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# CURRENT ECONOMIC COMMENT BY DISTRICT

Prepared for the
Federal Open Market Committee
by the Staff

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SUMMARY*

Four major impressions emerge from this month's Red Book reports. First, inflationary expectations remain strong and, in some areas, may be strengthening. Second, demand for business and mortgage loans has firmed, and additional interest rate increases are anticipated. Third, several reports characterize the recovery of spending and production as being gradual. Finally, the reports indicate slightly more optimism in the economic outlook.

The most commonly cited subject in this month's reports was strong inflationary expectations. Opinions are that there are no prospects for a significant reduction in inflation this year. Philadelphia reports that inflationary expectations seem to be somewhat stronger than they were a few weeks ago and that most businessmen believe that inflation is the number one problem facing the nation. Fifty business economists participating in a Round Table discussion at the Cleveland Bank have upped their estimated 1971 rise in the GNP deflator from 4.2 percent (estimated on January 29) to 4.7 percent (estimated on May 27). These economists also expect the rate of increase in the Consumer Price Index to accelerate to 4 percent in the second half of 1971. The nonbank directors of the Dallas Bank indicate that their firms have raised prices by an average of 5 percent since the beginning of the year and will raise prices again before year-end. St. Louis reports that there are some expectations of accelerated price increases later this year.

Several Districts report increased demand for business and mortgage loans. Mortgage rates have risen in some areas, and additional

*Prepared at the Federal Reserve Bank of Atlanta.

increases in mortgage rates and in the prime rate are anticipated. At Boston thrift institutions, for example, conventional mortgage rates have moved back up toward 8 percent from their April low of 7.5 percent. Kansas City also reports that, in some cases, conventional mortgage rates have ticked up a notch. More than 80 percent of the bankers polled by Richmond report an increase in demand for mortgage loans and more than 50 percent of those polled report an increase in demand for consumer and business loans. Chicago reveals that loan demand is weak but notes that loan commitment volume has increased sharply--probably an indication of expected credit stringencies.

Consumer spending continues to expand, but no major surge is expected. Most of those Districts commenting on consumer spending report slight-to-moderate increases in retail sales. St. Louis indicates retail sales are up strongly, taking into account that colder-than-average weather has retarded the movement of air conditioning equipment. Minneapolis, however, reports that optimism regarding retail sales seems to have dampened slightly during the last month.

A modest expansion of employment appears under way and further gradual gains are anticipated. Atlanta and Dallas report some instances of additional hiring. Philadelphia indicates that there is some step-up in hiring plans at the manufacturing level. The number of polled manufacturers who are planning to add employees is nearly four times larger than the number of manufacturers who are planning to cut back. Richmond notes that employment has been declining less than in previous periods. Dallas and St. Louis anticipate increases in employment, provided, in the St. Louis case, that the current rise in business activity continues into the fall. The consensus of the 50 economists who attended the Cleveland meeting is that there will be only a moderate expansion of real output, which will be accompanied by substantial unemployment.

On steel strike possibilities, it is generally recognized that the terms incorporated in the auto, can (and now, aluminum) settlements should set the pattern for agreement. Nevertheless, local problems and militant leaders may force a strike.

Plant and equipment investment is generally predicted to be weak, evidently because of excess capacity rather than high interest rates. There is also no evidence of an inventory buildup. Boston, New York, and St. Louis mention excess capacity as a deterrent to investment. Dallas, however, notes some increase in investment recently. The Atlanta Bank reports a sharp increase in inquiries received by a state Industrial Development Department.

Several Districts commenting on construction report strength. San Francisco, for example, reports that housing activity continues to grow and that commercial construction, especially large shopping areas and multistory buildings, continues to be important in that District. In some other areas, however, a leveling off in construction activity is noted, rather than further increases.

## FIRST DISTRICT - BOSTON

First District directors continue to express guarded optimism on the progress of the recovery, noting that the slight improvement in consumer spending first reported last month seems to be continuing. However, prospects for a significant slowing of inflation over the rest of 1971 are considered poor. In the financial sector, the gains noted for the past several months seem to be coming to an end. At Boston, area thrift institutions' conventional mortgage rates have eased back up toward 8 percent from their April low of 7 1/2 percent, and the large deposit inflows seem to be tapering off. Credit availability remains good, however, at thrift institutions, commercial banks, and large area insurance lenders. Despite the virtual disappearance of equity kickers and a drop in effective yield of more than 600 basis points over the last eight months, insurance companies are finding commercial mortgage demand very sluggish.

At the recent joint meeting of the First and Second District Boards of Directors, a list of common questions was given to each attending member to elicit their sentiment regarding the current business outlook. Among the five Boston directors responding to these questions, there was near unanimity. All agreed that the greater consumer willingness to spend reported a month ago seems to be continuing, with two of our directors further noting that this trend seems to be developing even in the area of luxury items. Four of the five expressed their conviction that housing starts for the year can hold at a 1.9-million unit level and that the primary deterring factor to gains beyond this level is inflated home prices. The fifth member, active in both commercial and mutual savings banking, noted that in his area sales seem to be proceeding well in spite of home prices.

All five directors agreed that capacity utilization levels--not high, long-term rate levels--will determine spending on plant and equipment over the next several quarters and that the outlook thus remains somewhat weak. Of the three directors answering a question on recent developments in the employment situation, two saw no changes and a third noted a tendency to slightly longer workweeks.

Commenting to the recent update of the DRI Model forecast and subsequent developments, Professor Eckstein stated that the leading indicators have become an absolute hodgepodge of contradictions and convey no sense of direction at all to him. Consistent with the latest DRI solution ($1,050-billion GNP for 1971), Eckstein noted that the extra inflation comes at least partly at the expense of the real GNP, a result he feels is descriptive of the real world in the short to medium run. In spite of the recent reversals in rate levels, Eckstein advised the System to concentrate on the growth rates of money stock and free reserves over the next quarter, shooting for something like a 7- to 8-percent annual rate of $M_1$ growth. Consistent with his past prescriptions, Professor Tobin took the opposite position, making a plea that System policy should simply be one of pushing on the aggregates hard enough to keep the bill rate steady to declining.

Professor Shapiro once again took a sanguine view of events. Dismissing the recent Kaufman speech as "utter, errant nonsense," he stated that most sectors are doing just about what was expected and that the recovery is proceeding in an orderly manner. He is not yet concerned with short-term rate levels and continues to predict a fall in long-term rates by the end of the summer. Shapiro cautions the System to hew closely to a 5- to 6-percent $M_1$ growth rate as its primary objective for the year. Shapiro and Eckstein concur in their conviction that housing starts of close to 1.9 million units now seem assured for the year as a whole.

Professors Wallich and Samuelson were unavailable for comment this month.

SECOND DISTRICT - NEW YORK

The overall picture that emerges from the answers to the questions raised with the directors of this Bank and of the Buffalo Branch and with other business leaders is one of cautious optimism regarding the economic outlook. Consumer spending was generally reported to be rising--albeit moderately--while there were no indications of further cutbacks in capital outlays. A good number of the respondents pointed to weak spots--notably, the adverse effect of high costs on residential construction and a continued unsatisfactory unemployment situation.

With respect to consumer spending, most of the directors indicated that such spending has continued on the upswing during the past month, although the majority felt the rise was only moderate. For example, the chairman of the board of a Rochester department store characterized the upward trend in retail sales as "slight," while it was the consensus of the Buffalo Branch directors that, although they noted a "slight acceleration" in consumer spending was occurring, there was no "clear signal" of a dramatic change in consumer attitudes.

Most of the respondents expressing an opinion on residential construction looked for a continued increase in activity in this sector. Virtually all of these respondents felt that home building activity was inhibited by the high price of houses, rather than by relatively high mortgage rates or a lack of mortgage funds. A typical reaction to this question was that of the chairman of the board of a large manufacturing concern who stated that "he believed that inflated prices were the limiting factor in the home building area." Similar sentiments were expressed by all the directors of the Buffalo Branch.

Turning to expenditures for plant and equipment, the continued lack of strength in this area was attributed to unused capacity and the accompanying decline in the profitability of recent capital investment, which have led corporations to be very conservative in their capital spending plans. However, there were no indications of further cutbacks in such expenditures. The president of a large oil corporation felt that oil companies and utilities must continue to expand plants to meet demand and that as a matter of fact these industries are "shifting to a scarcity" theme because they cannot meet the nation's energy needs. The feeling was general that the relatively high interest rates in the corporate bond market has little or no effect in limiting capital spending.

In general, the unemployment situation was described as unsatisfactory. The Buffalo Branch directors saw no improvement and indicated that local labor markets continued to be sluggish. The chairman of the Rochester department store stated that unemployment in that city was still rising. The president of an Ithaca bank, however, reported that unemployment in his area, at about 5 percent, was better than the average and had leveled off.

## THIRD DISTRICT - PHILADELPHIA

The general mood of businessmen, bankers, and economists in the Third District is that the recovery is continuing but at a gradual pace. Caution is still dominating inventory and plant and equipment decisions. Some step-up in hiring plans is occurring at the manufacturing level. On balance, inflationary expectations seem to be somewhat stronger than they were a few weeks ago. Bankers expect long-term rates to rise further.

The mood of manufacturers in the Third District is generally optimistic. Most of them believe the economy will continue to expand. For the immediate weeks ahead, they forecast an upward trend for new orders and sales. However, they remain cautious about building inventories and boosting outlays for new plant and equipment.

Increased business activity apparently is beginning to have an expansionary impact on hiring plans for District manufacturers. Since early 1970, more area manufacturers were laying off more workers than they were hiring. For most of the second half of last year, the percentage layed off was substantially greater than the percentage hired. This gap began to close earlier in 1971. For the last two months, the number of manufacturing firms adding to their payrolls has equaled the number cutting back. Nearly four times the number of manufacturers who were polled plan to increase the number of employees six months from now as plan decreases.

Inflationary expectations, however, continue to be very much alive. One director believes they are actually increasing. He says costs are rising rapidly and are exerting upward pressure on wholesale prices. Sooner or later, he says, prices at retail will begin accelerating again. There is fairly widespread acceptance of this view.

Most businessmen that we talked with believe that inflation is still the number one economic problem facing the nation.

A sampling of business economists in the Philadelphia area indicates that most are still forecasting a $1,045-1,050-billion GNP for 1971, with an unemployment rate near 6 percent at year-end. There is some disagreement, however, on the outlook for inflation. One group believes that a gradual recovery with lingering unemployment will be enough to dampen the pace of upward price movements. The other group contends that wage-push pressures are simply too great to be checked, even with the amount of excess capacity that is likely to prevail for the balance of the year.

Loan demand at banks is still on a very modest upward path. Most bankers we talked with anticipate that long-term rates will move up further. The reasons cited most often are a continuation of rising loan demand and the belief that inflationary expectations will intensify rather than abate. One country banker said he feels so strongly about higher rates that he wouldn't touch a 20-year mortgage for less than 8 1/2 percent.

FOURTH DISTRICT - CLEVELAND

This report is based on information obtained from about 50 economists who attended a regularly scheduled meeting of the Fourth District Business Economists' Round Table held at the Federal Reserve Bank of Cleveland on May 27, 1971. The consensus forecast for the remainder of 1971 that emerged from this meeting indicated moderate real growth, continued high unemployment, and only a modest improvement in the rate of inflation. In general, the group's outlook was changed little from the projections presented at our previous meeting on January 29, 1971.

The group's median forecast of current dollar GNP for 1971 was revised slightly upward from $1,045 billion to $1,050 billion. However, their estimate of the GNP deflator was also increased from a year-to-year gain of 4.2 percent to 4.7 percent. Thus, real growth for the year is still estimated to be only 2.7 percent. Moreover, several members expected an acceleration in the Consumer Price Index to a 4-percent annual rate during the second half of 1971, reflecting higher food prices and upward pressure on mortgage interest rates. With only moderate real growth anticipated, the business economists remained generally pessimistic about the prospects of any appreciable improvement in the recent 6-percent level of unemployment in 1971.

The majority of the economists noted that the strengthening of economic activity in the first quarter was generally in line with their expectations. Discounting the effects of the rebound from the auto strike and other distorting influences in the first quarter, the recovery of overall economic activity was moderate. Most of the underlying strength in the first quarter was centered in the interest rate sensitive areas of residential construction and state and local government spending. A large number of the Round Table members indicated concern that further increases in interest rates might choke off a continued expansion in these sectors later this year. Several economists asserted that mortgage rates have apparently bottomed out at relatively high levels, and representatives of several large commercial banks reported that the prospects for increases in the prime rate--to perhaps 6 to 6 1/2 percent by the end of this year--are strong.

The group did not foresee any significant improvement in the rate of business spending this year; therefore, the strength of the recovery in the months ahead will depend increasingly upon consumer spending. Most of the economists noted scattered evidence of improvement in consumer spending; however, no major surge in consumer spending was anticipated for the balance of this year. The group was encouraged by retail sales in March, April, and so far in May. Moreover, since the fourth quarter of 1970, the advance in retail sales has become more broadly based, reflecting some pickup in such hard goods as furniture and appliances. The rate of new car sales, however, is expected to decline following the first quarter post-strike rebound. The median forecast of domestic new car sales in 1971, submitted by ten economists associated with the automotive, steel, and rubber industries, has been reduced slightly since the January meeting to an annual rate of 8.5 million units. Estimates of imported car sales, however, have been increased by approximately 300,000 units to a level of 1.5 million units. In total, retail sales are expected to rise 8 percent in 1971.

Several steel industry economists reported that recent developments within their industry closely resemble the patterns experienced prior to the expiration of the labor contract in 1968. However, the steel inventory build-up in 1971 is expected to be about one-half million tons less than in 1968, because the economy was weaker at the beginning of 1971 and inventories held by steel consumers were much higher than in 1968. The median forecast for steel indicates domestic steel consumption of 102.4 million tons, domestic steel shipments of 93.6 million tons, and steel ingot production of 132.2 million tons. New orders for steel reached a peak early this year, and it is expected that production and shipments will peak in May and June, respectively.

## FIFTH DISTRICT - RICHMOND

Recent surveys of businessmen and bankers in the Fifth District indicate general agreement on the following points: (1) in manufacturing, reduced backlogs of orders with slight improvements in shipments and new orders; (2) substantial increases in manufacturing wages; (3) continued improvement in retail sales including automobiles; (4) substantial increases in loan demand, particularly business and mortgage loans; and (5) decreased optimism regarding future business conditions.

Improvements reported last month in District manufacturing have continued. Survey respondents indicated an increase in shipments and volume of new orders. Backlogs of orders, after showing a significant improvement in April, declined during May, according to respondents.

District bankers and retailers report improved retail sales. According to bankers, however, automobile sales were not up as much as they were in the previous month. Declines in inventories were reported by both manufacturers and retailers.

Manufacturers reported a slight improvement in employment. Very few respondents indicated increases in employment, but the number reporting decreases was lower than in the previous period. There was a slight increase in the number of bankers reporting decreases in their areas. District retailers report improvement in the employment situation.

Retailing and manufacturing respondents indicated continued increases in prices received. Upward pressures on wages continued, with more than one-half of the respondents in manufacturing and retailing and services reporting increased wage costs.

The construction sector of the Fifth District economy continues to be strong. Both residential and nonresidential construction showed substantial improvement in the District during the reporting period.

Respondents indicated that the demand for all types of loans increased in May. More than four-fifths of the bankers reporting indicated an increase in the demand for mortgage loans, and more than one-half reported increased demand for business and consumer loans.

District cash receipts from farm marketings continue to run below those of a year ago, although the decline is not as great as it was earlier in the year. Total cash receipts during the first quarter were 5 percent below those in the same period a year earlier. An 8-percent decline in livestock receipts more than offset a 7-percent increase in receipts from crops.

Although optimism has declined somewhat since the last survey, respondents remain optimistic on balance. Increased activity in construction--both residential and nonresidential--and in retail sales accounts for this guardedly optimistic outlook.

SIXTH DISTRICT - ATLANTA

Opinion seems to be growing that business activity has picked up and the outlook has improved. Leading businessmen and bankers throughout the District describe conditions with phrases such as "definitely up," "continuing to move at a steady pace," "moving steadily but slowly ahead," and "data seem to substantiate that the economy is on the road back." Bearish reports and attitudes have diminished. The increased optimism seems warranted on the basis of reports of new construction, plant announcements, and production increases. Inflation remains a worry.

A $.5-billion planned community has been announced for Nashville. The community will be called "Metrocenter" and will eventually include residential, commercial, industrial, and recreational properties. This follows last month's announcement of a $100-million plus project in the Atlanta area. Scattered construction announcements from elsewhere in the District include a major shopping mall in Pensacola, three apartment complexes in the Jacksonville area, a two-auditorium theatre in Vicksburg, a motel and convention complex in Auburn, and a recreational lake community near Montgomery. Condominium sales (and prices) along Florida's Gold Coast are reported to be up about 30 percent from last year.

A director of an industrial development department reports that he received more inquiries in April than he had received in all of 1970. Some firms, he notes, are looking for existing plants in order to get production under way quickly. In 1972, this director expects to see a resurgence much like the rapid growth of the early 1960's.

The tempo of plant announcements seems to be increasing. A plant that makes metal pellets for use in steel production will be located north of New Orleans on the Mississippi River. This could be the beginning of a major steel production industry. Other plant announcements include a wire plant in Tennessee, a polyvinyl chloride plant and a mobile camper plant in Georgia, two plants for making modular "home components," two apparel plants, and a shoe factory in Alabama.

There have also been a number of reports of improved business activity. Shoe plants in Tennessee, Mississippi, and Alabama are expanding employment. A Tennessee manufacturer of pleasure boats indicates that, for the first time, it has orders for all the boats it can produce before model changeover. Another producer of fiberglass boats is reported to be considering occupying an Alabama boat plant that was closed a few months ago. Manufacturers of furniture, appliances, and farm machinery in Tennessee are enjoying the best markets in a long time. A large chemical concern is reported to be seeking employees in Tennessee and initiating overtime. Disney World is beginning to fill 6,000 jobs for October's opening. Defense and aerospace companies near Orlando have evidently started to stabilize employment. Layoffs at the Atomic Energy Commission's Oak Ridge Plant are being scaled down.

Inflation remains a concern. One Tennessee banker reports that his bank is fighting inflation by reducing its staff to the bone. Hiring has ceased except when absolutely necessary, and resignees are not being replaced. The 50 to 60 summer employees usually hired will not be hired this summer. Cheaper sources of computer equipment are also being explored. He also reports that other institutions are cutting costs, including a private college that is paring its maintenance staffs and course offerings in order to balance its budget. Price increases continue in real estate and utility rates. One north Florida banker describes land prices as soaring. He claims there is a considerable appetite for any land, regardless of its location or potential profitability. A large Georgia electric utility has requested a 15-percent increase in residential rates and slightly smaller increases in commercial and industrial rates. Telephone and telegraph companies in parts of Georgia and Alabama have requested rate increases.

SEVENTH DISTRICT - CHICAGO

The moderate improvement in sentiment noted a month ago is still evident. But signs of a vigorous uptrend, except in residential building, remain elusive. Job markets appear to have stabilized, with some scattered rehirings, but students and teachers are swelling the number of job seekers. Propects are even less favorable than earlier for a significant diminution of upward price pressures. Demand for long-term funds remains strong, but demand for bank loans continues weak, although commitment volume has picked up sharply. There is no indication that the economy will again slide into a slump, but the reversal of the build-up in steel inventories after July and the ending of other temporary stimuli are expected to dampen the business uptrend. Looking ahead to 1972, a broadly based recovery is widely anticipated.

Orders have improved moderately for a variety of consumer goods, capital goods, components, and materials in the past several weeks. In almost all sectors, however, the order lead time remains very short. Nevertheless, stronger demand has encouraged price increases for such items as steel, nonferrous metals, building materials, plastics, and chemicals.

Inventories of most items are said to be well in line with requirements. Exceptions are extra holdings of steel, aluminum, and copper, awaiting strike developments. Many manufacturers have reduced goods-in-process inventories.

The outlook remains bleak for capital equipment generally. Farm equipment sales are reported to have improved recently, but data for first quarter show a large deficit from a year ago. The picture on construction-related equipment is mixed, with greatest strength in exports and mining equipment. The only really vigorous demand is for equipment related to pollution control.

Steel orders have slowed down to a level below shipments. Nevertheless, some transportation problems are beginning to hamper deliveries to steel users. On steel strike possibilities, it is generally recognized that the terms incorporated in the auto, can (and now, aluminum) settlements should set the pattern for agreement. Nevertheless, local problems and militant leaders may force a strike.

Concern about foreign competition continues to rise--in steel, machinery, and consumer goods. Some producers who used to emphasize an all-American product are developing or are seeking foreign sources for components (even including such bulky items as castings).

The current auto sales picture is clouded by effects of sales incentive programs. Inventories are now about right. Total sales of 9.8 million cars (including 1.5 million imports) will require strong demand for 1972 models.

With few exceptions, bankers continue to report demand for business loans as slow and disappointing. But there has been a sharp pickup in demand for firm commitments--paid for by fees or balances. Lines of credit, term loans, and revolving credit are all mentioned. Most of these commitments reflect a desire for insurance against future stringencies, because there is little indication that funds will be required in the near future. With slow business loan demand, banks are showing increased interest in mortgages, consumer credit, and broker loans.

More bankers, especially in Michigan, are investigating the advantages of holding companies and possible acquisitions of "bank-related" enterprises.

Inflows to bank savings accounts are reported to have slackened in recent weeks. CD money is not being sought aggressively. Savings inflows to S & L's, however, remain very strong.

## EIGHTH DISTRICT - ST. LOUIS

Leading businessmen in the Eighth Federal Reserve District continue to express optimism about current and future economic conditions. They expect wages to continue upward. Prices are also expected to continue upward and perhaps even accelerate later in the year. Retail sales continue to be strong, while housing as well as other types of construction have tended to level off at a plateau greatly exceeding the levels of a year ago. Employment seems to be stable, although some gains are anticipated if the current rise in business activity continues into the fall. For the most part, manufacturers have been able to expand production by using excess capacity.

Retail sales continue strongly upward. In view of colder-than-average spring weather, which tended to retard the movement of high-priced air conditioning equipment, this trend is an indication to retailers that prospects are very good for the rest of this year. They reported little change in recent months in the number of individuals who were unable to pay bills because of the loss of their jobs. This is in contrast to a large jump in such cases last fall.

Most manufacturers reported increased production and sales in recent months relative to a year ago. Manufacturers of supplies for the housing industry were quite optimistic, although there were scattered reports of inventories being drawn down. Most reported inventories are holding about steady; recent increases in production have been handled by using excess capacity built up in 1970. This is one reason that nonsignificant new plans for capital expenditures were reported, despite the prevailing optimistic expectations. Reports indicated little change in the longer-run investment plans for expansion.

Most firms reported a stable employment situation at this time. No more layoffs are expected, but there were only a few scattered reports of plans for new hirings.

Housing construction has tended to level off recently after big gains in previous months. One of the larger metropolitan areas in the District reported that housing construction is up 55 percent from a year ago. Primarily reflecting the national upturn in housing, demand for FHA and VA mortgages has been strong, and recently mortgage rates on both conventional and FHA-insured loans have risen. Loanable funds, however, generally remain plentiful, especially for those savings and loan associations operating primarily in the St. Louis market. There is some confusion as to the direction of current trends in interest rates paid to savers in St. Louis. Some savings and loan associations operating primarily in the local market have eliminated the 6-percent savings certificates in recent weeks, while others operating in both the local and national markets have eased the minimum deposit terms on high-rate certificates, indicating a desire to increase such accounts.

Underlying the current optimism in the housing industry was an undertone of apprehension that the current uptrend may be similar to some past upswings that led to housing recessions. They indicated a strong preference for a moderate and sustainable rate of expansion in home building.

Some concern was expressed over the problem of the dollar in international markets. One respondent feared that monetary policy makers will be forced to follow restrictive policies in order to correct the situation, thus, cutting off the economic recovery. Most respondents, however, believe that a high rate of inflation will continue.

This is a period of uncertainty for agriculture. Most crops have just been planted, and the outcome depends heavily upon weather conditions and disease. A big concern is the extent to which the southern corn leaf blight will appear again this year, even though resistant strains were planted to help reduce the damage.

NINTH DISTRICT - MINNEAPOLIS

Judging from the comments of bank directors and businessmen, sentiments about current and prospective economic activity have changed little over the last month. Respondents to our industrial expectations survey still foresee essentially the same sales gains as they did three months ago. Some bank directors are not quite as optimistic regarding consumer spending as they were last month. Almost without exception, the directors of this Bank are expecting the prime rate to rise soon and interest rates in general to move to higher levels.

Responses to our latest industrial expectations survey, taken in late April and early May, indicate that District businessmen have not significantly changed their sales expectations since early this year.

Sales during the first half of 1971 are still expected to about equal those of a year ago before rising appreciably above year-earlier levels during the second half. Most of the increase should occur in the durable goods sector, with sales rising 8.2 and 8.6 percent above year-earlier levels during the third and fourth quarters, respectively. Nondurable goods sales are expected to increase by about 5 percent during the second half of this year.

The survey also showed that some stockpiling may be occurring in anticipation of a possible steel strike later this summer. Respondents in the fabricated metals and transportation industries reported that their inventories were higher than would be normally needed for current and prospective sales levels.

The recent optimism regarding retail sales in this District seems to have dampened over the last month, although some directors reported that sales in their areas were still rising. A number of them felt that retail sales had slowed in recent weeks, primarily because of local conditions. However, one South Dakota director felt that farm machinery sales were down because buyers were not able to obtain bank financing. According to him, bankers have been experiencing some repayment problems due to the relatively poor agricultural income situation and, thus, have adopted more selective lending practices.

On the other hand, one bank director who had recently attended a meeting which included retailers from throughout the nation reported that they had experienced substantial sales increases during April and, thus, were considerably more optimistic than they had been earlier this year. Although not as dramatic, their sales gains in May have also been appreciable. He also mentioned, however, that the strongest areas were in apparel--particularly fashion items--and that hard goods sales were not as robust.

Aside from the surplus in farm machinery, retail inventories in the District seem to be in "pretty good shape." Retailers throughout the District have been watching their inventories very closely over the last year and so have not been trapped with too many goods on the shelves. In addition, retailers (especially apparel merchandisers) have been conservative in their purchasing because of the uncertainty in clothing styles. No strong recovery in purchases for inventories is expected. The directors of this Bank on the whole agree that the prime rate, as well as loan rates generally, will rise in the near future. Leading to this conclusion were such factors as the recent rise in Federal funds rates and the continuing heavy demand for business loans.

Although District banks are still experiencing strong savings inflows, they are having no trouble finding loan customers. One director felt that most of the people he knows believe "now is the time to borrow because rates are going up."

Mortgage rates in the Twin Cities have remained relatively stable over the past month, but in the past few days some lenders have been making slight adjustments in discount points on government-insured mortgages. Whereas discount points for prime mortgages were down to 1 1/2 points a week ago, they now have been raised to 2 points.

TENTH DISTRICT - KANSAS CITY

Businessmen continue to remain cautious on the economy. Steel stockpiling does not appear to be providing as strong an underpinning to second quarter economic activity as was anticipated earlier. Although the supply of mortgage funds for financing residential construction remains ample, the rate of deposit inflows is below the levels of earlier this year. One businessman is sure the recent turnaround in interest rates will slow recovery, while another thinks it represents a correction for an overly rapid decline. Others feel that progress against inflation will be extremely difficult so long as monopoly power prevails to the extent that it does. One of these rejects wage-price controls as unenforceable and ineffective because the cause is not treated. Thus, considerable confusion exists as to what is happening and what needs to be done.

Users and producers of steel indicate only modest stockpiling to date. Some who are carrying larger-than-usual steel inventories give reasons other than, or in addition to, the likelihood of a strike. One manufacturer blames lower-than-expected sales. Another claims to be hedging against further price increases. Still another thinks a prolonged strike most unlikely, although he admits to buying steel ahead--just in case. One purchasing agent points to mill ads for certain types of steel not normally available in shortage situations as evidence of little industrywide stockpiling. He adds that, if there is not a strike, steel producers will be faced with a slow fourth quarter as users are evidently accumulating adequate inventories considering current rates of use.

Steel producers and service centers throughout the District confirm the reports of only light overall stockpiling by their customers. A major steel producer in the Denver area describes orders as disappointing. He believes that steel demand is being held back by uncertainty in the economy and because steel companies are not providing financing for 60 to 90 days this time as they have done previously. A service center in Omaha says it is not doing much hedge buying because of the possibility of a construction strike in June but may do a little after this uncertainty is resolved. Two companies in Oklahoma give similar reports of only light hedging. A pair of steel distributors in Kansas City answered "some" to the question of steel stockpiling. One terms July an open-tonnage month, with plenty of room for orders. This has not characterized past strike-year patterns and gives users more room to hedge later, he said. The other pointed out that business is not such that firms are stockpiling in anticipation of strikes as in the past. Several of those contacted pointed to foreign supplies of steel and supplies from independents unaffected by a strike as contributing to the reasons for little stockpiling.

Farm machinery sales show some indications of improvement after two years of sluggish activity. Within the Tenth District, however, the prospects remain somewhat mixed, as sales in those areas suffering from the current drought are not expected to improve over last year. In fact, some decline seems likely. According to the machinery companies contacted, sales during the October-April period were generally disappointing--running 5 to 10 percent below year-earlier levels. However, the companies indicated that sales have recently picked up sharply, as farmers moved into the spring planting season and began preparations for the wheat harvest. One company reported an 11-percent increase in combine sales, and all representatives stated that large tractors (100+hp) have been moving especially well. With the exception of the drought areas, the outlook is generally optimistic for the remainder of the year, with sales expected to run moderately above 1970 levels. Much of the impetus for this expected improvement arises from the more flexible planting features of the new farm program, easier credit conditions, relatively high grain prices, and the deferred buying actions taken by farmers during the past two years.

The demand for mortgage credit has been heavy during the past few months throughout the Tenth District, except in areas where layoffs have been particularly high and have dampened consumer enthusiasm. Demand for funds to finance the purchase and construction of single-family units remains strong. The apparent bottoming out of interest rates has added some boost to demand, encouraging borrowers to go ahead with their home buying plans rather than wait for lower interest rates. However, the demand for funds may be slackening somewhat in the multi-family area.

Some increases in mortgage lending rates have occurred during recent weeks. In line with national developments, the points charged on FHA-VA insured mortgages have increased from the 2.5-3 to the 4-5 area during the past two weeks. In some cases, conventional mortgage rates have ticked up a notch. The prevailing rate on an 80-percent conventional loan is 7 1/2 percent (plus 1 percent origination fee).

The supply of mortgage funds for purchase and construction of conventional single-family units remains quite ample. Savings and loan associations report continuing strong deposit flows and mortgage commitments continue to rise. However, the rate of deposit inflows is below that which occurred earlier in the year. Savings and loan associations are responding by reducing their purchases of FHA-VA mortgages in the secondary market. This slowing of funds flowing into the secondary market is causing problems for some mortgage companies caught without commitments. In the multi-family area, the supply of funds has tightened in some cases due to the feeling on the part of the lenders that some overbuilding may be occurring in this area.

ELEVENTH DISTRICT - DALLAS

Economic activity in the Southwest is expected to continue to pick up through the end of 1971, in the opinion of the Head Office directors of this Reserve Bank. Employment and business investment have increased recently and are anticipated to rise somewhat more through year-end. There is some feeling that cutbacks in defense and aerospace spending will restrict the expansion. But the industries most directly affected appear to have passed their most critical period. Most respondents did not feel that much progress would be made against inflation between now and year-end. Moreover, they generally thought that both short- and long-term interest rates would rise, on balance, by year-end.

Most of the nonbank directors indicated that their firms, as well as other firms in their industries in the Southwest, were in fairly comfortable positions. Profits are expected to be greater this year than in 1970, and net capital investment is anticipated to rise about 5 percent over last year. These expenditures will be about equally divided between plant expansion and new equipment. In addition, most indicated that they were fairly satisfied with their current inventory positions, given their present outlook for business activity.

However, the directors did present a mixed picture with regard to the current employment situation of their firms. As compared with a year ago, about half of the firms have added people, on balance, while the other half had reduced the number of employees. Those adding more people did so because they either experienced a greater-than-seasonal pick-up in business or anticipated one. On the other hand, those with less employees indicated that the drop was due to technological improvements and other efficiency measures that did not require the replacement of some individuals who either retired or resigned. However, the employment outlook for the rest of the year was fairly optimistic. Most of the businesses expect to hire more people in anticipation of improved business conditions, and most respondents felt their businesses' employment trends and expectations are typical of their industries in the Southwest.

The responses of the banking directors also had a comfortable tone. Most indicated that, while loan demands currently are greater than at the beginning of the year, the increase was only moderate. However, they do foresee additional strength during the balance of the year, particularly for real estate loans. They feel their liquidity positions are adequate for present needs and, given reasonable deposit inflows, will be sufficient for the rest of the year. As of yet, the recent backup in interest rates has had no perceptible dampening effect on their deposit inflows.

There was some concern expressed by the directors with regard to the outlook for prices and interest rates. Most felt the rate of inflation would not moderate further by year-end. The nonbank directors indicated that their firms had raised the prices of most of their products by an average of 5 percent since the beginning of the year and would raise prices again before year-end. There was also a general feeling that interest rates would continue to rise moderately through the end of the year. Bank directors felt that lending rates at their banks would also rise over the balance of the year, largely in response to increased loan demand.

Indicators suggest the beginning of a modest recovery in District economic activity. April registrations of new cars in major Texas metropolitan areas were 2 percent higher than in March. Cumulatively, registrations are running about 10 percent higher this year than last. Department store sales through May 22 are running about 8 percent higher than a year ago. Nonagricultural wage and salary employment advanced from March to April and is slightly higher than a year ago. On the other hand, the seasonally adjusted Texas Industrial Production Index fell in April and is only slightly above the level for April a year ago. A drop in the production of transportation equipment was particularly noticeable. The Texas oil allowable was also lowered from 77.2 percent of maximum efficient production in May to 75.4 percent for June. But oil activity is still significantly above levels for a year ago. As a result of drought conditions in the Eleventh Federal Reserve District, wheat production in the five states is expected to drop a third from the year before and will be little more than half the 1969 crop.

TWELFTH DISTRICT - SAN FRANCISCO

According to reports received from bankers and businessmen in the Twelfth District, there has been no major change in the general pace of economic activity. Growth is at a moderate rate, as consumer spending remains steady and business investment plans are cautious. The recovery of the housing industry and the real estate markets is expected to be a growing element of strength in most areas, but the aerospace industry continues to cause problems in Washington and parts of California.

Our directors were asked to comment on investment activities in their area or industry. Most reported that, in the absence of a stronger expansion in demand, there would be no major increase in investment expenditures. Industrial firms are either carrying through programs planned earlier in the year without any recent upward modification or else limiting themselves to projects which promise immediate benefits in the form of cost reduction. Certainly there is no evidence that inventories are being built up. Firms continue to keep inventories closely tied to sales in order to reduce costs. A major oil company, for example, describes its inventories as "low but manageable." On the other hand, public investment is expected to be heavier in some states and large office building projects are continuing to be important in many of the major cities in the District.

The greatest weakness is in those areas where the aerospace industry is important. The Seattle-Tacoma District of Washington continues to experience low or declining retail sales and a stagnant real estate market. A further reduction in aerospace employment is expected. However, the local economy is described by one director as having reached a "hard floor" under personal income, but there will be no turnabout until the spring of 1972. The problems of Lockheed are causing further uncertainty in those parts of California where that firm and its principal suppliers are located; suppliers to the aerospace industry are reported to expect no pickup this year and very little next year.

The amount of vacant industrial property continues to rise in southern California. As one example, the vacancy factor for industrial buildings is 25 percent in some parts of Orange County.

Housing activity continues to grow in most states of the District. Commercial construction, especially large shopping areas and multistory buildings, continues to be important in California, Idaho, and Utah. Several large banks, for example, are constructing large, new head offices. The greater availability and lower cost of mortgage funds in the past few months has helped to stimulate real estate sales and construction activity.

The greater construction activity has helped the forest products industries, but the demand from construction is not sufficient to bring about a full recovery in that industry. The demand for plywood is weak, and prices for that particular product are falling. In western Washington, wood products are described as facing a poor market after anticipating an improvement, while in parts of Oregon, lumber mill employment is higher.

The prospects for agriculture are mixed. In western Washington, wet weather has created poor prospects for the local fruit crop. In Idaho, the picture for cattle prices is good, while that for the potato market is still uncertain because of the large carry-over from the previous crop.

Retail expenditures remain one of the stronger sources of demand, yet the rate of growth has not been great. Retail sales in some areas are reported as being at only the same level as last year, while in other cases, appliance sales are running 10 to 15 percent above levels of last year. New car sales are improving, but much of this activity is due to sales of small foreign cars. Overall, consumers are described as cautious.

Bankers continue to experience inflows of deposits, especially savings deposits. Also, there has been some firming of the demand for business and mortgage loans. Many banks are still attempting to expand their lending to make use of their larger supplies of funds. There has been some adjustment in interest rates. In most cases, the prime rate has been adjusted upward but not other lending rates to any degree. Most, but not all, banks have lowered their passbook savings rate to 4 percent.

In summary, there has been little change in economic or financial conditions, and the general expectation is for a continued gradual expansion of the economy.