preliminary (unadjusted) industrial production index in December and a 14 per cent jump in January unemployment. The production and employment cuts occurred primarily in the deeply depressed steel and machinery industries — precisely those European sectors which have yet to benefit from trade deals in a major way. With a worldwide "glut" of steel emerging, an estimated 200,000 workers have been or are about to be placed on short-time or laid off throughout Europe.

A related problem is the fact that, in every country, industrialists are short of funds for necessary capital investment programs, at the same time that trade unions are demanding pay hikes to compenstate for two years of declining real incomes. In West Germany a modest 6.9 percent metalworkers' wage boost last week evoked a wave of protest from employers' associations and economic institutes, who labeled the increase a precedent-setting "threat" to the economy.

Throughout Europe, previous government-employer ability victories to limit wage increases has eaten heavily into retail sales, eliminating the possibility of any internally based recovery and threatening the decimation of the skilled labor. Given this predicament, the continuing failure of European governments to take swift action to revamp the world monetary system will undoubtedly lead to serious economic deteoriation and renewed currency turmoil during 1977.

Unemployment

(IN THOUSANDS AND IN % OF LABOR FORCE)

	W.GERMANY		FRANCE	U.K.		ITALY	
	TOTAL	%	TOTAL	TOTAL	%	TOTAL	%
1973	274	1.3	394	618.8	2.7	669	3.7
1974	583	2.6	494	614.9	2.6	560	2.9
1975	1,074	4.7	840	977.6	4.2	654	3.3
1976							
JAN	1,351	5.9	1,017	1,303.1	5.5	681	3.5
FEB	1,347	5.9	978	1,304.4	5.5		
MAR	1,190	5.2	938	1,284.9	5.5		
APR	1,094	4.8	897	1,281.1	5.4	693	3.5
MAY	954	4.2	848	1,271.8	5.4		
JUN	921	4.0	813	1,331.8	5.6		
JUL	945	4.1	809	1,463.5	6.2	776	3.8
AUG	940	4.1	842	1,502.0	6.4		
SEP	899	3.9	955	1,455.7	6.2		
OCT	944	4.1	1,025	1,377.1	5.8	777	4.0
NOV	985	4.3	1,041	N.A.	-		
DEC	1,090	4.8	1,037	1,371.0	-		
1977							
JAN	1,240						

Consumer Prices

(% CHANGE FROM PREVIOUS MONTH)

	BRD	FRANCE	UK	ITALY
JAN	+0.8	+1.1	+1.3	+1.2
FEB	+0.7	+0.7	+1.3	+2.2
MAR	+0.4	+1.0	+0.5	+2.0
APR	+0.6	+0.9	+1.9	+2.6
MAY	+0.4	+0.7	+1.1	+2.0
JUNE	+0.3	+0.4	+0.5	+0.5
JULY	-0.4	+1.0	+0.2	+0.6
AUG	+0.4	+0.7	+1.4	+0.9
SEP	+0.0	+1.1	+1.3	+1.8
OCT	+0.1	+0.9	+1.8	+2.9
NOV	+0.4	+0.8	+1.4	+2.2
DEC	+0.5	+0.3	+1.3	+1.2
1975-76 % CHANGE	+ 3.7	+9.8	+15.1	+ 22.0

Investment Squeeze Hurting Callaghan Industrial Strategy

BRITAIN

The recent inklings of an industrial recovery for Britain, largely the result of the Callaghan government's attempts to shape the political climate for industrial growth, is in danger of disintegrating before it has had a chance to fully take hold.

The reason is the lack of investment funds available to industry. The government's willingness to make short-term compromises over sterling and credit policies to meet the conditions of the IMF loan announced in December could mean the failure of its positive industrial strategy — without an immediate move toward long-term investment credits for industry as outlined in the Ratti Export-Import bank proposal for Europe.

Following Prime Minister Callaghan's decision to take

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personal responsibility for the development of the country's economic policy, there has been a major push to change governmental machinery to allow for expanded export credits and development of new foreign markets. As announced during the Feb. 2 meeting of the National Economic Development Council, Britain's tripartite economic planning review body, the ECGD (Export Credits Guarantee Department) will be expanding its role as guarantor of funds for major projects abroad, and the British Overseas Trade Board (BOTB) will work closely with companies and industrial consortia to open up new markets. To accomplish this, Parliament has approved the extension of the ECGD credit ceiling from £18.3 billion to £25 billion, with an option to further extend it to £40 billion. As an indication of the level of expansion in trade the government is preparing for, in the year to March 31, 1976, the ECGD had extended only £8.4 billion, which accounted for 36 per cent of total UK export funds.

While trade with the Third World and Mideast has shown a remarkable increase over the last year, and the latest balance of trade figures show important gains in exports, the government's export strategy has yet to be consolidated in terms of concrete orders throughout the economy.

The preliminary success of Callaghan's strategy is shown by the December balance of payments statistics, which registered a return to the black by £21 million — only the fourth time this has happened since 1974. With the contribution of invisibles remaining steady at £200 million from November to December, most of the improvement came from increased exports—up to £2,362 million from £2,225 million in November. Industrial production has remained virtually stagnant at 102.6 (1970-100) in both November and December. Given this stagnation, it is not surprising that unemployment continued to rise in January, to 1,448,200 from 1,371,000 in November. Even if the government's industrial strategy succeeds, Callaghan has warned that unemployment will not come down, and will probably rise to 1,500,000 this year.

Probably the clearest indication of the government's success in stabilizing the economy is the steady value of the pound around $1.71, and the 75 per cent increase in the country's official reserves in January, by $3,067 million to $7,196 million. While this includes the transfer of the first tranche of the IMF loan into the country's coffers, it is also indicative of the high level of foreign confidence following the successful completion of the IMF loan and sterling balance support operation.

Despite the first indications of apparent success, the British economy is threatened with the return of the all-too-familiar inflationary spiral if the government cannot channel major capital investment funds to industry to relieve the bottlenecks that inevitably occur at the beginning of a "go" cycle. Money that by rights should have been available to industry through banks and building societies has instead been swept up in the flow of "hot money" through the City of London that has caused a phenomenal demand for gilts ("gilt-edged") Treasury bills).

The effect of this squeeze on industrial investment was clear in the release of the wholesale price index on Monday, which presaged a return to inflation rates of 40 per cent a year if January's rise of 3.2 per cent were to be maintained. The government's ability to reduce inflation is a key part of their economic strategy, since not only foreign confidence, but also their "social contract" with the trade union depends on the reduction of inflation to prevent a repeat of the wage-price spiral of 1974.

While more than willing to follow the government's initiative in boosting manufacturing industry investment, figures released recently by the Treasury Department indicate that industry as a whole is downgrading its investment intentions from a 15-20 per cent increase in 1977-78 (as reported by the Department of Industry earlier this year) to closer to 10 percent. In their February Monthly Survey of Business Opinion, the *Financial Times* indicates that for the 40-odd companies they surveyed in the electrical engineering, consumer durables and retail sectors, the rate of recovery was slackening due to lack of skilled labor and shortages of some supplies.

As Prime Minister Callaghan has stressed, exports are the key to any recovery, due to the expectation that home demand will continue to be depressed while the cost of living rises faster than income over the next year. Personal earnings increased by 3.5 percent from July to November 1976 while the retail price index rose by 5.1 percent in the same period. The so-called consumer boom of the pre-Christmas period was dependent largely on tourist business in the South-East around London, increased sales in liquor and cigarettes in expectation of an increase in VAT levels on Jan. 1, and a high level of consumer credit.

Balance Of Trade, Current Account

(Million Pounds, Seasonally Adjusted)

1976	Visible Exports	Trade Imports	Trade Balance	Current Balance
1st qtr	5,419	5,897	- 478	- 33
2nd qtr	5,992	6,946	-1,004	-533
3rd qtr	6,121	7,327	-1,206	-637
Oct	2,222	2,576	- 354	-154
Nov	2,226	2,736	- 510	-310
Dec	2,362	2,225	- 179	+ 21

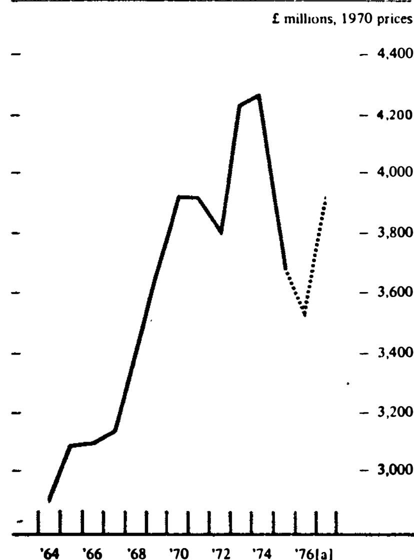
Money Markets

The renewed foreign confidence in the country's economic stability combined with high interest rates has attracted unprecedented amounts of "hot money" into the London gilts market, the effect of which has been to channel funds away from industry — just at the start of the government's industrial investment program — into purely speculative investment funds in the City of London.

Caught in the uncomfortable bind of having to juggle between maintaining gilt sales to finance the huge public

Fixed investment by manufacturing, distributive and service industries

The volume of investment is expected to recover next year, but would still be well below the previous peak in 1974.



[a] 1976 and 1977 figures are taken from the Department of Industry's investment intentions survey.

sector borrowing requirement — the strategy defined by Chancellor of the Exchequer Denis Healey in his speech laying out the conditions of the IMF loan in December to restrict the growth of the money supply — and financing industrial investment, the government last week informed the markets through the Bank of England that they were "not amused" with recent trends and promptly severed the automatic link between the Minimum Lending Rate (MLR) and gilt sales.

What prompted the Bank of England's decision was the overwhelming demand for gilts — £1.45 billion worth of bills were applied for on Friday, Feb. 4, with only £300 million on offer — a situation which normally acts as a trigger to lower the MLR. Despite the high cost of loans to industry, the government has refused to lower the MLR to the levels demanded by the market, in an attempt to stem the sale of gilts through depressing buyer expectation of a continued fall in interest rates. However, the MLR has fallen from its all-time high of 15 per cent in December to 12 per cent by Feb. 4.

To compensate for the squeeze on bank liquidity which the gilt sales have caused, the Bank of England has released a total of £1.460 billion to the banks in the last month, £1.1 billion in mid-January, and a further £360 million during the last week of January. Even so, very little bank lending to industry has gone for investment since end-of-year bank advances traditionally go toward providing for tax payments.

Industrial Profiles

One of the key growth sectors for the British economy is North Sea oil and gas development — a fact that is well reflected in the government's energy policy. With the fifth round of licenses for oil exploration in the North Sea,

U.K. Major Economic Indicators

1976	(Million Pounds) Consumer Expenditure (1970 prices, seas. adj.)	Production of Chemicals & Allied Industries (1970 = 100)	Production of Auto (thousands of units)	Production of Crude Steel (thousands of tons)	Money Supply M-1 (seas. adjusted)	Money Supply M-3 (seas. adjusted)
Jan		121	96.4	392	- 48	+399
Feb		124	119.8	450	+620	+572
Mar I	8,866	127	142.6	451	+140	+196
Apr		126	92.7	462	+340	+537
May		126	127.2	469	- 8	+238
June II	8,789	128	129.5	433	-174	+246
July		125	90.7	367	+545	+841
Aug		126	64.8	373	+352	+707
Sept III	8,928	132	98.2	430	+406	+989
Oct		127	109.0	458	-334	+534
Nov			110.0	487	+202	+169
Dec IV	8,955		96.0	376		

U.K. Trade By Major Areas

(MILLIONS OF POUNDS STERLING)

	EEC		U.S.		OPEC		EAST BLOC		THIRD WORLD	
	EXP.	IMP.	EXP.	IMP.	EXP.	IMP.	EXP.	IMP.	EXP.	IMP.
1973	4,034									
1974	5,516	7,712	1,771	2,257	1,210	3,794	514.7	741.9	2,380.0	2,581.0
1975	6,419	8,804	1,789	2,351	2,278	3,274	655.9	752.8	2,923.0	2,615.0
1976 I	1,970	2,504	534.7	685.8	684.4	974.3	175.4	243.4	826.4	753.6
II	2,251	2,876	614.5	744.8	763.2	998.9	189.0	309.2	829.9	925.8
III	2,332	2,716	645.1	746.0	781.3	1106.1	175.2	280.9	804.3	902.8

British Energy Minister Tony Benn made it clear that the government intends to take primary responsibility for the development of their oil and gas resources, and has refused to award licenses to those companies — Exxon and Aramco specifically — which have refused to agree to the government's 51 per cent option to buy up North Sea oil. As part of the fifth round, the British National Oil Corporation will, for the first time, take major responsibility for developing new fields, instead of merely participating in established consortia.

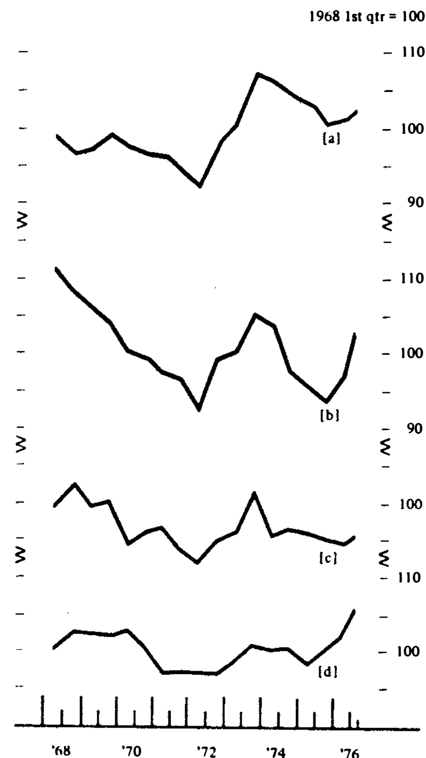
Strong support for the government's stated intention to use North Sea revenues (estimated to total £5.5 billion by 1980 and average £3.4 billion a year in the early 1980s) to promote industrial recovery has already come from British Petroleum whose shares are 61 percent owned by the British government. Announcing the doubling of BP's five-year investment program to £2.7 billion, BP chairman David Steel stressed that the program "will make a major contribution not only locally in terms of jobs, but also to the health and continuing development of the national economy."

The major sectors of British industry have been taking advantage of the fall of the pound during the fall months to boost their export share. In chemicals, exports were up 3.2 per cent, from £281 million to £290 million from November to December, while at the same time imports fell by £8 million to £185 million. However, the increase of 10 per cent expected in chemical output for 1976 did not materialize largely due to low domestic demand. Projections for growth in 1977 have been cut back from 8.5 per cent to 5 per cent. However, despite the high interest rates, the industry as a whole is attempting to maintain its existing capital programs, and it is expected that there will be an increase in the volume of investment in 1977 over 1976.

Similarly with auto, exports of motor vehicles were up by 50 percent in November; cars contributed heavily to this increase with exports growing by 87 percent. Car production rose only marginally last year, by 5 per cent to 1,334,000 units, while commercial vehicle manufacture, usually considered the strong sector of the industry in Britain, fell by 3 per cent to 370,700 units. Productivity

Price ratios relevant to UK export performance

The depreciation of sterling this year has sharply improved the relative profitability of exporting and the cost-competitiveness of UK industry.



[a] Ratio of competitors' export prices of manufactures to those of the United Kingdom (in dollar terms); partly estimated.

[b] Ratio of competitors' unit labour costs in manufacturing to those of the United Kingdom (in dollar terms); partly estimated.

[c] Finished manufactures: ratio of UK import prices to UK export prices.

[d] Manufactures: ratio of UK export prices to UK wholesale prices.

rose by three per cent, however, despite massive layoffs throughout the industry. Chrysler, for example lost 9,000 workers, almost a third of their workforce, while British Leyland cut back even more.

Unable to capitalize on the fall of the pound directly, the British Steel Corporation has carried the cheap British exports situation one step further by announcing a cut of 6 per cent in prices of hot rolled coil and sheet, specifically to undercut foreign rivals, Similarly, BSC will be increasing its stocks 800,000 to one million tons, despite recent cutbacks of 15,000 tons a week, to be able to ensure adequate supplies for orders. BSC is undertaking discussions with the government on the possibility of closing several old and inefficient steelworks to concentrate on newer works being built in other parts of the country.

Government Strategy

The Callaghan government unveiled the spearhead of its economic strategy at a meeting of the National Economic Development Council Feb. 2 which outlined proposals which promise to boost British exports by as much as £36 billion by 1980. Describing the government's proposals as "frankly experimental," Chancellor of the Exchequer Denis Healey and Industry Secretary Eric Varley laid out a program which highlights five industrial sectors for immediate development and stresses the need for increased financial and political aid to other companies to boost their exports.

Named for immediate attention were industrial engines, construction equipment, office machinery, electronic components and domestic electrical appliances on the grounds that 1) these sectors are central to export health; 2) these sectors represent world leaders in their markets and have expresse Britain'sness to expand their market performance; and 3) these are the sectors in which the government can most immediately contribute to industrial growth.

Major responsibility for implementing the government's industrial strategy is being given to the National Enterprise Board to undertake discussions with targetted companies on future investment and organizational plans. The NEB was formed in 1975 with powers to buy up troubled industries and provide financial assistance to firms considered to be critical for national economic health. Already the NEB has announced it will form a government-backed consortium for computer industry to coordinate export and product development projects for participating companies (still to be announced).

Franc Stabilized With Arab Support; Credit Crisis Looms In 1977

FRANCE

The French government has bought precious time for the national economy over the fourth quarter of 1976 and early 1977 by winning the support of its Arab trading partners in stopping the rout of the French franc on the international money markets. The political backdrop to this temporary success is the turnabout in French policy under the direction of Prime Minister Raymond Barre, who has repeatedly stated that French policy would be brought back into alignment with traditional Gaullist calls for expanded trade with the socialist sector and the Third World and for the creation of a gold-backed international monetary system. Arab receptivity to this shift has been expressed in promises of increased investment in French industry through the negotiation of trade deals and in the influx of Arab capital into French money markets. This critical margin of Arab money has played the largest part in stabilizing the franc and taking the immediate pressure off the national economy created by a collapsing currency.

French President Giscard d'Estaing's Jan. 22-26 trip to Saudi Arabia gave some indication of the levels of Arab capital accessible to the French economy. At that time, $3 billion in Saudi financing for the Egyptian-based Arab Military Industry Organization, to be constructed through joint British-French efforts, was firmed up, as well as a 3.5 billion franc housing construction contract. Rumors that the Saudis would also offer France a $5 billion loan to finance expanded trade continue to be circulated by some of Wall Street's leading oil analysts. Simultaneous with these trade-related initiatives, the Arabs have intervened on the international money markets to back the French currency. *Business Week* magazine reported in January that French banks have doubled their intake of Arab "hot money" short-term petrodollar accounts at the rate of $8 billion in new deposits in the last nine months of 1976. At the same time, Arab money has flowed into French government and corporate bonds on a large scale.

The 11 percent depreciation in the effective exchange rate of the French franc during 1976 was a continual source of inflation, resulting in a big jump in the cost of imported raw materials, and accounting for much of France's record 20.5 billion franc trade deficit. By successfully stabilizing the franc, the government has given a temporary boost to business confidence, expressed in a slight upturn of the stock market from its 1976 nadir levels, a 2.4 percent rise in industrial production in November, and a decline in unemployment from 1,041,000 in November to 1,036,900 in December. Significantly, the government was able to let up on its tight credit policies — resulting in a sharp decline of the key call money (interbank) rate from 10.25 to 9.75 percent at the end of January — since defense of the franc no longer requires as high interest rates. The declining call money rate decreases the cost of acquiring short-term