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CURRENT ECONOMIC CONDITIONS BY DISTRICT

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Federal Open Market Committee
by the Staff

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SUMMARY

The reports in this Redbook are more optimistic than in earlier months. The consensus of directors, businessmen, bankers, and economists is that the economy will experience below potential growth in real output in the second half of 1970 and early 1971. There is general agreement that wage demands are not diminishing, despite an easing in labor markets and prospects for further increases in unemployment. Concern about inflation remains widespread, and the directors at one Reserve bank explicitly express the hope that the FOMC would permit only moderate growth in the money and credit aggregates over the near term.

Housing and consumer durables, especially household goods, are evidently recovering, but the capital goods sector is sluggish. Indications are that the metalworking machinery industry has not yet seen the bottom of its recent decline. Districts in which machine tool producers are concentrated (Boston, Cleveland, and Chicago) specifically mention depressed conditions in that industry.
Six Reserve banks referred to the impact of cutbacks in defense and aerospace industries.

There are reports of selective price cutting at both the retail and the wholesale level and indications that price increases are becoming less prevalent. Cleveland reports price reductions in metal cutting machine tools and appliances; Minneapolis cites large price discounts to dealers by farm machinery producers; and Atlanta notes price weakening in some types of textile machinery. Philadelphia expresses concern about the likely effect of the corn blight on agricultural

prices, but Chicago reports that the damage caused by the blight may have been exaggerated.

Four Reserve banks specifically mention the improved liquidity positions of commercial banks in recent weeks. There are also reports of improved loan to deposit ratios and deposit flows, some limited softening in the demand for business loans, and scattered reports that borrowers are expecting lower interest rates in the months ahead.

FIRST DISTRICT - BOSTON

Commercial banking conditions in the First District continue to strengthen, and a marked improvement in general confidence seems to have established itself throughout the financial sector of New England. Retail and industrial sales activity can almost uniformly be characterized as mediocre, with prospects for more of the same over the next several months now widely accepted. One trend of interest: housing-related products seem to be picking up after several months of depressed sales.

Deposit flows into commercial banks are developing along very satisfactory lines. One of our Class A directors reports that his institution has had too much out in Federal funds and short-term municipals for several weeks now and would prefer to put these funds into business or consumer loans if the demand were there. Another of our Class A directors reports all time record percentage rates of dividend retention on passbook savings for two successive quarters now. Loan deposit ratios have fallen substantially at some commercial banks and most seem to be experiencing an improvement in liability composition. Commercial loan demand appears to be holding quite steady and in some instances falling off.

Regional industry, as noted above, is experiencing generally slow, but not depressed levels of activity. The impression is gained that small companies in particular are encountering difficulty in keeping more than three to six months of orders on their books. Exceptions may be noted, however. The heavy concentration of jewelry manufacturers in southern Massachusetts and northern Rhode Island report that 1970 sales levels to date are brisk. The textile industry, concentrated in the same area, has experienced a dramatic increase in demand for products associated with home sewing, reflecting the heightened consumer cost consciousness noted elsewhere this year. The New England machine tool industry, on the other hand, continues in a severely depressed situation with no letup in sight.

Several regional producers of chemical and mineral inputs into housing associated products (e.g., paints, carpets, linoleum, etc.) now discern a turnaround in demand as having occurred four to eight weeks ago. Regional labor markets, as noted in earlier reports, are softer than they have been for some years. This easing apparently extends into both blue- and white-collar groups.

The views of our academic consultants have perhaps converged some since earlier in the summer. Professor Paul Samuelson feels certain that the economic turnaround is behind us, and that the slowdown has been sufficiently mild that it will escape official NBER designation as a "recession." As a weak contraction tends to be followed by a sluggish expansion, Samuelson expressed concern that the existent real GNP gap will widen further over the next four quarters. Since a growth in real output of about 4 percent is necessary to avoid this, he concludes that authorities should permit a monetary expansion great enough to accommodate such growth. Noting that income velocity is likely to decline as short rates fall and as liquidity positions are replenished, Samuelson suggested that a 7 to 8 percent rate of monetary expansion is necessary to encourage any real output growth. He concluded by asserting that a continuation of the current mildly restrictive policy would buy very little extra in the way of inflation control and, therefore, is a poor trade-off against growth and employment needs.

Professor Tobin is in large part in agreement with Samuelson and suggested that the Fed should, for the time being, ignore any growth rate for targets for money stock, concentrating instead on promoting a reserve base expansion large enough to bring interest rates down. On the prospects for unemployment over the next year, Tobin is more bearish than Samuelson, suggesting they might well pass the 6 percent level.

Professor Wallich, too, sees growth in real output as sluggish well into 1971, but views this prospect with somewhat less alarm, suggesting that it is the most desirable course to pursue. On monetary policy, he defines a 4 to 6 percent growth of money supply as currently appropriate, and expressed hopes that short rates will continue to ease. He feels that the System can currently exert no control over long rates and that to try to bring them down with strong monetary medicine would place us in serious danger of repeating our 1967 mistake.

Otto Eckstein is, in many ways, currently the most sanguine of our academicians. He still projects an unemployment rate of no more than 5.1 percent through the end of 1971. He agrees, however, that a declining utilization of our real GNP potential should be avoided and appears to endorse a somewhat less restrictive monetary stance than we now have. His DRI model currently forecasts declines in investment over 1971 of a small enough magnitude (3 percent nominal, 8 percent real) that the expected rebound in housing can easily offset them.

SECOND DISTRICT - NEW YORK

Opinions were mixed among Federal Reserve bank directors and business leaders regarding current and prospective capital outlays, consumer spending, and the labor situation. In general, the assessment was: no recent cuts in, but careful watching of, capital spending; unchanged or improved consumer attitudes; and a rise in the availability of labor but no curtailment in union wage demands.

The president of an upstate bank saw no evidence of a slowdown in capital spending in his area; he referred to the difficulty recently experienced by his bank in finding a contractor for the construction of a new branch. A Rochester businessman stated that he had not heard of any plant construction programs being cancelled in his locality. He did note, however, that the largest corporation in the city had stopped building vigorously in the area because of labor market conditions and has shifted parts of its operations to Denver, Colorado. A group of business leaders generally indicated that a very careful watch on capital spending was being maintained in their industries and that their efforts were concentrated on modernization, replacement, and pollution control rather than on expansion.

Sentiment with respect to consumer spending was particularly mixed, with some interesting expressions of optimism. One upstate businessman reported that retail merchants in his area were gearing their inventories to expectations of lower volume and did not anticipate a general improvement until the yearend holiday season.

The president of an upstate bank felt that while sales continued to be good, a good deal of the rise in the dollar amount was due to price increases. He noted that lower priced cars were apparently moving well, but that the sale of more expensive cars, as well as luxury items in general, have suffered.

The chairman of a large medium-priced retail chain also felt that the continued rise in dollar volume was largely accounted for by price increases, as well as the opening of new stores. He also indicated that the weakest spots remained in the bigger ticket and higher priced items. However, while he could not point to a change in consumers' buying habits on the basis of currently available ''hard'' figures, his ''gut reaction'' was that consumer confidence had improved significantly over the past month as uncertainties over Cambodia, the stock market, and the liquidity situation abated. He expressed a ''subjective'' inclination to see this change translated into an improved sales picture in the near future.

The president of a large New York City department store was even more optimistic. On the basis of very recent developments, he felt that there had been a ''definite turn for the better,'' and that he looked with confidence for further pick-up in the coming months. He reported a particularly marked increase in the sale of household goods, which he attributed to a combination of pent-up demand and improved consumer confidence.

With respect to the labor market conditions, both the Rochester businessman and the upstate banker noted an increase in the availability of labor in their area. Notwithstanding the increased availability of labor, the Rochester businessman stated that there had been ''no easing whatsoever'' in union demands. The chairman of the large retail chain remarked that increased labor costs had made price reductions very difficult.

One director concentrated on the aerospace industry. He noted that 500,000 workers were laid off in that industry in the past year and that another 500,000 might also be laid off by next July. He attributed these difficulties to the tough Government attitude toward defense spending. He said that if Penn Central could go into bankruptcy, it was possible that Lockheed and other aerospace firms might be forced into a similar situation. In his view, the airline industry may be unable to pick up present commitments for new aircraft unless the Government permitted some mergers. He said that airlines needed a high utilization rate to be profitable and that, in some cases, this was only possible through merger. He commented on the tremendous amount of excess capital in the aerospace industry.

THIRD DISTRICT - PHILADELPHIA

Confusion is the most prevalent mood in the Third District. On the one hand, bankers, businessmen, and directors hear optimistic pronouncements from economists and Government officials that the economy is poised for an upturn and that inflation is waning. On the other hand, from their own vantage point, they foresee a sluggish consumer, further cutbacks in plant and equipment outlays, rising unemployment, and wage demands that are intensifying rather than abating.

Large merchants in the Philadelphia area remain pessimistic about sales. Despite talk from economists that a resurgence in consumer spending is near, regional retailers remain unconvinced. They plan further cutbacks in inventories and are holding new orders to a minimum. Retailers expect Christmas sales to be off considerably. One large department store has hired no one for several months, eliminating all overtime, and plans much smaller payrolls than usual for the holiday season.

Reports from manufacturers are bearish as well. Demand in the paper industry is at a low for the year, according to one director. Earlier forecasts of an autumn recovery have been delayed until 1971. The same is true for the clothing industry in the District. Elsewhere in manufacturing, the general feeling is that demand will remain soft. There is near unanimity in the view that capital expenditure plans will be trimmed further and that outlays for 1971 will show no increase from 1970.

Despite prospects of rising unemployment, businessmen believe that large wage settlements will continue to push prices up. In addition, there is concern that the corn blight eliminates the hope of sustained relief from rising food prices. So there is very little acceptance of the view that the fight against inflation is about to be won or that it is even going particularly well.

In a more general vein, several directors expressed the opinion that there is too much "grasping at straws" in the optimistic interpretation of recent economic data by Government spokesmen. Demand statistics are not as bullish and price data are not as encouraging as portrayed, say some board members.

FOURTH DISTRICT - CLEVELAND

Signs of recovery in the District's economy are becoming more numerous, although there is still weakness in the capital goods area, especially machine tools. Our directors remain concerned about inflation and hope that the Fed will permit only moderate growth in the money and credit aggregates over the near term.

Nonfarm payroll employment in the District rose in July, following declines in the three preceding months. The regional index of manufacturing output, which began to recover in June, rose sharply in July, largely due to gains in rubber, machinery, and primary and fabricated metals. Steel production, although stronger in the District than in the nation, appears to have risen less than seasonally in August. During the latter half of August, the District's insured unemployment rate, on a seasonally adjusted basis, was down significantly (by 0.4 percent) from the July average. Both residential and nonresidential construction contracts seem to be in recovery phases.

At a meeting of our Cincinnati branch directors on September 8, a director associated with a large electrical firm reported improvements in the firm's consumer-related products, but continued sluggishness in sales to heavy industry. The appliance industry is picking up slowly, but there has been considerable price cutting to reduce excessive inventories at both the manufacturing and retail levels. Bank directors report a considerable improvement in liquidity in recent weeks.

The directors of our Pittsburgh branch, at a meeting held in late August, expressed strong feelings that controlling inflation should have top priority for the Federal Reserve System in determining the proper course of monetary policy. One director, a professional economist, views the economy as being in ''an underemployment equilibrium''-a situation that he views as desirable to correct inflation. An industrialist director placed great importance on improving productivity in both the manufacturing and services industries. He is concerned that the growing importance of services in the economy may build inefficiencies into the system unless strenuous efforts are made to improve productivity in that area. Another director expressed a strongly held view that Treasury projections of receipts from income taxes in fiscal 1971 are unrealistic, particularly corporate taxes, which he believes are grossly overestimated by not taking account of large increases in pre-tax costs in recent years.

Last month, a major machine tool company in Cleveland sparked a wave of price reductions in the metal cutting section of the machine tool industry. The price reductions took the form of substantial increases in official discounts by manufacturers to their distributors, through whom most of the industry's products are sold. The spokesman for the company stated that the metalworking machinery industry will continue for many months to feel the impact of cutbacks in defense industries, particularly aircraft, which is an important user of machine tools. Commercial aircraft production, which is also weakening, will have a similar effect. These and other weaknesses in the demand for metalworking machinery stemming from capital goods producers are not expected to be offset in the near term by the expected recovery in the consumer durable goods sector.

FIFTH DISTRICT - RICHMOND

Surveys of businessmen and bankers in the Fifth District indicate general agreement on the following points: (1) increased shipments, volume of new orders, and backlogs of orders in manufacturing; (2) considerable improvement in retail sales, except for automobiles; (3) increased inventories in manufacturing, trade, and services, and excessive levels of inventories in manufacturing; (4) continued weakness in employment; (5) increased upward pressure on wages; (6) some improvement in the demand for business and consumer loans but weakened demand for mortgage loans; and (7) definite improvement in the optimism of respondents regarding future business prospects.

District manufacturers report shipments still slightly down on balance, but considerably improved from the last several months. An improvement noted last month in volume of new orders and backlogs of orders continued with the September report. Reports of improvement have come from manufacturers in building materials, electrical equipment, coal, fabricated metal products, and synthetic fibers. Numerous important producers in cotton textiles and furniture, however, report continued slow activity.

Retail sales are reported substantially improved for the first time in several months by businessmen in trade and services and by bankers. Automobile sales apparently have remained about unchanged from last month's report, which was one of considerable improvement.

Manufacturers report inventories have increased during the past month, and most of them continue to feel that inventory levels are higher than they prefer. Retailers' inventories are reported to have increased also, but retailers apparently do not feel that current levels are too high.

Employment declines continue to be reported by manufacturers in electrical equipment, metals, and furniture. The length of the workweek in manufacturing is also reported down. Retailers report some increase in employment and hours worked, but on balance the District employment situation remains weak. Reports of increasing unemployment continue, although District bankers report some decline in the supplies of available labor compared to reports of the past four months.

Price increases are reported by some manufacturers in fabricated metal items, electrical equipment, and coal. Price declines are reported by one manufacturer of cotton textiles. Reports of price increases by businessmen in retail trade and services are fewer than in recent months. Upward pressure on wages continues, however, in furniture and metals as well as in textiles, where annual wage increases are currently being awarded. Wage increases in retailing and freight transportation are also reported.

Last month's modest improvement in residential construction activity apparently has subsided. The only area of the District where respondents report increased residential building is Baltimore. Nonresidential building remains on the increase, however, following the pickup reported in August. Some respondents expressed the view that further improvement in both categories of construction is ahead.

Slight improvement is reported in the demand for loans by businesses and consumers. Demand for mortgage loans in the District, however, has tapered considerably from the improved levels of May through July.

The number of respondents reporting that they expect improvement in general economic activity increased sharply in the September survey, and a tone of optimism is present among respondents for the first time during the current year. Some respondents cautioned, however, that they believe recovery will be slow.

Manufacturers in the District continued to feel that their plant and equipment capacity is in excess of current needs. Reluctance to cut back planned capital expansions, however, has been typical of District businessmen. Some intentions to cut back were voiced last month, but apparently most manufacturers now feel that further reductions are not necessary.

Manufacturers in synthetic fibers, hosiery, cotton textiles, furniture, and fabricated metals continue to report inventories higher than desired, particularly in finished goods. This condition has been typical of District manufacturers for several months, and efforts to cut back inventories apparently are still being made.

SIXTH DISTRICT - ATLANTA

The consensus of directors, bankers, and businessmen contacted is that the moderate economic slowdown in the Southeast has run its course but that inflationary expectations are deeply imbedded and that recovery of spending and production will be sluggish. High unemployment areas were also surveyed-those experiencing a gradual increase in economic activity but suffering from persistent structural unemployment and those affected by factors such as aerospace layoffs. Areas experiencing structural unemployment foresee no early end to their difficulties.

Reports about the textile industry indicate that, with some exceptions, employment and production may be stabilizing after a decline. One industry executive described the industry as ''trying to bounce off the bottom.'' The same official reported that some types of textile machines have been offered at very attractive prices, while the demand for other types of machines, such as those used to make double knits and texturing, remains strong. Carpet manufacturing is also anticipated to expand in the near future.

The mobile home industry provides another example of an industry where employment and production seem to have bottomed out, attributed by one banker to a relaxation of tight money. In addition, a large auto assembly plant in the Atlanta area has added 500 workers to its lines. Appliance and furniture manufacturers in east Tennessee are encouraged by recent increases in orders.

However, there are indications that business is still lagging and that recovery will be slow. Directors and bankers from central and east Tennessee are pessimistic about significant improvement in business activity and expect unemployment to increase in the coming months. In two other states, telephone revenues have been rising less rapidly this year and the company continues austerity programs. Auto sales in the Atlanta area have slumped again after strengthening in June and July. A distributor of prestige men's clothing for the Southeast reported that some stores have eliminated a fall line of sport clothes, moving immediately into their normal winter lines. A rug producer stated that, while he expected an increase in sales, he was counting on an increase in productivity rather than an expansion of his labor force. Aluminum producers do not anticipate recalls of laid-off workers in coming months.

There has been only a slight dampening of inflationary expectations. Businessmen are nearly universal in their fears of steep wage increases. Unacceptable high wage demands are prolonging strikes that stymie major construction in Atlanta and Knoxville. In the past month, several District newspapers have carried editorials bemoaning the inflation problem. An average 23-percent increase in TVA electricity rates will be adding to cost pressures in the northwest sections of the District.

A telephone survey of areas experiencing high unemployment indicates they fall in two categories: rural, agricultural areas experiencing a gradual improvement in their industrial bases but suffering chronic unemployment and those affected by factors such as layoffs in the aerospace industry. Those in the first category see no early end to their persistent unemployment, yet nearly all described their economies as progressing normally. Negroes make up a relatively large portion of population in these areas. Among those areas affected by aerospace layoffs, Huntsville, Alabama, and Marietta, Georgia, are experiencing little difficulty adjusting, while the Cape Kennedy economy continues to drift in a vacuum. Although the Cape Kennedy layoffs have slowed, there has been no substantial influx of industry or retirees to fill the void. A deterioration in labor markets elsewhere has slowed out-migration from the Cape, yet much vacant housing remains. On the other hand, the Mississippi Gulf Coast area, where unemployment has been high, is expecting a surge of economic activity because of a large destroyer contract and accelerated rebuilding in the wake of Hurricane Camille.

SEVENTH DISTRICT - CHICAGO

The almost universal view among informed observers in the Seventh District is that only a very slight rise in real activity is likely through the remainder of the year. Businesses, consumers, and local governments continue to show caution in current spending and in making new commitments. Some industry analysts think that equipment output will continue to decline, perhaps reaching a trough in the second quarter of next year. The rate of price rise for finished manufactured goods appears to have been maintained. Labor markets continue to ease in almost all areas and lines of activity. Residential construction is headed up again, but most of the improvement is expected in multi-family units.

The great uncertainty, of course, is the possibility of a long strike in the auto industry. Those who follow the industry think it likely that negotiations will continue by mutual consent without a work stoppage beyond the September 14 deadline. The UAW is talking with General Motors and Chrysler, with the indication that one or the other will be the target if a strike is called. This development spotlights the limited weight that should be placed on ''informed opinions.'' Some knowledgeable people had been virtually certain that Ford would be the target again because ''G.M. is too strong, and Chrysler is too weak.''

Production is proceeding very rapidly on 1971 models, especially the new small cars. Important components of the new small cars—engine, transmissions, etc.—are being made in England and Germany, and some cars are being made in Canada. Therefore, if sales of the new small cars are strong, as expected, the beneficial effect—both on the balance of payments and on U. S. employment—will be limited.

Merchants find that consumers are continuing to "trade down" both hard and soft goods and are cautious in incurring instalment debt.

Sales of trucks and trailers recovered after the truck strike that ended in the Chicago area in early July, but the improvement was less than had been expected. Demand for trailers is not expected to revive until next spring.

Sales of farm and construction machinery have failed (by a wide margin in some cases) to meet expectations. New orders for machine tools are reported by one producer to be the "worst since the Thirties." This may be an exaggeration, but it characterizes the pessimistic mood of many equipment manufacturers. But sales of some types of equipment—associated with electric power generation, air conditioning, mining, and data processing—have remained relatively strong. New orders for a variety of capital goods components have improved slightly in recent months after a sharp decline in the first half. Despite the general pessimism, most equipment producers are convinced that many orders hang in abeyance awaiting a clarification of the business outlook.

A number of manufacturers who have reduced output report that inventories, both of purchased materials and end products, are at desired levels. An appreciable pickup of sales would require additional output to keep pipelines full.

Steel firms in this area are losing the export business that they obtained in the past year. Mill inventories are being maintained to fill domestic orders rapidly as required by close competition. With steel a notable exception, delivery schedules have not improved as much as in past years when excess capacity became general. Partly, this is because producers prefer to accumulate sufficient orders to permit economical runs of particular products and partly because of reductions in staff and other economies on the part of suppliers.

The Chicago-Gary steel area has an ample labor supply for the first time in about five years. Only special skills are hired currently.

Despite the rise in unemployment in all areas, employers continue to complain of the low quality of job applicants, absenteeism, ''poor attitudes,'' and related factors that hamper efficiency. Experienced workers with clerical, mechanical, and professional skills are still in demand, and less desired positions in restaurants, hospitals, laundries, dry cleaning, and commission sales remain unfilled.

Vacancy rates for housing units in the Chicago area have increased somewhat. Rents on apartments appear to have stopped rising. Doubtless, these developments are related to increased unemployment. Office space also has become more available. In view of the tremendous volume of office space scheduled to come on the market in downtown Chicago in the next few years, fears are expressed that the area will be overbuilt. We have no evidence, however, of cancellations or postponements of plans for construction of large new buildings—some very large indeed.

A reliable assessment of the damage caused by the corn blight is not available. Infestation is scattered geographically and the degree of damage varies widely, even within the same fields. Recent field reports, however, indicate a much smaller loss than had been feared—perhaps well under 10 percent of the crop. Moreover, carryover supplies of corn from previous harvests and large supplies of other grains assure ample feed for increased livestock production. Small seed corn companies are adversely affected because they concentrate on varieties that are susceptible to corn blight. Some of the larger seed companies are said to possess varieties of seed that are resistant, but the available quantity of such seed is not known.

EIGHTH DISTRICT - ST. LOUIS

A few scattered signs of improvement in economic conditions are apparent in the Eighth District, but pessimism is still the prevailing mood. Some major retail establishments report minor sales gains on a seasonally adjusted basis. Long-run investment plans are being revised downward in a few cases. Few firms are planning employment layoffs, but with the impending automobile strike and normal attrition, some further increase in unemployment is expected. Residential construction continues at a very low level, while apartment and office buildings are still being constructed at only a moderate pace. Farm commodity prices have declined sharply in recent weeks and during the remaining months of the year are likely to remain lower than average prices since January.

Retail sales have apparently increased slightly throughout most of the District in recent weeks. Major retail establishments in both St. Louis and Memphis report some gains in August on a seasonally adjusted basis. Likewise, one large St. Louis chain with numerous stores in outlying areas reports sales increases in the smaller cities and towns.

Major manufacturing industries still indicate little change in long-run expansion plans. Some manufacturing plants have been closed, but expansion continues in retail establishments, especially the discount type. There has also in recent weeks been some increase in inquiries relative to plant location sites in the St. Louis area.

There is little prospect for an increase in Eighth District employment in the near future. The larger manufacturing firms report little hiring and few layoffs, which implies a reduction in the work force through attrition. Expected employment gains in retail trade will likely be offset by some reduction of workers in the manufacturing sector. Defense employment in the District continues to decline corresponding with the national trend. Overall, the employment situation points to some further increase in the unemployment rate.

Business profits in the area continue on the weak side with little prospect for early improvement.

Residential construction is reported at a relatively low level throughout the District and is described as ''very low'' in St. Louis. Potential home purchasers appear to be switching their demand to apartments and mobile homes, at least temporarily. Apartment and office building construction continues at a moderate level. Applications for apartment rentals are reported to be most active in the low to medium price range. High interest rates, greater labor costs, and outdated building codes are being blamed for the reduced level of home construction.

Some banks report increased liquidity. One bank in the District, with $45 million of deposits, lowered its prime rate to 7 1/2 percent last week. Consumer loan demand at commercial banks is up, especially in Arkansas, where finance companies have been leaving the state.

Farm commodity prices have declined sharply during the past month, pointing to lower food prices and reduced farm incomes in the months ahead. Lower meat prices are in prospect for the rest of the year, compared with levels a year ago and earlier this year, but grain prices average somewhat higher, reflecting the impact of the southern corn leaf blight on production. Eventually, if grain supplies are reduced substantially, they will have an upward impact on livestock and meat prices.

NINTH DISTRICT - MINNEAPOLIS

Economic conditions in the Ninth Federal Reserve District continued weak through July and August. Primarily as a result of increasing unemployment nationwide, there appears to have been some back-migration to the rural areas and smaller towns of the District. Retailers in the District have become more optimistic in their six-month sales forecasts, but District manufacturers have revised their anticipations downward. Retail price increases are becoming less prevalent than they were earlier this year, but industrial price increases show no signs of abating.

Increasing rates of unemployment in urban centers nationwide are resulting in some movement back to rural areas and small towns in the District. Bank directors felt that more people would be coming back if there were suitable job opportunities not necessarily at the same skill or pay levels. It is interesting to note, however, that some of the directors felt that this reverse migration, although largely caused by lack of urban job opportunities is also the result of a growing disenchantment with urban conditions. For example, one director cited the case of Billings, Montana, school system which received 1,200 teaching applications this year, many from experienced teachers in eastern cities.

Directors and officers of this bank, with some exceptions, felt that retailers are becoming more optimistic in their sales outlooks for the rest of the year. Reasons given for this optimism included such things as the recent signs that the slowdown nationwide may have bottomed out and the fact that people are not as uncertain about their employment status as they were a few months ago.

Some of the directors, however, cited cases where retailers were not anticipating sales increases through the rest of the year. One director, from his observations of retailers in the Twin Cities, felt that they were becoming more conservative in their outlooks over the next year than they had been six months ago. Directors from agricultural sections of the District observed that retailer's outlooks were generally favorable, but that there was some concern about sales because of recent sharp drops in livestock prices and lower crop yields in some areas due to a lack of moisture.

In contrast to the generally brighter retail sales outlook, District manufacturers do not expect any significant recovery in sales over the next six months. Respondents to our quarterly industrial expectations survey taken around the first of August revised their previous expectations downward. Sales in the current quarter are now expected to be only 2 percent greater than a year ago before rising in the next two quarters to about 4 percent above year-earlier levels. This finding is consistent with observations by this bank's directors. One case was cited in which a farm implement manufacturer, apparently overstocked with certain types of machinery, was offering large dealer discounts in order to move this machinery out of inventory. Another director felt that capital goods producers had been hurt by the recent cutbacks in plant and equipment expenditures.

There are some indications that price increases at the retail level are becoming less prevalent than they were a few months ago. One director felt that although settlement of the recent teamsters' strike has resulted in some upward price adjustments, retailers are trying to cut down inventories by reducing prices. For example, boat sales were down this year, and dealers are selling them at only slightly above cost. Dry goods prices have remained essentially flat over the last few months, and increased competition from suppliers has held down price increases in men's wear. There is some indication that wholesale prices of men's suits have risen slightly in the last month or so, but retailers are shaving their margins in order to maintain prices.

The directors felt, however, that industrial price increases have not become less prevalent or less frequent than they were six months ago. With the exception of some price cutting to lower kinds of farm equipment inventories, the directors were not aware of any cases where industrial prices have been reduced. Moreover, they felt that industrial suppliers are still making across-the-board increases: U. S. Steel has announced a 5-percent increase for steel used in construction effective on November 16. This is essentially the same rate of increase posted on January 1 of this year, and it appears that other steel companies will follow U. S. Steel's lead. At the beginning of next year, the price of cement used in construction is also scheduled to rise about 5 percent, much the same as it did at the beginning of this year. In addition, users of foundry products recently faced a 6-percent across-the-board price increase.

TENTH DISTRICT - KANSAS CITY

Business and economic conditions remain reasonably firm across most of the Tenth District. Reporters generally stress the volume of construction in several of the large cities and the steady trend in total employment. In general, agriculture is experiencing a fairly good year, although there are a number of areas with moisture deficiency. The exceptions to this generally favorable appraisal of the District's economy continue to be Wichita, where aircraft production is down substantially, and Kansas City, which has been plagued by a long construction strike.

In Kansas City, that strike appears to have reached an end with the agreement this week to a four-year contract by one of the striking unions and the builders association. Negotiations with four other unions continue, and the outlook for settlement is hopeful. The agreement with the common laborers union is strongly inflationary, involving an overall increase of $4.15 per hour over a four-year period. Thus, laborers who have been receiving $4.02 per hour will receive $8.16 per hour by 1973. The first year increase is $1.00 per hour.

Settlement of the strike in Kansas City will bring a renewal of construction and a new tempo in the local economy. A major strike in the auto industry, however, would prolong depressed conditions in Kansas City. For the longer run, the impact of the inflationary construction settlement is uncertain at this time, but is probably adverse to new construction.

Loan demand at District banks has eased somewhat, but continues strong. However, there is scattered evidence that demand is turning weak in some places. For example, a large Denver bank reports it has had requests from other banks to purchase loans, including requests for $1 million purchases. Not much change in loan demand is expected during the fall if interest rates stay at current levels. There are indications, however, that some customers are waiting for lower rates and that a reduction in the prime rate could result in an increase in loan demand.

Deposit experience in different cities has been mixed depending upon the activity of larger banks in seeking CD's. The suspension of ceilings on CD's of under 90 days maturity has enabled several of the larger banks to attract substantial amounts of funds. Some other banks report that their CD growth would be more significant if the minimum size for large CD's were reduced to $50,000.

Despite the growth of CD's, bank-related issues of commercial paper have remained substantially unchanged. The extension of reserve requirements to commercial paper will not produce initially a significant reduction in the amount outstanding. A couple of banks were vigorous in their protests of the application of reserve requirements to outstanding commercial paper issues, since the interest costs on such paper are fixed and the reserve requirements effectively increase the cost. Most of the banks will continue to issue some commercial paper because of its advantages over large CD's, such as smaller size possibilities, longer maturities without interest ceilings, and the ability to terminate a contract.

The combined effect of the extension of reserve requirements to commercial paper and the 1 percent reduction in requirements against time deposits over $5 million will vary greatly among cities. Banks in a couple of cities will experience significant increases in required reserves, while reductions elsewhere will be relatively small.

There is a general consensus that the prime rate will be reduced in the next few weeks. For the most part, bankers do not believe that a reduction is justified at this time in view of the continued strong loan demand and the high cost of obtaining funds. Because of these considerations, several bankers indicated that a prime rate reduction may not be extended to as many borrowers as in the past.

ELEVENTH DISTRICT - DALLAS

Data for this report were gathered by telephone interviews with branch board directors in early September. On balance, the directors appeared to be cautiously optimistic. They noted that the slowdown never got too severe and there are now some signs of a modest pickup in business. Inflation is still strong in the view of most directors. The bankers reported a continuation of heavy loan demand, but also improved liquidity positions at their banks during the last three months. A few bankers expect the prime rate to be cut before the end of the year, an expectation based on noneconomic reasons. Construction may have picked up slightly in very recent weeks.

Business conditions are generally regarded as somewhat stronger now than three months ago. Several of the bankers noted that business never got particularly bad and that conditions now appear to have leveled out or picked up in the last three months. Several of the nonbank directors noted that their firms' orders had picked up recently, and they looked for some expansion in orders for the rest of the year.

While a few directors see price pressures easing, most list the continuation of inflation as a major concern. Those who do see some signs of abatement in price inflation refer particularly to selected goods prices, while appearing discouraged about services prices. The nonbankers reported that prices of inputs were not rising quite as fast in the most recent weeks as earlier this year, except perhaps for machinery parts. Product price declines were reported by two directors, one due to a local market milk-price war and the other to generally slack demand for paper and paper products over the past six to nine months. All directors expressed concern over the price of labor. One voiced a fear that the minimum wage would be raised and possibly tied to the CPI, a move, if adopted, that he considered certain to add to cost pressures in the months ahead. A number of directors cited the auto negotiations as crucial in either setting a pattern of moderate wage increases or excessive wage increases. There was some feeling that the outlook for inflation would improve if the auto settlement was moderate (below 8 percent in first-year wages).

The bankers were almost unanimous in reporting that liquidity positions at their banks had improved in comparison with three months ago. The only banker reporting a worsening in his liquidity position cited seasonal factors as the cause and expected improvement in October. The bankers were split about evenly on whether liquidity was still a serious problem for firms in their area. The nonbankers, however, indicated that they did not feel liquidity was a problem for firms in their industry. On balance, it appears that liquidity is of much less concern now than a couple of months ago.

Loan demand is reported strong by most bankers. Over half reported that loan demand was greater now than three months ago, while many who judged their loan demand to be weaker or the same as three months ago still characterized that demand as strong. Real estate loans were reported especially strong in several areas, and one banker noted heavy demand for feedlot and cattle loans. Banks in Corpus Christi, Texas, face heavy loan demand from individuals and businesses desiring to repair damage from Hurricane Celia.

Most bankers reported that the recent reserve requirement changes would ease their bank's position only slightly, with the move viewed as being more psychological than substantive. There were indications that the ease in reserve positions would improve liquidity but would not lead, at least directly, to additional loan commitments. One large Houston bank reports that it is considering abandoning the sale of commercial paper as a result of the reserve requirement changes. This bank would expect to concentrate more effort on increasing its volume of large CD's outstanding.

Economic conditions do not currently justify a further cut in the prime rate, according to District directors. Several expect a cut, however, before the end of the year because of political and public relations considerations. Two bankers indicated that they had not yet lowered their prime rate from 8 1/2 percent and might maintain that rate even if most banks make another cut in the next few months.

Signs of a pickup in construction activity in recent months were noted by some bankers, but no strong rebound is reported. One banker commented that many construction companies were forced out of business during the last 18 months so that it may take some time for resources to move back into the industry. The few areas where construction strength was cited were FHA-235 housing, university and local government construction, and gas drilling.

TWELFTH DISTRICT - SAN FRANCISCO

There is a somewhat more optimistic tone to the comments received this month from Twelfth District bankers and businessmen. The immediate pace of economic activity has not moved toward a higher rate of expansion as yet, but the general feeling seems to be that the worst of the current slowdown is over and that there will be a recovery toward the end of the year, or in 1971. Much of this optimism is based on expectations of easier monetary conditions.

In the meantime, the current situation has not changed from recent months. Businesses are not reporting major expansion plans and are still under pressure to reduce costs. Several reports stress continuing efforts to keep costs under control. In some cases, these efforts have taken the form of layoffs of both production and clerical workers. Several firms have raised prices partly because of rising costs and partly to offset revenues lost from falling sales.

A common response has been to attempt to cut inventories or at least prevent them from rising. A frequent explanation for the emphasis upon inventory reduction has been the high cost of finance; this is especially true of smaller businesses. Lower sales have also been a factor, although the lower sales have resulted in inventories being somewhat higher than intended. One firm reported that it announced a price rise and gave its customers a chance to make price-protected orders. The response was smaller than expected and this was interpreted as suggesting that customers would rather pay a higher price later than build up inventory now.

One exception to this trend is in the oil industry where inventories are being built up in certain products, despite a slight decline in total inventories. Crude oil inventories are being kept at above normal levels as a cushion against anticipated periodic foreign crude supply shortfalls during the remainder of 1970. On the other hand, light-product inventories are being kept at minimum level to reduce carrying costs.

As before, the areas with the greatest problems are those dependent upon the aerospace and lumber industries. The Pacific Northwest, in particular Seattle, and to a lesser extent, southern California, reported continued heavy unemployment, and, especially in the Seattle region, rising vacancies in real estate. Retail sales in the Pacific Northwest, while not actually falling, were described as comparing unfavorably with the same period a year ago. The rise in unemployment in the aerospace industry in southern California has not had as marked an impact since the local economy is more diversified. Nevertheless, retail activity is slower than normal, as is true of most areas.

A few regions have experienced what they describe as a good year. This is the case for Utah, Idaho, and parts of Nevada where the local economies are more dependent on agriculture and tourism. Tourist expenditures were at normal levels. Yields from the principal crops are very promising and prices for agricultural products and livestock are expected by farmers to hold at present prices. Banks in these areas reported that their customers had a year approximately as good as last year, if not better. Retail sales, in consequence, have held up in these states and inventories have not fluctuated much during the past few months.

Housing continues to show some strength in multiple units (except in the Seattle area) but not in single-family homes. For single-family homes, both construction of new units and sales of existing homes have fallen off compared with 1969. There has been some increase in the availability of funds and some reduction in interest charges, which, it is expected, will help the housing market.

Bankers in the Twelfth District report a continued buildup of deposits and an easier liquidity position. Some commented that they are not bidding as aggressively for long-term CD's and others noted that the public is increasing its savings. Although the banks are continuing to exercise care in their lending, they have been able to ease up somewhat on their restrictions and in some cases are looking for new borrowing customers. These moves to greater ease are still minor and lending is still carefully scrutinized.

In summary, the reports indicate a shift toward more optimism even though no immediate improvement is being felt. Unemployment has not started to fall and firms continue to devote efforts toward cost and inventory reduction. The general impression seems to be that the economy will begin to expand at a faster rate by the end of the year.