							
Drawing rights on IMF (Increase-)	--	- 226	- 72	--	- 91	- 63	- 13
Consolidated credits (Receipts-)	12	9	3	1	4	1	4
Gold & foreign exchange (Increase-)	- 616	- 678	292	102	-535	-537	45
Total	- 604	- 895	223	103	-622	-599	36
Total financing	- 757	- 213	483	599	-563	-732	17

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.

The surplus on capital account was the second important contributing factor in the improvement of the payments position. The private capital account moved from a deficit of fl 65 million in the first quarter last year to a surplus of fl 169 million in the first quarter this year. The inflow in the first quarter of 1965 was almost entirely the result of net foreign purchases of Dutch securities totaling fl 183 million, probably reflecting the high level of interest rates in the Dutch capital markets. At an effective yield of around 6 per cent, long-term Dutch bonds have become attractive to both domestic and foreign investors. The inflow of private investment funds was only in part offset by renewed purchases of foreign securities by Dutch investors. After withdrawing a net total of fl 101 million in the preceding three quarters, Dutch investors placed a net total of fl 84 million in foreign securities in the first quarter of 1965.

Therefore, aside from the usual outflow arising from official payments, the only deficit item in the balance of payments was the outflow of commercial bank capital, which may reflect the movement of funds out of the Netherlands in response to the inauguration of the U.S. balance of payments program.

Official reserves unchanged

After declining slightly in the first quarter of 1965 as a result of the small balance of payments deficit, official reserves remained unchanged for the second quarter as a whole after adjustment for IMF transactions. An overall decline of $59 million in gold and foreign exchange reserves was offset by an increase of $60 million in the Netherlands IMF position. (See Table 7.)

Reflecting the foreign exchange losses in May and June, the rate for the guilder weakened on the foreign exchange markets, declining from 27.792 U.S. cents at the beginning of May to 27.751 U.S. cents at the end of June. The rate strengthened again in July as foreign exchange holdings of the Netherlands Bank rose $77 million over the month and strengthened further in the first part of August. (See Table 8.)

Table 7. Netherlands: Changes in Official Reserves 1963-July 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
Quarterly change:						
1963	I	--	7	7	--	7
	II	--	88	88	-5	83
	III	--	15	15	5	20
	IV	20	26	46	--	46
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
Monthly change:						
April		--	14	14	--	14
May		33	-80	-47	60	13
June		--	-26	-26	--	-26
July 1/		--	77	77	--	77

1/ Estimated.
Source: International Financial Statistics; Netherlands Bank.

Table 8. Netherlands: Exchange Rate in U.S. Cents per Guilder 1/
January 1964-August 1965

Par Value	27.624
Lower Limit	27.42
Upper Limit	27.84

Monthly average

1964	January	27.753
	May	27.681
	June	27.627
	July	27.657
	December	27.831
1965	January	27.831
	March	27.827
	April	27.780
	May	27.768
	June	27.735
	July	27.761

End of Week

April	16	27.788
	30	27.756
May	7	27.792
	14	27.776
	21	27.763
	28	27.743
June	4	27.737
	11	27.715
	18	27.730
	25	27.751
July	2	27.749
	9	27.758
	16	27.765
	23	27.771
	30	27.754
August	6	27.812

1/ Noon buying rates.
Source: Federal Reserve Board.

Financial markets under pressure

Upward pressures on interest rates indicated that, despite the restoration of external balance, there still remained an imbalance between demand and supply of funds. External influences, such as the United States measures to curtail the outflow of funds and the rise of German long-term rates to over 7 per cent--which makes them competitive with Dutch yields after allowing for the German 25 per cent withholding tax--probably played a role in the upward movement of Dutch interest rates. But the very large increase in domestic demand for funds presumably was the primary factor leading to the establishment of a 6.25 per cent yield on new private issues--an exceedingly high yield for the Netherlands.

Net recourse to the public ("openbare") Dutch capital market from all sources (e.g. public authorities, domestic business, and foreigners) totalled about fl 700 million during the first half of 1965 as compared with only fl 240 million in the first six months of 1964. In addition, demands of the business sector on the private ("onderhandse") capital market reportedly were very large; business traditionally obtains more than half its financing on the private market. This increase in demand for funds would support indications that any slowdown in investment demand so far has come only from smaller enterprises; large enterprises, particularly those connected with the exploitation of the natural gas deposits, are continuing to enlarge their investment expenditures.

Further indication of continued strong demand for capital funds can be found in the fact that during the second quarter credit expansion by commercial banks again began to exceed the agreed limits by increasing amounts. In mid-May, banks were required to put up interest-free penalty deposits with the Netherlands Bank to the amount of fl 133 million because they had exceeded their credit limits by this amount. Required deposits increased to fl 169 million in June, and to fl 202 million in July; in mid-August, however, they fell back to fl 153 million.

The general shortage of capital funds was reflected in an upward movement of yields on new issues. Whereas the Bank for Dutch Municipalities had been able to place successfully a loan with a 5.25 per cent coupon at 99-3/4 per cent of par in March, several major loans in April and May had to be issued with 5-3/4 per cent coupons at par. In June a 5-3/4 per cent loan of the National Investment Bank issued at 99 per cent of par could be placed only with difficulty; on July 15 the Government floated a fl 300 million loan carrying a 5-3/4 per cent coupon at 98-1/2 per cent of par. These yields appeared to be sufficiently attractive to draw funds into the market; in fact, that loan was so heavily oversubscribed that allocations amounted only to 1.1 per cent of subscriptions.

The upward movement of long-term rates caused Parliamentary questions about the danger of adding to inflationary pressures through the attraction of foreign capital. The Minister of Finance indicated that this danger was not imminent, partly because of the rise in yields in other financial centers. He estimated that about 10 per cent of the Government loan had been taken up by foreigners. Short-term rates also reflected the continued tight monetary situation. (See Table 9.) Treasury bill yields moved from 3.54 per cent per annum in April to 4.13 per cent in July, however this was still 13 basis points below the peak reached in July 1964.

Fiscal measures expansionary

Recent fiscal measures are expected to add to demand pressures in the second half of the year, partly offsetting the continued tight policies of the monetary authorities. The revised budget of the new Government for the current year raised Government expenditures by fl 200 million ($55 million) above earlier estimates. The additional expenditures will be made in the fields of development aid and education, while an extra fl 50 million will be made available to the municipal authorities in order to ease their liquidity problems. In addition, the borrowing quotas of the local authorities were raised by fl 200 million, partly because of anticipated large outlays for the natural gas pipeline system. Furthermore, the Government is considering exempting investment in housing from the loan ceiling.

The Government justified its departure from the principle that government expenditures should not rise faster than national income by the need to eliminate bottlenecks which were hindering further economic growth and general welfare. The increased spending commitments for 1965 are to be financed by long-term borrowing on the domestic capital market; increased spending commitments for 1966 are slated to be covered by increases in indirect taxation. However, the Government still remains committed to put into effect the second stage of the fl 1 billion tax cut by mid-1967; the first stage became effective on July 1, 1965.

These recent budgetary decisions will put further pressure both on the interest rate level and the general level of demand.

Table 9. Netherlands: Selected Interest Rates, January 1964 - July 1965
(per cent per year)

		Call Money Rate	Three Month Treasury Bill Rate	Government Bond Yield
Monthly Average				
1964	January	1.67	2.31	4.83
	April	2.49	3.00	4.71
	July	3.72	4.26	5.02
	October	3.24	3.80	4.84
1965	January	2.43	3.29	4.98
	February	3.69	3.34	4.94
	March	3.05	3.39	4.95
	April	3.39	3.54	5.02
Week Ending				
1965	May 7	4.13	4.00	5.05
	14	4.25	4.13	5.08
	21	3.00	4.13	5.13
	28	3.00	4.06	5.21
	June 4	3.00	4.06	5.28
	11	2.00	4.06	5.31
	18	2.50	4.06	5.24
	25	3.00	4.13	5.27
	July 2	2.50	4.13	5.27
	9	3.13	4.13	5.28
	16	4.25	4.13	5.27
	23	4.13	4.13	5.27

Source: Netherlands Bank.