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CURRENT ECONOMIC CONDITIONS BY DISTRICT

Prepared for the
Federal Open Market Committee
by the Staff

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TABLE OF CONTENTS

SUMMARY*

There is substantial agreement among bankers, businessmen, and economists that the recovery now underway is of moderate proportions and is clearly not strong enough to have a significant impact on the employment-unemployment situation over the near term. Despite the persistence of underlying slack in the economy, the Reserve Banks note little retardation of the rise in both industrial and consumer prices. In view of the sluggish demand conditions in the capital goods sector and disappointing retail sales, it appears that cost-push influences continue to fuel the inflationary momentum. Some recent financial developments mirror the sluggishness in the real sector. Bankers report that loan demand is relatively weak. They are concerned over the decline in short term interest rates, and there is widespread agreement that the System should not move toward further monetary ease at this time.

With few exceptions, the Reserve Banks report that retail trade in January and February was not particularly strong. The post-strike rebound in auto sales thus far appears to be less robust than expected. Both San Francisco and Kansas City commented on the cost-conscious auto buyer. Sales of small cars (foreign and domestic compacts) are providing the major impetus to an otherwise lackluster auto picture. A number of Reserve Banks mentioned, in one form or another, that restoration of consumer confidence is the key element in the business picture. According to the Boston Bank, retail credit men in Rhode Island attribute cautious consumer spending to unemployment and the fear of layoffs. Dallas comments that bankers in their

*Prepared at the Federal Reserve Bank of Cleveland.

district feel continued inflation has tended to dampen consumer confidence and spending.

The Banks uniformly report that current and prospective capital spending remains weak, except for the push stemming from the utilities. Businessmen want to see concrete evidence of a solid upturn in economic activity before they begin to increase capital outlays. Cleveland mentioned that recovery in computers and machine tools is not expected until yearend or early 1972, while Boston notes that prospects are now better for a pickup in machine tools by yearend.

The only areas consistently mentioned by the Reserve Banks as exhibiting strength were capital expenditures by utilities, steel production, and residential construction. Boston, however, commented that improvement in housing related industries has been disappointing. As mentioned by Cleveland in the last Red Book, Chicago and Kansas City this time attribute part of the strength in the steel industry to buying in anticipation of expected price increases.

Concerning the outlook for employment and unemployment, there are widespread indications that businesses plan to continue with cautious hiring policies (and in some instances plan further layoffs). As is the case for capital spending, there is a reluctance to hire additional employees until the recovery gathers momentum.

On the financial front, the Reserve Banks generally report weak loan demand from consumers and businesses. The exceptions are a pickup in mortgage demand and in loans to finance steel stockpiling. Bankers are generally concerned about the decline in short-term interest rates and a developing profit squeeze. Atlanta mentioned that reductions in

FIRST DISTRICT - BOSTON

Reports of moderate to disappointing conditions continue to predominate among our respondents in nearly every field. Area financial institutions show no material change over last month, with the earlier spate of mortgage rate cuts tapering off, at least temporarily. The pickup in orders in housing-related industry has thus far been disappointing and much less than commensurate with the level of starts expected later this year. Similarly, auto industry suppliers report order levels below earlier expectations for the post-strike period. In summary, the economic pickup continues to elude us.

The winter recreational industry in New England has had a poor season, with sales of both equipment and services below last year. The traditional automobile sales held on Washington's birthday failed to attract the normal interest this year, and dealers report only a marginal improvement in sales over earlier in the winter. A survey of Rhode Island Retail Credit Grantors Association taken last week provides additional evidence of the gloom in retailing. Asked to characterize current sales volume with that of six months ago, 63 percent replied that it was lower, and 10 percent stated it was much lower. Fear of unemployment and layoffs was identified by this same group as the major deterrent to higher consumer expenditures.

One of our directors, heading a highly diversified manufacturing corporation, reports that price shading has broken out in a number of his divisions over the last three months. Order backlogs are continuing to shrink at most tool companies, although hopes now seem slightly higher for some pickup in new orders by the end of this year. The aerospace industry continues to present a very mixed picture, with some firms adjusting well to the decline in defense procurements and others suffering severely.

Professor Eckstein reports a slight retrenchment in the DRI model forecast of 1971 GNP, with the figure revised to $1,045 billion. He expressed disappointment with the First Quarter GNP results as they seem to be developing. On the matter of strength in the housing sector, he noted a very poor conversion rate of permits into starts in the late months of 1970 and suggested that our January and February start figures may be artificially high as a result.

Reiterating testimony given to the JEC last week, Eckstein once again warned against excessive monetary stimulus. He continues to endorse a 5 to 6 percent growth target for M1, but urges the system to push hard enough to achieve it. Eckstein expressed the hope that fears of a "snapback" effect will not deter the FOMC in its pursuit of stated targets, as this theory has little basis in fact. No significant snapback can be found in past recoveries once you take out inventory adjustements, a procedure that seems particularly appropriate in the current slowdown, since no major inventory changes have accompanied it.

Professor Eli Shapiro expressed general satisfaction with the current mix of fiscal and monetary policy, cautioning only that we do not fall below 5 to 6 percent in monetary growth. Shapiro sees the recent turnaround in long rates as largely an "indigestion" problem, stemming from the flood of offerings that emerged when long rates declined to the 7 percent vicinity. He is confident that long rates will decline to that level again by late summer. Citing the escalating cost of construction, Shapiro expects starts over 1971 to reach no more than 1.75 to 1.8 million. Industrial and commercial construction should decline 4 to 5 percent in real terms from 1970 levels. Shapiro further expects cuts to break out soon in passbook rates at thrift institutions and feels they are justified.

Professors Tobin and Samuelson expressed nearly identical views, with both focusing primarily on the discrepancy between desirable growth rates of real output and what we're likely to achieve. Both endorsed a monetary target in the 7 to 9 percent range, attaching particular urgency to this, as we are largely locked into a budget that is only mildly stimulative, at best. Samuelson specifically discussed the notion that the system is now "pushing on a string," suggesting instead that we're in a period where the linkages between monetary stimulus and real activity are very mushy, but still effective.

Professor Wallich added nothing new to his comments of earlier months and continues to feel that it would be ineffective now (and harmful later) to push any harder with monetary policy than we have been doing.

SECOND DISTRICT - NEW YORK

The overall impression of the economic outlook that emerged from opinions expressed by Directors of the Federal Reserve Bank of New York and of the Buffalo Branch and by other business leaders continued to be one of uncertainty, with little indication that a strong recovery is in the offing. Sentiments were mixed regarding consumer spending. It was generally agreed that no significant pickup in plant and equipment outlays was likely over the coming months. A strike in the steel industry was widely expected and evidence of stockpiling was mounting. Business loan demand was reported to be holding up well in Western New York (Buffalo), but to be relatively weak in the New York City area. As in previous months, concern over inflation was evident with several respondents calling for more direct government action in this area.

With respect to retail sales, the treasurer of a large chain of department stores reported that business over the Christmas season and during the January sales had been "reasonably good," but that sales in February had been sluggish and that his firm was budgeting for only a gradual increase over the coming months. The vice president of a large photographic equipment firm stated that his company saw evidence of a lack of strength in consumer spending in the fact that retailers seemed to be living off their inventories. The chairman of the board of a large New York City bank stated that consumer spending has not "blossomed" as might have been expected, while the president of a large finance company felt that, on the basis of consumer loans extended by his firm, the consumer is still "hanging on to his dollars."

On the other hand, the executive vice president of a large New York City department store, with branches in the suburbs, reported that business had been excellent from the week before Christmas through the third week of February (10 to 15 percent above last year), although it subsequently slowed; he looked for "good solid" business in the months ahead, but expected that "hard work" in the form of promotional sales and good values would be required. Similarly, the president of a Rochester department store reported that sales--notably promotional sales--were better than last year. Finally, several other respondents felt that retail business was good, and the president of a chain of variety stores was very optimistic with respect to 1971 sales.

With respect to outlays for plant and equipment, respondents expressing an opinion on the subject generally saw no strengthening in such outlays as compared to a month ago, i.e., 1971 outlays would probably remain at about 1970 levels. In this context, the respondents did not feel that liberalization of depreciation allowances would result in a significant upgrading of capital spending plans.

Several bankers and other business leaders looked for an increase in inventory investment in the form of strike-hedging stockpiling of steel. A strike in the steel industry appeared to be widely expected, although opinions differed as to its probable length.

One director felt it would be short-lived, with the settlement in the automobile industry setting the pattern for the steel settlements. Others felt it would be longer, with this expectation showing up in inventory policies. Thus, two directors of the Buffalo Branch, who are associated with firms using large quantities of steel, reported their firms planned to have a 90-day supply on hand by August 1, as against normal inventories for about 30 days, while the large photographic concern looked for a long strike and plans to build its steel inventories to six to eight weeks above normal levels. In addition, several bankers reported making arrangements to finance a substantial buildup in steel inventories. Another director, the president of a large manufacturing concern, felt there would be a long strike if the economy is strong, "but none if it goes down."

Views regarding the demand for business loans at commercial banks varied according to locality. The Buffalo Branch banker directors reported that loan demand at their banks was holding up well. The chairman of a large New York City bank, on the other hand, saw the loan picture as weaker than a year ago. The chairman of another, smaller, New York City bank characterized loan demand as "sluggish" and reported that his bank had not experienced any increase in demand following the prime rate cuts.

As in previous months, deep concern was expressed over inflation. A director characterized the recent government action in the construction industry as a step in the right direction. Several other business leaders, however, felt the need for stronger direct government action on the wage and price front. One business leader felt that, with the 1972 election ahead, the President was caught between "fire and drowning" and would probably make concessions in the fight against inflation to reduce unemployment.

THIRD DISTRICT - PHILADELPHIA

Area executives expect the mild business expansion to continue. Nevertheless, the outlook is still mixed. Thus, some industries, such as paper, see no improvements. Retailers are not expecting strong consumer demand this spring. Bankers are caught in a profit squeeze and several of those we contacted saw no early pick-up in loan demand. On the other hand, there are some hopeful signs. For example, the number of manufacturers experiencing increases in sales and new orders far outweighs those realizing decreases. But, the evidence is still not convincing that a substantial recovery is underway.

Area executives expect the mild business expansion, which got underway in January, to continue. Thus, our latest business outlook survey shows that for February more than five times as many manufacturers polled in the Third Federal Reserve District are registering increases in sales and new orders as are realizing decreases. However, the business outlook is still mixed. Thus, one of our Directors reports that prospects for the paper industry are unchanged and gloomy. Another Director, whose company makes fabricated metal products, reports his own firm is doing well because of orders from the power industry, but that reports from other industries with which he has contact are uniformily gloomy. Nevertheless, a number of regional executives are mildly optimistic about March. But part of their optimism reflects an expected rebound from the business depressing effects of the GM strike rather than a major shift in economic trends. Consequently, area businessmen are reluctant to hire additional employees until more solid evidence of a recovery is apparent.

District retailers report that in February consumer purchasing fell back to the level of last year. One pointed out that considering that sales were flat all last spring, this is not very comforting. Durable sales are still running behind a year ago, but not by as much as they were a few months ago. Some of the current weakness may be because of the apprehension and uncertainty about the size of the Pennsylvania state income tax.

A number of retailers are concerned that not much more is in the works for spring. Another filip to demand through special sales is less likely in the months ahead because no additional discounts are likely to be forthcoming from manufacturers. They are watching very closely so as not to become overstocked again.

On the financial side, a majority of the city banks report loan demand is soggy. One bank, however, does report a noticeable strengthening of loan demand, and several are optimistic about developments in the spring. All of the banks are concerned with the decline in short-term rates and the developing profit squeeze. As they see it, they are limited in what they can do about the squeeze which some of them expect to get worse. Labor costs are rising, loan demand is too weak to justify increases in lending rates, and cost of some sources of funds still is relatively high. Some of the banks say that quality of credit continues to be a problem. None of the banks, however, reports any progressive deterioration in credit quality is discernible now, although a number of soured loans have yet to be worked out.

Several of the banks report continuing concern with the inflation problem; some volunteered comments on their concern about the potential inflation impact of the administration's economic goals for 1971.

FOURTH DISTRICT - CLEVELAND

The consensus view of an informal survey of several of our directors is that there is a considerable amount of optimistic talk about the economic outlook at the senior management level in major firms in the Fourth District and elsewhere. The optimism, however, is tempered with caution resulting from a lack of specific evidence signalling an upturn in overall activity or at the individual firm level. As a result, many firms, especially capital goods producers, are pessimistic about a quick resurgence in economic activity, but expectations of improvement near the end of 1971 or in early 1972 are reported to be widespread.

One director, the president of a large manufacturer of computers and business machines, reported that the ready availability of credit, declining interest rates, and expectation of stimulative fiscal policy in fiscal 1972 have generated some optimism, although many businessmen remain uncertain about the time paths of the expected recovery. The key element in the business picture, according to this director, is the consumer. Once consumer spending picks up and utilization of existing plant and equipment returns to near-capacity levels, business spending for additional plant and equipment will increase and the recovery process will be underway. This director indicated that sales of cash register equipment have held up relatively well, in spite of numerous postponements of new store locations by major retail chains. Computer sales, on the other hand, have been severely depressed and are not expected to recover until yearend or early 1972.

A second director, who is the chairman of a large diversified manufacturing firm (major divisions include auto components, defense and space products, and electronics), expressed the view that economic activity will probably improve during 1971. He also reported that there are a number of favorable "straws in the wind" from his firm's point of view: consumer-oriented products (radio and TV parts and auto components) have picked up; orders for offshore oil drilling equipment have risen; sales of automated supervisory control equipment have edged up slightly; and Government related business has increased modestly. Furthermore, this director expressed continued concern about inflation and indicated that he has expressed directly to senior Administration officials strong support for the Government's actions in the construction industry. He is convinced that the persistent inflation is the result of cost-push pressures. Some prices have declined and he believes that excess capacity and competition would force businessmen to be more responsive in pricing policies in the absence of continued excessive wage demands. This director also expressed the view that consumer confidence is precariously balanced and that further "bad news" or unexpected shocks could further undermine consumer confidence and, thus, hamper the expected recovery in economic activity.

A third director, the president of a major glassware and glass container firm, reported that their new order backlog for consumer glassware is slightly higher than the year-ago level, reflecting an increase in orders from retail chains. Glass container orders are about equal to the early 1970 level. Orders for and shipments of industrial glassware, especially home lighting equipment, are significantly above last year's level, as a result of the "boom" in housing. This director also referred to the "apparent optimism," but indicated that his own situtation is very quiet, "we're waiting" and "there is nothing stirring."

A fourth director, the president of a medium-sized machine tool manufacturing firm, reported that industry leaders are more optimistic about the chances of a recovery in business and in demand for machine tools by the end of 1971 or early 1972 than they were two or three months ago. The renewed optimism is based, in part, on current and expected stabilization policies and also on a recent sharp increase in requests from customers to see salesmen. So far, however, the flurry of activity has not been translated into an increase in new orders. At the present time, order backlogs for the industry are at the lowest level in several years, incoming orders are dismal, and as a result, employment has been sharply curtailed.

On the financial side, two bank directors have expressed strong sentiments to the effect that the System has gone "far enough" in reducing interest rates and they are prepared to oppose any further reductions in the discount rate. One banker-director, the chairman of one of the largest banks in the District, expressed grave concern about the international repercussions of any further easing in monetary policy, indicating that foreign central bankers will "...not fool around with us." This banker reported no pickup in business loan demand. This director also serves as a member of the Board of Directors of several national firms, and he reports that the management of these firms has no expectations of a quick turnaround in activity in the immediate future, especially in the manufacturing area.

The second banker-director, the chairman of a medium-sized bank in the District, was opposed to any further easing of monetary policy in psychological grounds. He reported strongly held convictions that consumer spending will not surge upward as long as there is a feeling that "...everything is going down." Banks have more than enough funds, interest rates keep falling, and individuals in his area are very concerned about reaching some sort of "bottom" from which a recovery can start. This director would like the System to hold steady on its present course (as he perceives it) and permit the recovery to unfold. In his view, consumers could react in an adverse way to any further signs of monetary ease.

FIFTH DISTRICT - RICHMOND

Surveys of businessmen and bankers in the Fifth District indicate general agreement on the following points: (1) some improvement in manufacturers' shipments, volume of new orders, and backlogs of orders; (2) significant further improvement in retail sales, including automobiles; (3) stability in the employment situation, but no clear evidence of improvement; (4) further reductions of prices in manufacturing, but not in retail goods and services; (5) sharp improvement in residential construction, and some increase in nonresidential construction; (6) substantial increases in mortgage loan demand, and slight increases in consumer loan demand, but no significant improvement in business loan demand; and (7) a generally more optimistic outlook regarding future business conditions.

District manufacturers report an improvement during February in their shipments, volume of new orders, and backlog of orders. This is the first significant improvement in the sentiment of District manufacturers since September. Improvement is reported by important producers in ferrous metals, metal products, furniture, hosiery, and synthetic fibers.

Retail sales improved further during February according to District bankers and businessmen in trade and services. Automobile sales continued the sharp upswing begun in January.

Manufacturers report that inventories have declined somewhat in recent weeks, while retailers' inventories have tended to increase in line with seasonal expectations.

While some further declines in employment are reported by District bankers for their respective areas, some improvement is reported by District manufacturers. Also, manufacturers report no significant change recently in the length of the workweek. On balance, the District employment situation appears to have stabilized, although definite improvement is not yet clearly in evidence.

Some further reductions in prices are reported by manufacturers in textiles, electrical equipment, nonferrous metals, and coal. Builders materials producers, however, report price advances, and retailers indicate that prices of consumer goods and services are continuing to rise on balance. Continued upward pressure on wages is reported by respondents across the Board.

Considerable improvement in residential construction activity is reported for February by District bankers in South Carolina, North Carolina, Virginia, and Maryland. Nonresidential building activity is also reported significantly improved. Comments received from survey respondents indicate a recovery in progress in the construction field.

Mortgage loan demand in District banks is reported to have improved sharply during February. Consumer loan demand also increased slightly, according to bankers. Business loan demand, however, still is reported down in February, but not as depressed as it had been for the previous three months.

The general outlook of survey respondents improved substantially in recent weeks. Comments received from respondents indicate growing optimism concerning consumer spending, residential construction, employment, and prices. Some continuing strikes and the prospects of the strikes during the current year, however, contribute some caution to respondents' outlooks. Manufacturers, who have pared down capital expansion plans rather sharply in recent months, continue to indicate no significant desire to increase spending in this area in the near future.

SIXTH DISTRICT - ATLANTA

Reports from business leaders reveal that 1971 is off to a slower start than even they had predicted, especially in the area of retail sales nevertheless, most businessmen and bankers think there is some reason for cautious optimism. Inflation is still causing concern.

Retailers report that 1971 sales are off to a disappointing start. For example, an auto dealer describes his sales as up one week down the next. A major department store concern indicates slow January and February sales and that prices are still rising. Also, customer delinquencies are twice their year-ago level. The President of a luxury jewelry firm says high-priced merchandise is still selling slowly, but that moderate-priced lines are moving well. He added that watch and diamond prices have not been going up. A representative of a major appliance manufacturer reports that his company has not noticed a turnaround in consumer spending. Added evidence of weakness in retail sales is indicated by the behavior of sales tax receipts, which have risen only slightly in some areas.

There are other signs that business is only stabilizing rather than expanding strongly. Telephone revenues from commercial and corporate accounts, especially for long distance calling, have been rising slugglishly although residential demand has remained strong. A diversified electrical manufacturer reports that the only area of his business with a substantial backlog is electric generating equipment. According to a paper producer, newsprint sales were weak in January. Also, aerospace-related layoffs have occurred in a few areas. A firm that fabricates metal for aircraft parts is reported to be cutting its overhead by $30,000 per month. A leading apparel manufacturer in

Tennessee, previously a very steady employer, recently laid off workers.

Nevertheless, reports from businessmen and bankers throughout the District indicate that confidence is building. Some optimism is being generated by reductions in interest rates and increases in the availability of financing. An auto dealer is encouraged by reductions in his interest expenses, which he expects will permit greater merchandising efforts that, in turn, should help improve the retail market. Construction activity is strong in several areas, with interest rate reductions expected to encourage further revival. However, there have been rumors of vacancies in some apartments catering to singles.

Price increases continue, especially in utility rates, and inflation remains a concern. Construction industry representatives do not think the repeal of the Davis-Bacon Act will have much impact.

SEVENTH DISTRICT - CHICAGO

The $1065 billion GNP "goal" for 1971, announced by the CEA a month ago, has been regarded with skepticism by observers in this District. The consensus appears to continue to center on $1050 billion. Nevertheless, the controversy appears to have an impact on psychology. The high figure for GNP, coupled with pressures for a more expansive monetary policy from various sectors (including Administration circles), is commonly taken to mean that "the government" is determined to get spending rising rapidly, even at the risk of a renewed acceleration of price inflation.

Demand for workers of all degrees of skill and experience remains very slow. Unemployment compensation claims in February continued to run well above last year's levels in all areas of the District, except Michigan, where cutbacks in auto production schedules were underway a year ago.

Strikes are hampering output in many industries, although the overall impact is much less than during the GM dispute. At last reports, labor disputes had closed a laundry appliance manufacturer in Iowa, a machine tool producer in Illinois, an auto assembly plant in Wisconsin, and ready-mix concrete facilities in Indianapolis. Labor militancy is causing many employers to offer large increases in compensation in initial stages of negotiations, despite an ample supply of potential workers.

Evidence available in this District does not support Rinfret's recent statement that total capital expenditures by business firms will rise 11 percent in 1971. Orders for both capital goods components and finished equipment remain slow. In the case of machine tools and steel mill equipment, the situation is extremely depressed. There is no prospect for an early recovery for commercial or manufacturing construction activity. The airlines are reducing or postponing acquisitions of new equipment wherever possible. Railroads and truckers would like to buy new equipment, but their financial resources are limited. However, capital outlays of utilities will be very strong and the petroleum industry expects to spend about 8 percent more in 1971.

Demand for steel is at a very high level, but it is impossible to determine what share of current demand represents a desire to build inventories for strike protection. Orders are also stimulated by a desire to anticipate price increases in mid-April and on June 1, when price moratoriums expire. A Chicago steel producer describes current orders as "fantastic," with no recent slackening from the high January level, as reported by some Eastern mills. This firm's order backlog is well above the backlog of the similar period of 1968.

Some observers of auto industry trends are puzzled by the apparent discrepancy between the 1 percent decline from a year earlier in retail sales of the automotive group in the January 1-February 20 period, as published by the Bureau of the Census, and the 13-percent increase in dealer deliveries of passenger cars (at higher prices), reported by the auto manufacturers. We are told that some GM dealers are falsely claiming that some of the new cars they order are already sold, in order to profit from contest incentives. Also, the average size of car is less than a year ago. These factors appear insufficient, however, to explain the apparent discrepancy between retail sales and deliveries.

Some capital expenditures by auto firms are being postponed indefinitely, awaiting firm decisions on the standards to be adopted to curb pollution.

Residential construction activity will rise sharply in this District in the spring season. Men and materials are available in ample quantity. Multi-family units will be especially strong. Unfortunately, the program to build modular units in the City of Chicago, started in 1968, has "flopped," according to a recent evaluation, with only a few units completed and no prospects for a revival. There is a push to rehabilitate low-income housing in the large cities, some of which had been rehabilitated only a few years ago. Business of title firms has been 10 to 30 percent higher than a year earlier in recent months.

The continued heavy calendar of new corporate security issues continues to surprise informed individuals. Short-term rates continue to decline, but there is no consensus on the trend of long-term rates. Business loan demand at commercial banks is said to be "about seasonal." New commitments have increased, but lines are not being taken down as rapidly. Large banks are offering to make term loans more readily--up to seven years in maturity--but usually want to include interest rate escalators. Business firms usually prefer fixed rates, so the bargaining continues.

EIGHTH DISTRICT - ST. LOUIS

The trend of business conditions in the Eighth Federal Reserve District is generally unchanged from the moderate uptrend reported a month ago according to a number of businessmen that were interviewed. Although most reporters indicate that recent levels of activity are insufficient to support much optimism, all expect substantial gains before the close of the year. Retail sales are running slightly ahead of a year ago on a dollar basis. Homebuilding is likewise stronger. The employment situation, however, is generally stable with few hirings and a relatively high level of unemployment. No early improvement is seen in capital investment, despite lower credit costs. Financial agencies report rising availability of both short- and long-term credit.

Some large retailers report that post-Christmas sales continued ahead of year-ago levels through February, but that the increase was somewhat less than anticipated on the basis of the sharp pre-Christmas gains. The increase from a year ago was only sufficient to offset price increases. Sales in real terms, however, are believed to be higher on a seasonally adjusted basis than during the autumn months.

Most manufacturers made their major retrenchment moves in late 1970 or in January of this year, but further moderate employment reductions were announced in February. These layoffs, however, were probably offset by employment gains in the services, trade, and construction industries. Most of those interviewed expect unemployment to continue relatively high through the spring and summer months, reflecting both the conservative attitude of businessmen in hiring and an increase in the labor force.

Homebuilding continues to be the brightest feature on the business horizon. All phases of this industry, including lumber, plywood, and especially the construction of lower priced homes, report more than seasonal gains from levels of last summer.

Despite the generally increased optimism by businessmen since the turn of the year, no early improvement in capital spending is foreseen. Few manufacturers appear willing to risk investment in major expansion projects at this stage. Exceptions include one retailer who reported a moderate increase in investment plans, and the utilities, which were not seriously affected by the slowdown. Utilities continue to expand to meet longer run demand projections. Otherwise, the investment slowdown continues, and little optimism is found for an early resumption of capital spending at levels existing before the slowdown.

Financial corporations reported further increases in liquidity during recent weeks. Mortgage rate reductions have so far been relatively small, but some agencies state that excessive quantities of credit are available at the quoted rates, pointing to further rate reductions. A number of savings and loan associations are now advertising for borrowers, and one commercial bank indicated that net income this year will be well below 1970 levels because of the sharp decline in bank lending rates.

Respondents, in general, expect the rate of inflation to continue to subside through 1971. The agriculture and food sectors may tend to push prices up in the second half of the year, in contrast to the downward influence of these sectors in late 1970. Farm commodity prices fell sharply late last year, but meat and other livestock product prices have already turned upward. With reduced supplies in prospect in the Third and Fourth Quarters, further increases in such prices are expected.

NINTH DISTRICT - MINNEAPOLIS

Unemployment, seasonally adjusted, in the Ninth Federal Reserve District has tended to remain at around 5 percent of the labor force since last fall, and there are no strong indications that it will change significantly over the next few months. Although businessmen have generally become a little more optimistic in their sales and profits expectations. This is not reflected in their planned capital expenditures or hiring policies. The directors of this bank were generally disappointed in President Nixon's decision to suspend the Davis-Bacon provisions regarding the payment of union wages on Federal and Federally assisted construction projects, preferring somewhat stronger actions to reduce the rate of inflation.

Although there are some notable exceptions, the directors of this bank feel that businessmen in the Ninth District are slightly more optimistic than they were a few months ago. Businessmen in general, however, have postponed the expected turnaround date and now feel that the pickup in activity will not come until the second half of the year, and then only gradually. As a result, they are still very cautious in both their capital expenditure and hiring policies. Businessmen who are not anticipating a pickup in sales this year are primarily located in the extreme eastern and western portions of the District. In addition, one large Twin Cities manufacturer, who had large layoffs in 1970, is concerned enough about the outlook to be predicting further layoffs if business does not improve.

The cautious hiring policies of area businessmen is evident from activity at State Employment Service offices. A telephone survey of 22 nonmetropolitan Minnesota State Employment Office managers disclosed that employers in their areas generally have no plans to do any other-than-seasonal hiring in the next few weeks. Also, 17 of these managers indicated that some unemployed workers had returned to their home areas from the Twin Cities.

The results of our latest quarterly industrial expectations survey, taken early in February, tend to confirm the observations of the bank directors. The survey's manufacturing respondents do not foresee any significant sales improvements in the early months of this year. But sales should rise later this spring and continue to improve throughout the third quarter. Although sales are expected to match last year's levels in the current quarter, they are anticipated to be 3.6 percent higher than a year earlier in the second quarter, before advancing 8.8 percent in the third.

The expected improvement in district industrial sales later this year can be traced to durable goods manufacturers, primarily those in the electrical and nonelectrical machinery industries. Both of these industries have had severe drops in sales over the last year, but expect to rebound quite sharply by the third quarter of this year. In addition, manufacturers in the primary metals, fabricated metals, transportation equipment, and scientific instrument industries expected strong increases in third quarter sales.

Sales gains in the nondurable goods industries are not expected to be as dramatic as in durable goods industries, but these manufacturers also foresee definite improvements by the third quarter.

For the most part, the directors of this bank expressed disappointment with President Nixon's recent suspension of the Davis-Bacon Act provisions and felt that substantially stronger action was needed. One director felt that the unions "called his bluff, and that (President Nixon's) action was a weak-kneed backdown after all that conversation." Construction people privately feel that suspension of the Davis-Bacon Act will have no effect on the rise in construction costs. One director, while disillusioned with the president's specific action, did feel that further steps could be taken in the future if construction costs continue to rise. Another director, who is opposed to wage and price controls in principle, favored the Administration's action to suspend the Davis-Bacon provisions. According to him, the Davis-Bacon Act supported artificially high construction wages in his area, and wages will not return to normal levels.

TENTH DISTRICT - KANSAS CITY

The qualifiedly optimistic cast to Tenth District economic activity reported on last month would again seem to be borne out on the basis of reports from Directors and conversations with nearly two dozen purchasing agents representing manufacturing, wholesale, and retail firms doing business both nationally and within the several District states. As was the case last month, construction activity was singled out as being a sector of considerable strength. In addition, steel stockpiling is making a positive contribution to inventory investment on the part of several steel-using producers among those queried. At the same time, retail trade thus far has failed to show any significant signs of buoyancy.

In a number of the District metropolitan areas, construction activity appears to be quite strong. Retail trade, on the other hand, appears to be merely holding its own over year-ago levels. However, the auto component is a soft spot in the overall sales picture, with the major impetus to auto sales being provided by small cars. In Kansas City within recent weeks, Ford Motor Company has announced some shaving of earlier first quarter scheduled production. The General Motors assembly plant in Kansas City, which turns out Buicks, Oldsmobiles, and Pontiacs, has not made any such announcement and within the industry it is acknowledged that the Pontiac Division is faced with the biggest job of rebuilding its dealer stocks--a fact that supports high activity levels for the Kansas City assembly plant.

Looking down the road to the outlook for the months ahead, one Director in the steel fabricating business reported that work was backed up and expressed optimism over the outlook for new orders. However, another Director voiced a good deal of concern over what he felt to be a general lack of consumer confidence and expressed the view that, unless a turn in confidence could be brought about, he was decidedly pessimistic about the economic outlook. Yet, this concern about recession appeared to be a minority view on the part of most respondents. In terms of the responses of the purchasing agents, what was left unsaid may well have been as significant as the information they volunteered. Last July, when these sources were queried, their overall attitudes regarding the outlook were clearly pessimistic. This time, none mentioned the danger of recession, and the consensus was that moderate and continuing improvement in economic activity was expected.

With respect to the price situation, both for the present and the near term, the responses of purchasing agents suggested little abatement of inflationary pressures. As our sample included a large number of steel users, expectations of price advances came as no surprise--particularly since a number of these firms had purchased steel under a one-year, no-price increase arrangement. At its expiration, the purchasing agents expect sizable price increases to be posted. However, even for those firms not heavily involved in steel purchasing, they report that the cost of materials continues to rise at about the same rate as in past months, with little price shaving occurring. Given this price picture, despite expectations of an improved sales picture in the months ahead, inventory investment--with the exception of steel as noted earlier--is quite conservative. The view of one purchasing agent, that "we are as low on inventories as we can safely operate," would seem representative of the respondents as a whole. Cost consciousness is the overriding consideration in inventory behavior and imports are utilized wherever cost advantages dictate. In terms of the prices which these firms charge for their own outputs, cost increases of materials are cited as the basis for present and future price increases to their customers.

On the banking scene, developments seem to corroborate events in the real sectors discussed aboved. Overall, loan demand remains weak, and this is especially true for some of the large national accounts. While there has been little change in business loan demand during the past month, an exception is those firms who are borrowing to finance steel stockpiling. Loan demand on the part of locally based firms appears to be relatively stronger than from national firms, and some slight pickup in loan inquiries is occurring. Some of the slack in business loan demand is being taken up by other loan categories. For example, some bankers report a rather noticeable increase in their participations from country correspondents. Also, the demand for construction loans is strong.

Deposit flows continue strong in both demand and time accounts, considering seasonal factors. The large banks have reduced rates on large CDs in line with the national market. In addition, the beginning of some easing of rates on consumer CDs is appearing. For the most part, however, banks appear to be willing to encourage deposit growth in anticipation of an improvement in business loan demand in the coming months. Some banks are now soliciting loans in an attempt to generate loan volume. In the meantime, excess funds are being placed mainly in Federal funds and other short-term liquid assets.

ELEVENTH DISTRICT - DALLAS

Although bankers in the Eleventh District generally expect economic activity in this area to improve over last year, weak loan demand and continued inflation remain worrisome. A recent survey of bankers (some of whom are head office and branch directors) from large- and intermediate-size banks reveal that, despite a general lowering of interest rates, loan demand continues to be sluggish. Real estate lending has picked up slightly in some areas, but business and consumer loan demands are generally weak. Since December, demand deposits (not seasonally adjusted) have declined, while time and savings deposits have risen moderately, permitting banks to lower rates paid on CDs. Loan demand in the District remains sluggish and nearly all respondents report no material change in recent weeks. There has been some slight increase in real estate loans, especially at the smaller institutions, but both business and consumer instalment loans are reported to have declined. Defense industry layoffs and some uncertainty about the economic outlook probably account for much of the weakness in loan demand. In addition many bankers note that continued inflation has tended to dampen consumer optimism and spending. However, pent-up demand for housing, coupled with lower mortgage rates, has led to some increase in real estate loans.

All of the respondents reduced their prime rate recently, with most of the larger banks now quoting the New York prime rate. However, many of the smaller banks report prime rates 1 to 1 3/4 percentage points higher than those in New York. Presently the larger banks typically carry 10 percent of their loans at the prime rate, while smaller banks report carrying anywhere from 2 to 30 percent of their loans at prime. Nearly all of the banks surveyed do make mortgage loans;

however, the smaller banks usually report holding a larger portion of their loan portfolio in mortgages. Current policy towards investment as well as loan portfolio management differs widely between the institutions surveyed. In general, the respondents currently hold 60 percent of their investment portfolios in U. S. Government securities. However, a few banks lean heavily on municipal holdings. At present, large banks typically hold 40 percent of their investment portfolio in municipal securities with an average maturity of eight years. Smaller banks generally hold a somewhat larger amount of municipals, with a six-year average maturity. Nearly all of the respondents report regular participation in the Federal funds market; however, few have outstanding commitments with other banks for regular transactions. Of those with outstanding commitments, larger banks currently buy or sell from $2 to $15 million daily, while smaller banks trade from $0.5 to $3.5 million per day.

Probably reflecting sluggish economic activity as well as seasonal factors, demand deposits at most of the respondents' banks have declined since yearend. Demand deposit levels have generally fallen (5 to 10 percent annual rate)--with some of the larger banks showing even a more substantial decline (15 to 25 percent). Total time and savings deposits are up at most banks, as passbook savings deposits have shown a moderate increase since December. Although many of the smaller institutions do not issue large CDs ($100,000 plus), those that do report a sizable volume of new issues since yearend.

Although market interest rates have fallen across-the-board, nearly all of the banks surveyed are paying the ceiling rate on passbook savings deposits. In the light of recent declines in money market rates, some of the respondents recommend that the Regulation Q ceiling on savings deposits be lowered to 4 percent, although not until ceiling rates payable by savings and loan associations are lowered.

Recent figures on economic conditions in the District seem to indicate continued slow growth. Although actual nonagricultural employment for the District was down slightly in January, seasonal expectations had suggested a much sharper drop. Retail sales for January and early February are up 9 percent over last year--a possible sign of some slight improvement in the consumer sector.

Industrial production has remained essentially unchanged with some small increase in manufacturing of both durable and nondurable goods.

Texas oils allowable for March are unchanged from February, which makes them more than 5 percent lower than the record levels of last November. However, all other District states are now producing at record levels. In addition, District agricultural conditions appear to be improving. Expected acreage to be planted with sorghum and other grains is up 10 to 14 percent over last year. Placements into Texas feedlots during January increased 45 percent over the same period a year ago--resulting in a new record number of cattle on feed.

TWELFTH DISTRICT - SAN FRANCISCO

There has been no basic change in the attitudes of businessmen in the Twelfth District. They see little sign of further declines in economic activity, but they also see little sign of an immediate recovery. To some extent, this situation is a reflection of continued cautious spending by consumers. Banks report continued increases in deposits, but no equivalent rise in loan demand.

Most of the businesses contacted in the District report no change in their spending plans. They are awaiting further increases in orders before instituting expansion plans. There are regional variations from this general picture. In Arizona, new orders were up in February after two months of declines, and production is at the highest level since last March. In Utah, mining and manufacturing are doing well, but in Southern California, the problems of Lockheed are causing some concern and adding to feelings of uncertainty. Many vacant industrial properties in Southern California are on the market without much interest being expressed at this time by prospective tenants. On the District level, business inventories have stabilized at present levels and further declines are unlikely.

The level of unemployment has stopped rising in most areas. Small employment increases are reported in Arizona and Southern California, but Washington continues to have problems as the rate of registered unemployment was higher again February.

One industry that is expecting a mild recovery is lumber and plywood manufacturing. Production is rising and some mills have reopened in Oregon and Washington. Although lumber prices have risen, some manufacturers feel that the upward pressure may diminish somewhat between now and the spring building season.

Consumer spending has been cautious. Retailers have reported some successful post-Christmas sales, but the volume was approximately the same as in 1970. Consumers are not making greater purchases of big-ticket items, such as refrigerators and furniture, and they are very price-conscious in their buying attitudes. Generally, sales of durables are sluggish. Another aspect of this same situation is a higher rate of repayments on consumer credit. Overall, retail sales are only slightly higher than in the same period last year, but retailers expect the sales picture to improve later in the year.

Automobile sales reflect this greater caution on the part of consumers. In most areas, sales are described as slow and this is true even in such otherwise buoyant areas as Arizona, where auto sales are at approximately the same level as last year. The one category generally singled out as registering increasing sales is that of foreign-made cars, there are also some reports that sales of domestic compact cars and used cars are relatively strong.

Banks continue to experience rising deposits but little change in loan demand. Business loan demand is stable, despite efforts of individual banks to generate more loan activity. There has been no marked increased in mortgage demand, despite lower interest rates. In particular, savings and loan associations have had difficulty in generating sufficient loans to utilize their heavy inflow of savings. The savings and loans are attracting some funds because they have not lowered their interest rates, while banks have cut their CD and consumer-type deposit rates. Some banks report that they are considering the possibility of lowering the passbook savings rate, but none has done so yet. There are some banks, however, that have not cut their CD and time deposits rates. Most of these are smaller banks, with the exception of one large California bank that is actively promoting its higher rates on consumer-type time deposit. In summary, the banks have sufficient funds to meet an increase in loan demand, and in the meantime, there is downward pressure on interest rates.