

MONTHLY ECONOMIC ANALYSIS

W. Europe Undertakes Expanded Trade to Counteract Deflationary Downturn

The major economies of Western Europe showed a significant downturn in industrial activity and an alarming rise in unemployment during October and November of 1976. The tightening of trade and domestic credit during August and September, reflected in a cut in consumption of over \$12 billion in Britain, Italy and France alone, was demonstrably responsible for these serious developments in the real economy. The deceleration of inflation rates not only in West Germany, but in France and Italy as well pinpoints the European-wide deflationary downturn into which Europe has moved.

To deal firmly with this dangerous conjuncture, the governments of Italy, Britain, and West Germany have adopted the political policy of expanded international trade, and have undertaken implementation of the credit policy necessary to finance it. The three countries have made explicit efforts to expand their trade arrangements with the OPEC oil-producing and the Comecon nations. Together these efforts represent much more than a simple export drive, and imply the genesis of a new international monetary system to replace the bankrupt U.S. dollar as the principal international reserve currency and trade medium.

Since the summer 1976 doldrums, production throughout Western Europe has taken an overall downturn. The sole exception to the bleak picture was the export boom in Britain and Italy during the second and third quarters, which represented no more than a bargain basement looting operation against these collapsed economies and currencies and which petered out in October for lack of continuing export demand. In the Federal Republic production fell ominously by one per cent in November, while the latest production figures for France and Italy show October production dips of 4.7 per cent and 2.8 per cent, respectively. Overall incoming orders for West Germany, which had been Western Europe's star on the order boards, similarly fell two per cent and three per cent during September and October. Orders remained flat in November.

The immediate result has been a jump in unemployment rivaling that of the 1974-75 depression. West German unemployment rose sharply during December to 1.09 million, the level of late 1975, while French unemployment in November rose to 1.04 million, with government forecasts for 1.2 and more early in 1977. The British unemployment figure for December was 1.37 million, relatively flat but projected to rise sharply in January.

Restriction of trade credit in France, Italy and Britain and domestic credit to industry in West Germany created this debacle. For example, the imports restriction in

the austerity programs instituted in France, Italy and Britain hit directly against West German trade, and generally against all intra-European trade. West German exports to the EEC as a whole dropped from the second quarter to the third quarter and again from September to October. This included a September to October drop in West German exports to France and Britain by two and four per cent respectively.

Credit restriction policies across Western Europe resulted in decelerating inflation rates. The wholesale price index in West Germany dropped absolutely by -0.2 per cent in September, -0.1 per cent in October, and -0.3 per cent in November. The French wholesale price index dropped by 0.2 per cent in October, while the rate of rise in consumer prices has fallen from 1.1 per cent to 0.9 per cent to 0.8 per cent during September, October and November, respectively. Even the rate of rise of the Italian consumer price index slowed during October and November.

Not surprisingly, a new approach to international fi-

		UNEMPLOYMENT			
		Nov. '76	Oct. '76	Sept. '76	Nov. '75
USA	(s.a.) 000s	7,769.0	7,569.0	7,400.0	7,701.0
	%	8.1	7.9	7.8	8.3
Holland	000s	220.1	218.8	220.6	222.3
	%	5.4	5.3	5.4	5.4
France	000s	1,040.0	1,025.0	955.4	1,020.0
	%	4.7	4.6	4.3	4.6
W. Germany	000s	984.7	943.7	898.7	1,114.2
	%	4.3	4.1	3.9	4.9
		Oct. '76	Sept. '76	Aug. '76	Oct. '75
U.K.	(s.a.) 000s	1,305.5	1,319.3	1,307.4	1,185.4
	%	5.4	5.6	5.5	5.0
Belgium	000s	230.7	222.9	223.1	208.9
	%	8.8	8.5	8.5	7.9
Japan	000s	1,000.0	1,010.0	1,030.0	1,030.0
	%	1.8	1.9	1.9	1.9
		July '76	April '76	Jan. '76	July '75
Italy	000s	776.0	673.0	681.0	648.0
	%	4.0	3.5	3.5	3.3

Unemployment rose in most of the major industrial capitalist nations, starting last fall, reflecting the general "slowdown" in world production and trade.

nance has taken hold in Italy, Britain, and West Germany, an approach characterized by moves toward a new international monetary system to get at the real problems of industry. Only France, whose government remains in the hands of pro-Wall Street President Giscard d'Estaing, has refused to join in the growing actions against U.S. dollar hegemony in Europe.

The Italians have led the way, with the Libyan purchase of ten per cent of Italy's Fiat auto giant marking the beginning of similar arrangements between OPEC and British and West German companies including British Petroleum and Volkswagen. In these deals OPEC capital is infused directly into European industry to foster industrial development. More importantly, direct government-to-government oil-for-machinery barter deals have begun to proliferate between these European governments and OPEC member's national oil companies, bypassing the U.S. multinational oil companies control of the European oil market — and bypassing payments in U.S. dollars. Exemplary is the arrangement announced last week under which ENI, Italy's national oil company, will trade Italian industrial goods for four to five million metric tons of oil per year. The National Iranian Oil Company will provide this oil to ENI's European sales network outside Italy.

The end on which these interim trade policies converge

is significant Italian, British, and West German support for last month's proposal by the Soviet Union that the Comecon's unit of account, the gold-backed transferable ruble, be used as a new global form of credit to finance expanded East-West and Third World-developed sector trade. Scores of prominent West European bankers and their foreign ministers have voiced support for the transfer-ruble proposal. The Banca d'Italia stands out in this category. As a medium-term transitional program to the transfer-ruble scheme, the Italian government has called for the formation of an East-West European Bank which would promote large-scale trade expansion and be capitalized through European and Arab foreign reserve contributions.

These qualitatively new international monetary mechanisms make bright prospects for Europe in the medium-to-long term. This, of course excepts France under the Giscard government, which rejects such financial mechanisms because of their political implications for the independence of Europe from the financial policies of the New York banking community. Without institutional arrangements for the new expansion of trade, no country can possibly deal with current deflationary developments except with the destructive options of still more deflation, or severely inflationary resort to the printing presses.

West Germany Economy Limpers Into 1977

West German economic activity took a downward turn in October and November, and the continuation of the production drop is heralded by declines in both foreign and domestic industrial orders. In monetary policy, the central bank continues to emphasize that inflationary measures will sabotage real growth, and has met the speculative expansion of the money supply with strict control of monetary aggregates. The Schmidt government thus far has also declined to introduce more than a token fiscal stimulus on the grounds that overall international economic contraction, the root of the problem, must be directly addressed to promote trade and investment.

The unfavorable prospects for the West German economy must accordingly be qualified in view of the government's attempts to help major trading partners' recoveries, as exemplified by Schmidt's quiet support for the British policy of high-priority industrial growth, and by the new entente between Italy and the Federal Republic expected to be consolidated this month, possibly with trade-assistance credits, around the meeting between the heads of state of the two nations. Bringing North-South relations to a new level of mutual profitability and expansiveness was the keynote of the Chancellor's New Year's addresses, which specifically focused on economic as well as diplomatic relations with Arab oil producers.

Meanwhile, the key indicators for production and trade are negative. After rising somewhat above the "summer lull" level, industry's total output showed a 1 per cent drop in November from the downwardly revised October figure. Domestic manufacturers' view of the future is

Period	All Industries	Basic and Producer Goods Industries	Capital Goods Industries	Consumer Goods Industries
1975 Aug.	104.5	101.6	102.1	101.9
1976 Jan.	102.1	97.8	99.3	100.9
Feb.	111.0	109.2	108.8	111.1
Mar.	108.8	109.6	104.5	108.8
Apr.	117.4	118.8	113.8	117.3
May	116.3	117.9	115.0	113.0
June	118.2	119.5	117.8	111.0
July	99.0	108.6	88.4	91.7
Aug.	97.9	105.9	88.2	92.2
Sept.	113.3	115.3	109.1	113.9
Oct. (p)	120.2	116.4	117.0	126.0
Nov. (p)	119.1	(n.a.)	(n.a.)	(n.a.)

(p) — Provisional
(n.a.) — not available

Source: Deutsche Bundesbank