

BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM

Division of International Finance

REVIEW OF FOREIGN DEVELOPMENTS

January 24, 1967

Rosemary Darlington

8 pages

Recent Economic Developments in the Netherlands:
July-November 1966

This paper reflects the personal opinion of the author and must not be interpreted as representing the opinion of the Board of Governors. It was prepared primarily for internal circulation within the Federal Reserve System, and must not be cited, quoted, or reprinted without permission.

January 24, 1967

Rosemary A. Darlington

Recent Economic Developments in the Netherlands,
July-November 1966

Since mid-1966, demand pressures have definitely begun to ease in the Netherlands and a number of soft spots which had been discernible earlier have begun to spread.^{1/} These developments resulted partly from the cumulative effects of a very restrictive monetary policy and certain anti-inflationary fiscal measures, and partly from the slow-down in demand in some of the Netherlands major trading partners, notably Germany, Belgium and the United Kingdom.

The response of the economy to the weaker demand situation was most noticeable in the labor market, where unemployment has been rising and job vacancies have fallen to their lowest level since the beginning of 1961. Even though the 1.5 per cent unemployment rate in December cannot be considered high and there are still two vacancies for each unemployed, this situation is much easier than it was a year earlier when unemployment stood at 1 per cent and there were four vacancies for each unemployed. (See Chart.)

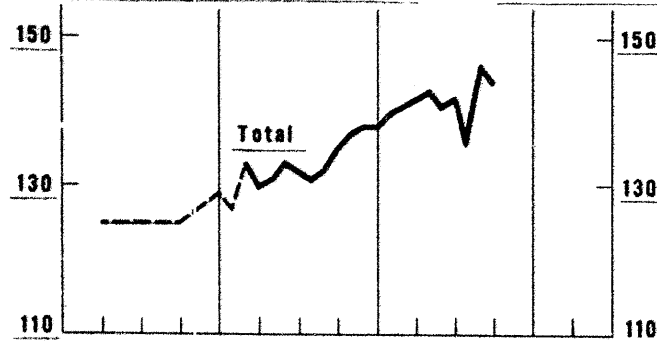
In addition, there has been a tendency for prices to stabilize since mid-year. Consumer prices, which rose 7.6 per cent from October 1965 to April 1966, actually declined by 2.3 per cent between April and July

^{1/} See "Recent Economic Developments in the Netherlands, January-June 1966," dated August 19, 1966.

THE NETHERLANDS

INDUSTRIAL PRODUCTION

s.a. 1960=100



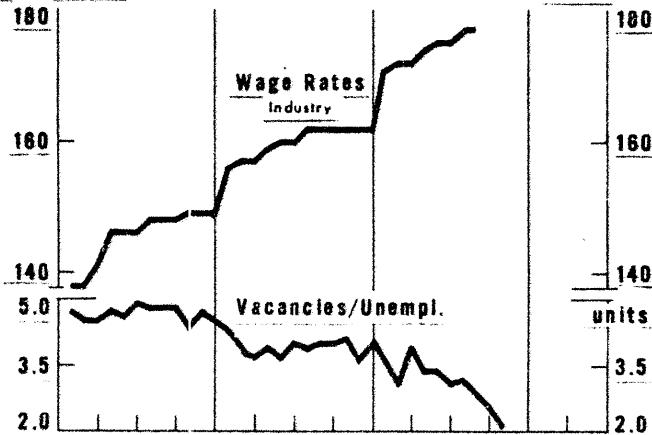
PRICES

1960=100



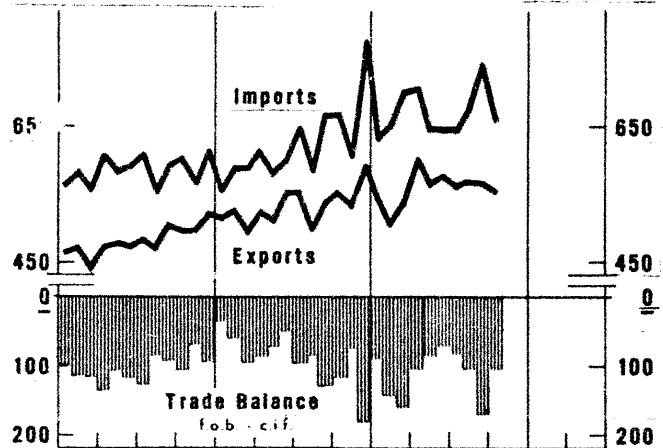
LABOR

1960=100



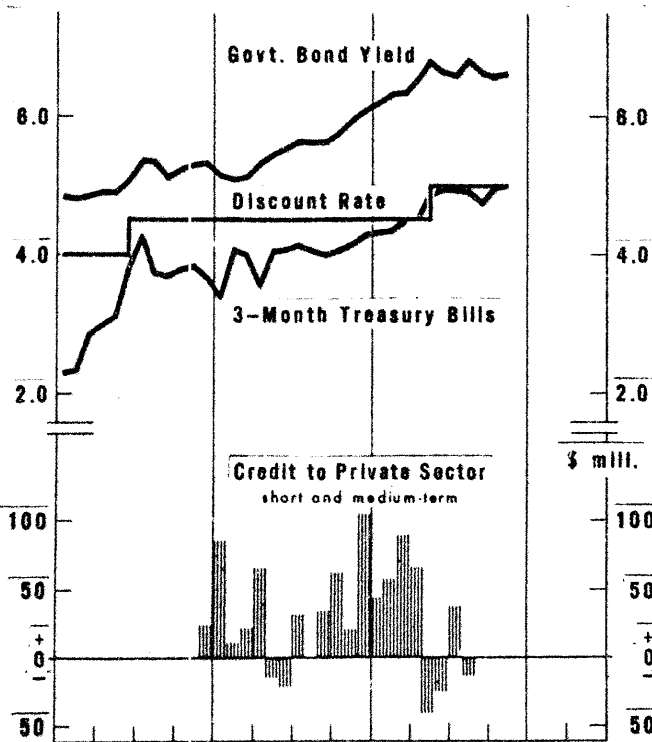
FOREIGN TRADE

s.a. \$ mill.



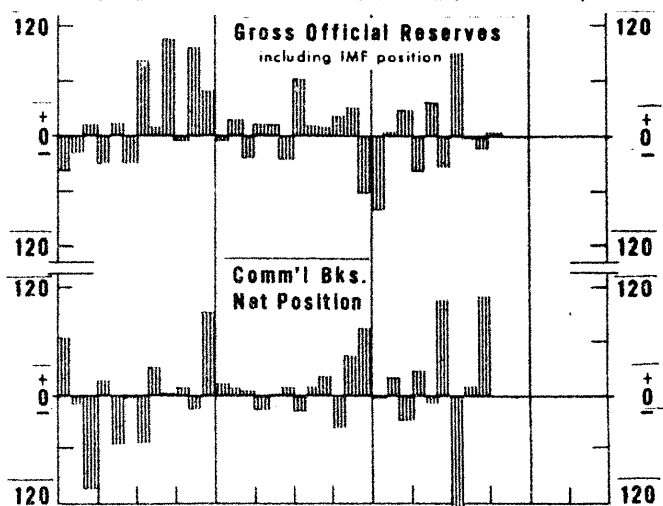
FINANCE

% P.A.



CHANGES IN INT'L. RESERVES

\$ mill.



1964 1965 1966 1967

1964 1965 1966 1967

and remained at the July level through October. Export prices (unit values) also declined by 2.8 per cent between May and September. Wholesale prices of manufactures rose, however, by 1.7 per cent between May and September. (See Chart.)

The greater price stability recorded since May has reflected the influence of three factors. In the first place, in May the Government imposed a general price stop and established criteria to govern further increases in prices. Secondly, there were seasonal declines in food prices and the end of the hoof-and-mouth epidemic led to lower prices on meat products. Finally, the easing of aggregate demand has undoubtedly contributed to the recent greater stability of the price indices, although the existence of price ceilings means that market prices do not accurately mirror the underlying cost/demand situation.

In response to the easing in the growth of demand, domestic business activity has been expanding at a slower pace than previously. Seasonally-adjusted industrial output rose 5.3 per cent over the preceding six months in the October-March 1966 period but only 1.9 per cent in April-September. (See Chart.) Total consumer spending (which is available only on an unadjusted basis) has been growing more slowly, particularly in real terms, but nonetheless showed a year-over-year increase of 5 per cent in August.

The major weak spot in the Dutch business situation is the further weakening of private investment demand. Fixed private business investment expanded 5 per cent in real terms in 1964 and

1 per cent in 1965. For 1966, an 8 per cent expansion had been projected, but only a 4,5 per cent increase appears to have been realized; most of this increase represents investment in transport equipment by the Royal Dutch Airlines (much of which was spent abroad) and by a major shipping company, and only a minor portion was accounted for by investment in machinery. For 1967, a small absolute decline in private investment is now expected. Because of these developments, the Social-Economic Council has recommended government measures to stimulate investment during 1967.

With the diminishing pressure of excess demand within the Dutch economy, imports during 1966 grew at a much less rapid rate than they had throughout 1965. (See Chart.) However, export sales, which had grown very rapidly during the spring months, also leveled off at mid-year and actually turned down slightly in September and October. As a result, the deficit on trade account (exports f.o.b. and imports c.i.f.) widened.

On a balance of payments basis, the Netherlands' external accounts deteriorated during 1966, partly because of the larger trade deficit and partly because of reduced investment income from abroad. The worsening of these two accounts can be seen particularly in the results for the first half of 1966. (See Table 1.) For the third quarter, large inflows of funds to Dutch commercial banks (other than their money-market investments abroad) produced an over-all payments surplus which was much larger than the seasonal surplus normally expected in this quarter.

Table 1. Netherlands: Balance of Payments, 1965-III Quarter 1966
(cash basis, millions of guilders)

	1965		1966		
	<u>1st Half</u>	<u>III</u>	<u>I</u>	<u>II</u>	<u>III</u>
Current Account					
Trade balance	-1,180	-579	-794	-617	-523
Investment income	178	353	39	- 11	287
Other services	708	356	268	394	377
Total	- 294	130	-487	-234	141
(Current account-- transactions basis)	(- 382)	(492)	(-804)	(-343)	(282)
Private capital					
Securities transactions	95	152	139	137	100
Direct investments	- 184	- 12	- 94	- 65	- 52
Long-term credits	246	- 41	-172	101	29
Other	5	- 44	85	14	- 22
Commercial bank capital ^{1/}	- 321	-224	-259	- 51	208
Total	- 159	-169	-301	136	263
Government Capital	- 46	50	- 16	- 56	- 52
Errors and Omissions	65	- 42	18	- 10	- 15
<u>Surplus or Deficit (-)</u>	<u>- 434</u>	<u>- 31</u>	<u>-786</u>	<u>-164</u>	<u>337</u>

^{1/} Excluding net foreign reserve positions.
Source: Ministry of Finance.

The Central Planning Bureau expects the Dutch current account to shift from a deficit of \$138 million in 1966 to a surplus of \$83 million in 1967. In the light of the domestic situation, it is reasonable to expect a further slowdown in imports; but it is more difficult at this time to see the strong upturn in exports which would be necessary to realize such an improvement in the trade position during the current year.

The softening of export demand in the latter part of 1966 contributed somewhat to the lessening of demand tensions in the Dutch economy. However, the main cause of the recent easing of demand pressures (and presumably the source of the expected improvement in the Dutch trade accounts in 1967) has been the series of stabilization measures taken by the Dutch authorities, especially during 1965 and 1966.

The main emphasis of these programs has been on credit restraint. Credit conditions tightened significantly during 1965 and remained tight during 1966 but there has been a slight easing tendency since August. Thus, yields on long-term government bonds rose 49 basis points in 1964, 73 basis points in 1965 and a further 60 basis points to an August 1966 peak of 6.81 per cent. By November, however, yields had fallen to 6.61 per cent. In October and again in December, new 7 per cent public-sector bond issues were successfully placed at par for the first time since the 7 per cent coupon was introduced in May.

The recent slight easing in credit market strains can also be seen in a reduction in the "excessive" short- and medium-term bank lending by the banks to the private sector. As one part of the stabilization program, loans by individual banks which are in excess of the permissible norms require penalty deposits at the central bank: these deposits averaged fl 70 million in the July-October period, compared with fl 97 million a year earlier and some fl 162 million for the March-June 1966 period.

As its contribution to the stabilization program, the Central Government's anti-inflationary efforts were concentrated in two areas: on indirect taxes and on wage-price management policies. Indirect taxes were raised in the spring of 1965 and also in 1966. Wage increases have continued to be subject to Government review or approval despite the liberalization of the wage negotiating process.^{1/} The Government has, furthermore, continued to maintain a restraining hand upon prices; for instance, in September 1965 the Government ordered hotel and restaurant prices rolled back if they exceeded October 1, 1964 prices by more than 4 per cent and in May 1966 the Government announced a number of measures, among them a price freeze and a limit on wage increases for 1966.^{2/}

At the same time that it has maintained wage and price controls, however, the Dutch Government has also pursued a generally inflationary budgetary policy based primarily upon increased social expenditure commitments. Government expenditures increased by 13.4 per cent in 1965 and by an estimated 14.2 per cent in 1966. The budget deficit widened from fl 1.5 billion in 1965 to fl 1.9 billion in 1966. (See Table 2.)

^{1/} Previously, wage negotiations had been subject to much closer Government supervision. Between 1958 and 1962, all collective bargaining agreements needed the approval of the Board of Mediators, which was subject to the general directions of the Government. The percentage increase in wages in each sector was conditional upon the productivity increase in the sector, with the national increase in productivity representing the average permissible increase. Following 1963, wage increases were based upon a permissible average percentage indicated by the Social-Economic Council but considerable room for deviation from the norm was possible for individual contracts. Wage agreements were reviewed by the Board of Government Mediators only in the case of agreements judged to be dangerous to the economy. For 1967, the Government has issued wage guidelines applicable to all individual contracts.

^{2/} See "Recent Economic Developments in the Netherlands, January-June 1966," dated August 19, 1966, p.4.

Thus, the expansionary effects of the Government's budgetary policies seem to have offset the economic effects of its anti-inflationary efforts.

Table 2. Netherlands: Central Government Budgets, 1964-1967
(fl millions)

	<u>1964</u>	<u>1965</u>	<u>1966^{1/}</u>	<u>1967</u>	
				<u>Orig.</u>	<u>Revised</u>
Expenditures	14,575	16,439	18,990	20,140	20,140 ^{a/}
Revenue	<u>13,180</u>	<u>14,951</u>	<u>17,081</u>	<u>18,960</u>	<u>19,460^{b/}</u>
Budget deficit	-1,395	-1,488	-1,909	-1,180	- 680

1/ May 1966 estimated outcome.

a/ Subject to further cuts of fl 300 million.

b/ Another possible fl 100 million may be raised by changes in tax measures announced by the new Government.

Source: Netherlands Government Budget Memoranda for 1965, 1966 and 1967.

Measures taken in the closing months of 1966 may, however, reduce budgetary strains on the domestic economy. After the Government fell over a dispute about budgetary policy, an interim Government was formed by Professor Zijlstra^{1/} and steps were taken to bring about a greater degree of budgetary balance. In order to reduce the proposed budget deficit from fl 1.2 billion to about fl 700-800 million, two steps were announced:

- a. The second step of an income tax reduction which had been scheduled for January 1, 1967, was postponed to July 1, 1967; and

1/ Professor Zijlstra had been designated as Mr. Holtrop's successor to the Presidency of the Netherlands Bank. The appointment was to become effective May 1967. Zijlstra relinquished this appointment in order to take over the task of forming an interim government. This interim government is to remain in power at least until general elections are held in February 1967.

- b. An increase in turnover taxes which had originally been scheduled for January 1, 1968, was advanced to July 1, 1967.

In addition, excise taxes on gasoline and motor vehicles and turnover taxes on shoes and textiles were raised as of January 1, 1967. Furthermore, the Government announced an intention to reduce expenditures by fl 300 million during 1967, but no decisions have yet been reached about where the cuts are to be made. For 1967, original spending proposals projected a total of fl 20.14 billion or an increase over 1966 of about 6 per cent.

The smaller budget deficit for 1967 will mean an easing of strains on Dutch capital markets. The entire fl 1.2 billion 1967 deficit was to have been financed through the Civil Service Pension Fund. Any reduction in central government financing needs during the current year will enable the Pension Fund to accommodate local authority long-term capital needs and, thereby, facilitate bond market financing for other local authority and for private sector financing needs.