CONFIDENTIAL (FR)

CURRENT ECONOMIC CONDITIONS BY DISTRICT

Prepared for the
Federal Open Market Committee
by the Staff

December 8, 1971

TABLE OF CONTENTS

SUMMARY*

The general tenor of the twelve Red Book reports may be summed up as follows: a present business situation that is generating little enthusiasm; an emphasis on uncertainty, perhaps even greater than usual; and a future viewed with some optimism. This generalization alone of course conceals a range of views, especially for the present situation: "sluggish" conditions are reported from Philadelphia and Cleveland, while Boston and Dallas report "good" or "improving" conditions, and some Atlanta District businessmen suggest that "pessimism has been exaggerated." The consensus is greater, however, on the existence and retarding influence of uncertainty—more than a little of which emerges from the presently unknown influence of Phase II policies and their implementation. Yet, expressions of optimism for the months ahead are found throughout the various Bank reports.

As might be expected in a period of uncertainty and adjustment to new policies, considerable variations of opinion were gathered by the Reserve Banks from respondents to their inquiries. In construction, for example, the Richmond Bank reports some slackening in both residential and nonresidential building; in Chicago, residential vacancy rates are up and new permit issuance has slowed down; and construction activity has tended to level off recently in St. Louis. On the other hand, continued strength in construction is reported from Atlanta, Kansas City, and San Francisco. Several Banks found mortgage money abundant, and rates and terms easing. Saving and loan savings inflows remain strong, and

---

*Prepared by the Federal Reserve Bank of Kansas City.

life insurance companies also reportedly have ample funds and are in search of investment opportunities.

Consumer spending, past and expected, also varies considerably from District to District. On balance, there does not seem to be great strength in this sector. Retailers contacted by the New York Bank expect a "good, if not spectacular, holiday season," an attitude shared to a greater or lesser extent by merchants in the Kansas City, Dallas, Minneapolis, and San Francisco districts. Prospects might be thought a little brighter in the Richmond and St. Louis areas; a little dimmer in the Philadelphia area.

Those Banks remarking on inventory investment nearly all cast some doubt on a sudden rise in the rate of inventory accumulation. The New York Bank's respondents see no significant pickup in business inventory spending, a view seconded in the Boston report. In the Dallas District, where sales have been slow recently, retail inventories are described as "excessive," and St. Louis reports that retail inventories there are not growing with sales. In the San Francisco District, inventories are being "deliberately kept low and geared to sales," while Chicago states that "Inventories continue under tight control." In a somewhat different view, the Richmond Bank notes some recent slight increases in manufacturers' inventories, but finds retail inventories declining to more desired levels.

The steel industry's position was commented on specifically in the Chicago and Cleveland reports. Steel orders—"disappointing" overall, but variable from firm to firm and plant to plant—appear to be in for gradual improvement, bringing operations back to "normal" next year for the entire industry. In the meantime, the steel industry is "depressed" as the inventory liquidation is prolonged by increased imports and lower-than-expected current consumption of steel.

While the steel situation has combined with several strikes to bring recent employment declines in the Cleveland District, employment growth is lagging in other Districts, too. Philadelphia reports little new manufacturing employment, a condition expected to extend into the immediate future. Some slight improvement in employment in scattered areas of the New York District is apparently bringing little improvement in overall unemployment. Employers in the Boston District note that, with capacity use rates so low, a sizable rise in demand will be needed before employment is expanded. Yet, improving employment situations are reported in the Atlanta, Dallas, and Richmond districts.

The relatively few comments on business capital spending indicate no current spurt in such activity. However, there has been some increase in purchases of heavy trucks, construction and materials handling equipment, and especially of farm machinery. Both the Minneapolis and Kansas City Banks commented that the investment tax credit might be partly responsible for the latter, along with the harvesting of bumper crops and rising farm income. Agri-business firms generally are quite optimistic about their future sales prospects.

There was agreement on the Atlantic and Pacific Coasts on the frailty of business loan demand and its relationship to the moderate pace of economic activity. The New York Bank noted that "the demand for business loans does not suggest any quickening in the pace of business activity," and the San Francisco Bank commented as follows: "...with few exceptions, bankers describe business loan demand as weak, reflecting the moderate pace of business spending."

Business loan demand was only "seasonal" in the Philadelphia area; "slow, and weaker than usual" in the Chicago District; and weak at major banks in the Eighth District. In the Kansas City District, however, business loans were stronger in November than in other recent months.

The range of feelings expressed about Phase II include uncertainty, skepticism, and optimism. Several businessmen in the St. Louis District feel that the new programs have hindered business spending so far, and some "see little hope for improvement in prices and profits." Some respondents in the Chicago District feel that sufficient price rises will not be allowed to keep up with cost increases. A major fear, expressed in the New York report and implied in the reports from San Francisco and Chicago, is that controls on prices will be more effective than those on wages, and that a profit squeeze will result, especially for large companies. While not overly optimistic about the program's complete success, there was an attitude that its influence would be favorable— "better than nothing," with "a 50-50 per cent chance of 'crudely and clumsily' moderating the pace of inflation," according to one director of the New York Bank. As the San Francisco Bank aptly concluded: "Overall, Phase II was greeted with less enthusiasm than Phase I, because its duration and character are more difficult to assess."

FIRST DISTRICT — BOSTON

Only a few of our directors could be reached this month, but the responses of these directors were much more optimistic than they were a few months ago. Business was described as "good" or "improving."

A manufacturer supplying raw materials to the tire industry reported that "business looks good in the month of November." Business was also reported as "good" by a manufacturer of leisure-time boats. Despite the large volume of orders in the boating field, the manufacturer is only building to order, not to stock. Inventories are, however, being built up by retail dealers who are very optimistic about next season's sales.

Southern New Hampshire, which already has a far lower unemployment rate than the national average (3.8 per cent), is the only area where manufacturing plants, previously not in the labor market, had recently begun hiring again. Both the shoe and textile industries were reported now to be looking for new help. Other manufacturers noted that, since they were still operating below capacity, demand would have to rise much farther before they would have to expand their labor force. Despite the steadily improving industrial picture, there has not been any inventory accumulation beyond incoming orders.

None of our respondents have recently increased their capital spending plans; however, one manufacturer in the machine tools business was very optimistic about new sales possibilities in the Soviet Union. He noted that our Government has loosened up its export licensing for sales to the Soviet Union and that another firm has received tentative orders for $60 million. One of our director's firms is the first American company to receive financing from the

Export-Import Bank for machine tool sales of $1.2 million to Rumania.

All five academic respondents were contacted. Eckstein reported the current picture is mixed—retail sales show no signs of a substantial upward breakout, yet the talk of business fears and uncertainties has clearly been exaggerated. Shapiro and Samuelson expect a gain of about $100 billion in GNP in 1972. Shapiro anticipates rates on new issues of Aa bonds to decline to about 6.5 per cent by June of next year, and found no reason why long rates would rise in the second half of 1972. Tobin and Wallich expressed skepticism about the $100 billion gain in GNP. Wallich anticipates an $85 billion gain with long rates falling and short rates rising only at the end of the year.

Shapiro sees considerable progress in the international monetary situation. He specifically disputed analogies which have been drawn between the present situation and 1929. The major difference between the two periods is that countries now know much more about how to manage aggregate demand. Samuelson stated that the needed change in exchange rates was a big one, and warned against "premature" settlements based on minor realignments. He urged that monetary policy not be used to offset any downward pressure on the dollar.

With regard to the recent lack of growth in the money stock, Professor Wallich said that the drop in inflationary expectations had reduced the demand for working capital and therefore for borrowing. The Fed should take advantage of this opportunity to "gather reserves" so that it can afford to expand if it became a political necessity to hold down interest rates. If rates were to start to rise, however, the Fed must be mindful that it has very limited leeway to keep rates down.

Both Shapiro and Wallich expressed strong agreement with Governor Maisel's recent speech. Wallich indicated that 5 to 6 per cent rate of monetary growth would not allow for sufficient real growth, since the upper limit of velocity growth would be about 2 to 3 per cent, particularly in light of falling interest rates. Tobin felt that 6 to 8 per cent growth in the money stock would only be accommodating the economy's growth, not aggressively pursuing more rapid growth. Samuelson argued that the simple notion of the desirability of smooth growth in the money stock is "a bad thing." He suggested the Fed should be prepared to accept "choppy" money supply figures. For example, if foreign governments should wish to hold substantially fewer U. S. securities, an irregular bulge may be expected to appear.

Even with a $100 billion GNP gain and real growth of just under 6 per cent, Eckstein calls the 1972 script an inadequate social policy. Basic business confidence will be "great," there will not be a "boom economy" or dangers of excess demand inflation, and unemployment will not drop substantially. Next year will be a replay of the early 1960's, only worse. The problem for monetary policy, Eckstein argued, was how to move interest rates down without excessive expansion in liquidity. He projects long rates to drift down only slightly and then to rise.

Wallich suggested that a floating prime rate was capable of considerable mischief—that there was danger of a precipitous upshoot. He urged the Federal Reserve System to study this problem.

SECOND DISTRICT — NEW YORK

Assessment of the economic situation by the directors of the New York Bank and the Buffalo Branch and by other business leaders continues restrained. The feelings of uncertainty expressed last month concerning the effectiveness of Phase II in controlling inflation have not been dissipated, little headway has been made in reducing unemployment, business continues to pursue cautious inventory policies, and the demand for business loans does not suggest any quickening in the pace of business activity. Consumer spending over the holiday season is generally expected to exceed last year's levels, although there was no feeling that the trend in such outlays was pointing toward boom proportions.

With respect to Phase II, the Buffalo Branch directors thought that the program might result in some slowing down in the rate of inflation, but most were not optimistic regarding the chances of meeting the 2 1/2 per cent goal for prices. These directors felt that the Price Commission would be reasonably successful in holding the price line, particularly among larger companies, but that the Pay Board would have difficulties in controlling wage increases—in part because the Board in its initial operation was "bucking" against wage increases granted before the "freeze" period and not yet put into effect. Against this background of relatively more effective controls on prices than on wages, the vice president of Rochester's biggest firm predicted a profit squeeze, particularly for large companies. Among the New York Bank directors, one characterized Phase II as a "mixed up affair" and suggested that the only way price increases could be held at 2 1/2 per cent would be if "business is bad." The chairman of the board of a large manufacturing concern felt that the program had a 50-50 per cent chance of "crudely and clumsily" moderating the pace of inflation. (The same odds on the success of the program were also quoted by two Buffalo Branch directors.) He felt the program could not work for more than 12 to 18 months, but regarded this as better than nothing.

As to the unemployment picture, the directors that expressed an opinion on the subject generally saw little, if any, improvement. The improvement in some scattered areas was attributed to special circumstances. A Rochester businessman, a director of the New York Bank, not only saw no strengthening of the job situation, but referred to further layoffs by his own firm and by Life magazine. The chairman of the board of the large manufacturing concern reported that he was not aware of any significant turn for the better. Among the Buffalo Branch directors, only two saw some discernible improvement. The vice president of Rochester's largest firm saw a slight strengthening, which he linked to the completion by most employers of their efforts to reduce costs and improve productivity. The chairman of the board of a Buffalo bank reported some increase in employment in the Buffalo area associated with the partial resumption of steel production; however, he did not view this as indicating an overall upward trend in local employment, and characterized the local labor market as "still very weak."

In general, the directors saw no indication of a significant pickup in business inventory spending. The Rochester businessman "detected" continued caution in businesses' inventory policies. None of the Buffalo Branch directors saw any change in such policies, with the possible exception of retailers stocking up for the holiday season. The chairman of the board of the large manufacturing concern, however, felt that there had been a "slight" improvement in this sector. None of the directors reported a rise in business loan demand that might suggest a quickening of pace in business activity, although the banker directors at the Buffalo Branch reported a strong demand for mortgage loans.

With respect to consumer spending, opinions were mixed and on balance not particularly exuberant. Most of the Buffalo Branch directors described retail sales as "brisk" and running above last year, at least in dollar terms. Among the New York directors, the president of an upstate bank pointed to the strong performance of automobile sales, but felt that, apart from this sector, business remains "spotty." Most of the retailers who were contacted reported that business had begun to pick up in recent days, and they were expecting a good, if not spectacular, holiday season. The chairman of the board of a large Rochester department store, however, stated that his firm would be fortunate to equal last year's dollar volume during this Christmas season.

THIRD DISTRICT — PHILADELPHIA

In general, business conditions in the Third District are sluggish, although the outlook over the next six months remains optimistic. Key manufacturing indicators, such as new orders and sales, have shown little change in the last month. The consumer sector shows normal seasonal patterns as does business loan demand at area banks. However, District manufacturers and economists see increased activity by next spring. Price increases in the District seem to have leveled off, and area businessmen do not anticipate a resurgence of inflation in the near future.

District manufacturers polled in the Bank's monthly business outlook survey generally assessed business activity as unchanged from October. Most of the key indicators for November, such as new orders and sales, were essentially flat. Virtually no companies reported that they had added employees during the month. And the manufacturers expect the lull to continue in the immediate future. Over half see no change in new orders and over 80 per cent expect to add no additional employees during December.

A majority of the manufacturers remain optimistic about the longer run; however, approximately two out of three anticipate a jump in sales and new orders by next spring, while almost one-fourth of the executives canvassed intend to add employees to their payrolls during this period. Nearly 25 per cent plan to increase capital expenditures six months out. The longer-run optimism also is picked up by area business and bank economists. They expect a 9.6 per cent growth in GNP during 1972, with about two-thirds of that expansion representing a real gain in output. The economists also predict that business spending will be a major factor in the expansion, especially in the last two quarters of 1972. Fixed investment is forecasted to rise at an annual rate of 6.7 per cent during the first half of 1972, and 12 per cent during the second half.

Signs in the consumer sector are somewhat mixed. Members of the Bank's Board of Directors find no observable upsurge in consumer confidence. There appears to be a normal seasonal increase in retail sales, although retailers are not especially bullish. Area bankers reported a gradual upward trend in consumer credit during the last two months. Looking ahead, area economists expect that consumer spending will rise about 9 per cent during 1972, with outlays for durable goods setting the pace. Private housing starts are expected to level off in 1972 after a strong finish in 1971.

Business loan demand at area banks appears to remain seasonal in nature, with some strength in retail and nondurable goods sectors. Most customers appear to show neither great optimism nor pessimism, but retain the wait-and-see attitude.

On the price front, nearly 90 per cent of the District manufacturers polled reported no change in prices for November, and over 80 per cent expect that trend to continue through December. Furthermore, the percentage of businessmen expecting price increases six months ahead has dropped substantially since July, the last full month before the freeze. Area economists expect that the rate of increase for consumer prices will slow to just under 3 per cent for the second half of next year, compared with 3.7 per cent for the first half.

FOURTH DISTRICT — CLEVELAND

Sluggish conditions in the steel industry and labor-management disputes are among the major factors impeding economic recovery in the District. High imports and low domestic consumption are prolonging the steel inventory liquidation. Several of our directors are concerned about international financial uncertainties, and domestic uncertainties regarding congressional legislation and Phase II. Finally, many District bankers report recent high rates of consumer-type savings inflows, but general reluctance to cut interest rates on those savings.

The depressed state of the steel industry and labor-management disputes (coal mining, office machinery, and glass, among others) were largely responsible for District nonfarm payroll employment dropping to a new cyclical low in October, following an upturn in September. Declines occurred in both the manufacturing and nonmanufacturing sectors. Our electric power index of manufacturing output, which had started to recover in September, also declined sharply in October. The index has declined in four out of the past six months and is now about 5 per cent below the level of last spring. Even after allowance for strikes, the pace of recovery in the District remains sluggish. As of October, total nonfarm payroll employment and manufacturing employment were both below the levels recorded at the trough of the past recession. In mid-November, the District's insured unemployment rate was still high by historical standards (more than three times the pre-recession level). With further layoffs in the steel industry reported after mid-November, especially in the Pittsburgh-Wheeling-Steubenville area, overall unemployment is likely to remain at a high level through yearend.

Economists from three major steel companies informed us that the inventory liquidation phase is being prolonged, partly because of a high rate of steel imports since the steel settlement, and also because of a lower-than-expected level of steel consumption in the current quarter. All the steel economists said orders are gradually improving, but the auto industry is still not placing normal orders. Imports are expected to exceed 17 million tons this year, compared with the 15.4 million ton voluntary quota. (Countries that did not agree to the quota, such as Canada, Sweden, and Great Britain, are partly responsible for the excess of steel imports; some EEC countries have also overshipped; but Japan is still within her quota.) The steel economists expressed the opinion that general confusion about prices has resulted in very little price-hedge buying of steel.

The reports of some of our directors also indicate that the current economic situation is sluggish and that the outlook—to the extent one can compensate for uncertainties—is somewhat brighter. The directors believe that the new economic policy has been deflationary thus far. Uncertainties about congressional legislation and implementation of Phase II have resulted in a postponement of decisions regarding capital spending projects. Uncertainties with respect to foreign exchange rates, according to one director, are seriously hampering his firm's export orders. Another director, however, reported that his company recently received a $300 million contract to provide nuclear reactors for Spain. Much of the work, including designing, engineering, and manufacturing, will be done in the Pittsburgh area over the next five years.

Bankers report renewed growth of consumer time and savings deposits since October, which they attribute to the lower level of competing market interest rates. However, there appears to be little likelihood of a cut in bank interest rates on consumer time instruments. (One banking director and several officers of smaller banks and savings and loan associations noted that the savings inflow is too heavy to justify current interest rates paid, but no bank has been willing to take the lead in adjusting rates downward.) No change in business loan demand has been detected. Real estate, consumer instalment, and commercial and industrial loans to local customers are all growing rapidly; but business loans to large corporate customers, especially those with access to the commercial paper market, continue at their recent slow pace.

FIFTH DISTRICT — RICHMOND

Results of our regular survey of businessmen and bankers in the Fifth District indicate that the moderate expansion in business activity evident in the last several months is still under way. Manufacturers report increases in shipments, new orders and backlogs of orders, and retail sales continue relatively strong. Construction activity is not as vigorous as it has been in recent months, with some slackening in residential construction being especially evident. Loan demand continues to follow the pattern set in recent months, with consumer loan demand especially strong.

In general, District manufacturers report that shipments, new orders, and backlogs of orders are up over the previous reporting period. Increases are reported in such industries as furniture, textiles, chemicals, and electrical equipment, while decreases are reported by hoisery, apparel, and synthetic fiber producers. Manufacturers' inventories were reported to have increased slightly for the first time in several months and the level of inventories, relative to desired levels, showed some improvement over last month.

Although the long coal strike dampened business activity in some areas, on balance District bankers and businessmen in trade and services report that retail sales are up in their areas. Further increases in automobile sales were also reported. Retailers' inventories declined substantially from the previous reporting period and the proportion of retailers reporting inventory levels too high declined sharply.

Contrary to the situation in the previous months, manufacturing respondents and District bankers report increases in employment, and manufacturing hours worked per week showed a slight increase over last month. Trade and services respondents indicate a continuation of the increase in employment which began two months ago. On balance, banking respondents report no change in the available labor supply in their areas.

Although several manufacturing and trade and services respondents reported that prices received had decline, the overwhelming majority of respondents reported no change in prices received. Price declines were especially evident among metal producers. No price increases were reported. There was a sharp increase in the number of manufacturing and trade and services respondents reporting increases in wages paid.

Responses from District bankers suggest some further slackening in both residential and nonresidential construction. For the first time in several months, the number of banks reporting a decline in residential construction in their areas was greater than the number reporting an increase. Although loan demand varies considerably from area to area in the District, demand for business and mortgage loans generally continues to follow the pattern of recent months. The number of bank respondents reporting an increase in the demand for consumer loans increased substantially over the previous period.

District farmers' cash receipts from farm marketings during January-September were 1 per cent below those a year earlier, with a 5 per cent decline in livestock receipts more than offsetting a 3 per cent gain in receipts from crops. Quality of the 1971 flue-cured tobacco crop was noticeably better than last year's, demand was strong, grade prices were the highest in history, and the general average price was at an alltime high—some 8 per cent above the 1970 average.

The general economic outlook of survey respondents remains favorable. Approximately 60 per cent of the banking respondents believe that an increase in general business activity is likely over the next three months.

SIXTH DISTRICT — ATLANTA

An improvement in business sentiment has occurred during the past six weeks, at least among businessmen located in areas of the District that have usually been relatively prosperous. For example, most attendees of a recent meeting of Nashville business leaders agreed that pessimism has been exaggerated, and that business was not as bad as it has been made out to be. A Tennessee director claims that optimism in his area is greater than at any time in the past few years. Directors representing north and central Florida described prospects, especially in the construction and real estate field, in glowing terms. Some businessmen doubt the efficacy of Phase II because of the large wage increases granted by the Pay Board.

Despite recent reports of overbuilding in some sectors, construction activity is reportedly showing strength. A rash of new developments has been announced around Orlando, including a residential-commercial development valued at $50 million and another valued at $20 million. Total real estate activity is running about 100 per cent above last year's level in the Orlando area, mainly because of Disney World. There have also been several announcements of large residential-commercial developments in the Tampa area, including a $16 million condominium and two shopping centers costing a total of $3.2 million. For the third time in the past year, a large parcel of land along the north Florida Gulf Coast has recently changed hands. A residential development is being planned for the site. A $43.5 million loan has been secured for the completion of the final stage of hotel-office-condominium-apartment complex in downtown Atlanta. A large planned residential community has been announced east of Atlanta, and planned communities are reportedly under consideration for two areas southwest of Atlanta.

Construction activity is evidently benefiting from an abundant supply of mortgage money. Executives of two life insurance companies claimed that they are having a difficult time finding investment opportunities, especially because the demand for mortgage money for commercial construction has been weak. They also report that real estate investment trusts are beating the bushes for opportunities to place funds.

The employment outlook has improved. Disney World will add 2,000 workers by Christmas, 1,100 more than originally planned. A tire plant in central Alabama has recently added 200 workers. Directors from two areas in Tennessee report that unemployment is negligible.

Plant announcements continue at a modest pace. New chemical plants will be built in Vicksburg and Baton Rouge. Construction of a large seafood packing plant in Brunswick, Georgia, has begun. A life insurance company is setting up regional headquarters in Jacksonville, and two national concerns are reportedly interested in locating in the Jacksonville vicinity.

Two wage settlements have come to our attention since the end of the freeze; they call for first-year raises of 9 and 11 per cent. The portion of the raises above 5.5 per cent is evidently being held up, pending Pay Board action.

The outlook for the citrus industry has reportedly never been better. Although a good crop is expected, demand has been so strong that the carry-over of frozen orange juice concentrate from last year's bountiful harvest is small.

SEVENTH DISTRICT — CHICAGO

The air of uncertainty emphasized in the last Red Book forecast is still widely prevalent in the Seventh District, but signs are accumulating that business and financial executives believe price-and-wage guideline decisions will be flexible and reasonable. The major consumer durables industries continue as the strongest sectors, but some producer goods are showing increased vigor. Inventories continue under tight control. Regional unemployment estimates are generally more favorable, but the reliability of the estimates are in doubt in some cases. Business firms are moderately optimistic in projecting results for next year. Credit is available in all markets, but demand for business loans remains slow.

The period since mid-August has been characterized by softening in prices of finished producer equipment, parts and components, and nonferrous metals. The freeze helped to accelerate the impact of market forces. As a result of earlier increases, some prices contained a good deal of "water." But many executives believe that cost increases justify larger price increases than those that have been, or will be, allowed. They believe that labor contracts negotiated before and during the freeze will be allowed to stand, and that "catch-up" increases will be granted to unions in related fields that are now entering negotiations. There are some complaints about the limitation of dividend increases to 4 per cent in cases where increases had been planned to aid sales of new stock issues.

Some labor leaders appear to be concerned that their rank-and-file are not sufficiently militant in support of union positions relating to the new economic policy. Educational efforts have been expanded as a corrective measure.

In the capital goods sector, demand for heavy trucks has increased significantly in recent months. Increased sales of farm, construction, and materials-handling equipment are expected in 1972. Orders for parts and components have improved slightly in the past month or two. Producers of railroad equipment believe additional orders are held in abeyance, awaiting certainty on the state of the investment tax credit. Inventories of capital goods producers are relatively low.

The extremely high level of sales of passenger cars (at least until the final third of November) has puzzled auto producers. Dealer profit margins have been favorable, so the price freeze is not the whole story. The dock strike has been the major factor dampening sales of imported cars, but appreciation of foreign currencies, upward cost pressures abroad, and the surcharge are all playing a role.

Steel orders are still disappointing, overall, but the picture varies substantially from firm-to-firm and plant-to-plant. One Chicago-area steel producer, with 90 per cent of its normal work force on the job, was surprised at the number of workers who did not respond to recalls from layoff. Steel operations are expected to be back to "normal" early next year for the entire industry, and 1972 as a whole is expected to see an 8 per cent rise in shipments from 1971.

Further evidence has developed in the past month to suggest that the housing market has passed its peak, at least temporarily. In the Chicago area, vacancy rates have increased, and the issuance of new permits has slowed. The situation varies among sections within the area, however, and the level of total residential construction remains very high.

Some very large commercial construction projects have been activated recently in the Chicago area. Office structures are included in the new announcements, despite the large volume of space coming available in the immediate future and in the next two years. Work on some structures is said to have slowed down. Speculative builders are less prominent, with most new projects supported by large enterprises that will occupy much of the space.

Return to work orders last week to striking dock and grain elevator workers are credited with boosting the price of corn, especially the cash price, because foreign demand can be accommodated. Pressures from the farm sector may have encouraged the return to work. Comments of the Secretary of Agriculture nominee, that steps will be taken to boost corn prices, also helped.

Commercial banks report business loan demand slow, and weaker than expected. Purchasers of certificates of deposit are reluctant to take maturities beyond 30 days, because of uncertainties over interest rate trends. The potential supply of new municipal issues remains very large. Life insurance companies have ample funds to invest because of both reduced demand for policy loans and increased prepayments of mortgages as homes are sold. Life companies favor large mortgages—industrial, commercial, and multifamily residential—over alternative investments.

EIGHTH DISTRICT — ST. LOUIS

Leading businessmen in the Eighth District report that business activity in recent weeks has continued to move up at a moderate rate. Consumer demand is encouraging with pre-Christmas sales well above levels of the same period a year ago. The higher sales level, however, has had little impact on business confidence and spending plans. Uncertainty continues to dominate the local business community, largely as a result of the confusion relative to Phase II of the new economic program. Construction has leveled off. A high rate of savings flows continues, while interest rates on mortgages are generally unchanged. Commercial loan demand remains relatively low. Agricultural conditions in the District are generally favorable and long-run trends toward greater efficiency continue.

Retail sales have increased substantially in recent weeks. One large St. Louis department store reported that sales were running well ahead of the budgeted level. Another reported that early Christmas sales were significantly above levels of the same period last year. Likewise, other cities in the District, particularly in the Little Rock area, report similar trends in retail trade. Retail inventories have apparently lagged sales trends. One major District department store reported that inventories are now 14 per cent less than a year ago despite major sales gains. The achievement was made through machine inventory control.

Despite increased consumer optimism, much of the business community remains relatively pessimistic and confused. Businessmen question the compatibility of the decisions of the wage and price boards, and see little hope for improvement in prices and profits. A representative of a major St. Louis corporation reported that the controls had stymied business investment. Another reported that manufacturing industries are still not ready to make new investment commitments. Even though sales are picking up, the outlook for profits is not sufficient to provide incentive for new capital outlays. Reporters in Memphis also conclude that the wage-price program is hurting industry.

Construction in the Eighth District has tended to level off in recent weeks, but the pattern is quite mixed. Following sharp gains in residential construction in St. Louis during the summer months, home sales have dropped substantially in recent weeks and builders have larger than desired inventories of new homes. Apartment construction has also been dampened by a higher vacancy rate. In other parts of the District, however, construction continues to expand. Numerous commercial projects are reported to be under way in the smaller cities and towns, especially in the Memphis and Little Rock Branch areas, and the industry generally remains optimistic about the prospects for next year.

Savings flows remain strong throughout the District. A large share of the gain in savings, however, is going to the savings and loan associations. Rates paid savers and the rates charged on mortgages have both remained stable for several weeks.

Reflecting both business pessimism and the greater efficiency in handling inventories, commercial loan demand remains weak at major District banks. National credit lines are reported to be inactive, and demand for credit by small local firms is not sufficient to offset the decline by larger firms. A large St. Louis retail firm reported major savings in costs of money borrowed for inventories despite the rise in sales.

In the agricultural sector, autumn weather conditions were excellent for harvesting the generally large crops. The dock strike was believed to have had an unfavorable impact on farm commodity exports and grain prices. Nevertheless, the farm situation is much better than a year ago. The larger volume of production has more than offset price declines for most crops and livestock products. The long-run decline in number of farms continues. Good managers are expanding their operations, and the less capable ones find employment elsewhere. An Arkansas reporter estimated that the number of rice farmers would decline 10 per cent from 1971 to 1972.

NINTH DISTRICT — MINNEAPOLIS

Uncertainty over Phase II has not affected the pace of business activity in the District, and businessmen have not let the uncertainty interfere with their prior planning. Retailers are still looking forward to a good Christmas season, and District retail sales during Thanksgiving week were very encouraging. In addition, a recent newspaper poll revealed some improvement in consumer buying intentions for next year. Except for some increase in farm machinery sales, prospects of a 7 per cent tax credit have not yet affected District investment spending.

According to reports received from Bank directors, uncertainty over Phase II has not affected the pace of economic activity in the Ninth District. One director stated that businessmen in his area were going ahead with their plans despite any uncertainty over Phase II. Another director considered Phase II a topic of conversation, but felt that it has not altered business decisions. One report, however, indicated that small businesses had held down, or delayed, raises due to difficulty in interpreting Phase II guidelines. The only adverse impact of Phase II reported by another director was that the time spent by businessmen in interpreting Phase II rules had kept managers away from more productive endeavors.

The directors also felt that the implementation of Phase II has not adversely influenced consumer sentiment in the District, and they reported that District retailers expect their sales to improve. One director, however, did express some concern over consumer skepticism about the effectiveness of Phase II because of the large wage and price increases that have been permitted by the Pay Board and Price Commission. Also, a newspaper poll conducted in the Twin Cities metropolitan area revealed that only 46 per cent of the respondents believed that Phase II would ultimately be successful in holding down inflation.

The prospects for District Christmas spending are relatively bright this year. Bank directors were unanimous in expressing the opinion that this would be a good Christmas season for retail trade, and reports from around the District revealed that sales during Thanksgiving week were encouraging. However, one director did state that, while retailers in his area were looking forward to improved sales, they were not exuberant about their expectations. A business economist for a large Twin Cities-based retailer said that he expects Christmas spending at department and discount stores in the upper midwest to be up 12 to 15 per cent from a year ago—an outlook shared by a major Minneapolis-St. Paul retailer.

Looking forward to next year, the results of a recent Minnesota poll disclose some improvement in Minnesota residents' buying intentions from a year ago. Last year, 14 per cent of the survey's respondents were planning to buy either a new or used car during the next 12 months. This year, 17 per cent reported they planned to buy an automobile during the next year. Twelve-month buying intentions for home furnishings were also up slightly from 12 months earlier. However, the survey revealed that Minnesota residents did not significantly increase their buying intentions during Phase I, as only 2 per cent reported that they had made unanticipated major purchases during the first 75 days of Phase I.

In the view of Bank directors, the prospect of a 7 per cent investment tax credit has not changed business spending plans in the District. One director, however, did indicate that the expectation of the investment tax credit had stimulated farm machinery sales in his area. In another director's opinion, the 7 per cent investment tax credit would be beneficial in the long run.

TENTH DISTRICT — KANSAS CITY

Increased volume of crop marketings and higher livestock prices are boosting farm income and the agribusiness sector of the Tenth District economy, despite the negative impact of the dock strike on grain prices. Retail sales during the early part of the holiday season have been moderately stronger than last year's pace in the major metropolitan areas of the District. With demand deposits falling more than seasonally in November and business loan demand strengthening, bankers are resisting further commercial loan rate reductions. Mortgage rates, however, have eased in recent months, including a marked decline in late November in several District cities. Savings and loan institutions—still enjoying strong savings inflows—and builders are optimistic on the outlook for construction.

District cash receipts from farm marketings for the first three quarters totaled $5.9 billion—4 per cent above the year-earlier figure. Fourth quarter receipts should show a good advance over last year, with most of the increase reflecting sharply higher prices for livestock. Lower wheat and feed grain prices will probably more than offset an increased volume of marketings—pushing crop receipts down. Since the livestock sector accounts for roughly two-thirds of the District's farm income, retrenchment of crop prices and the disruptive effects of the dock strike have not seriously depressed the aggregate farm income picture. Large quantities of wheat were shipped abroad before October 1 in anticipation of a further widening of the dock strike. Feed grains and soybeans—the two commodity groups most affected by the strike—are relatively less important in the District than elsewhere.

Several agribusiness firms were contacted about their 1971 sales and also their prospects for next year. Suppliers of fertilizers, pesticides, and grain-storage equipment reported good years—attributing their gains largely to the sharp increase in crop acreage. But two feed manufacturers indicated that sales have been slipping, although they expect a modest improvement for the year as a whole. Farm machinery sales—which had been sluggish for three years—spurted in the third quarter and are continuing to run well above year-ago figures. Bumper crops and anticipated tax credits were offered as explanations. Agribusiness firms were generally optimistic about sales prospects. The consensus was that prices would show little, if any, additional upward pressure—although the manufacturers of farm implements and grain-storage equipment reported that some increases were likely in view of higher steel and other costs.

Retail sales throughout the District appear to be running somewhat stronger than a year ago, although only a few reports suggest a real loosening up by consumers. Most officials of the major department stores surveyed are cautious in discussing their holiday sales to date, using such terms as "satisfactory," "disappointing," and "no great shakes." Some specialty and jewelry shops report substantial sales increases, but no movement toward expensive items is discernible in department stores. Sales of wine and liquor by one chain of stores were described as only slightly improved over last year's mediocre levels. Meanwhile, ski areas are setting new attendance records.

District commercial banks report a more than seasonal fall-off in demand deposits during November as offsetting considerable growth in consumer saving deposits. A large November volume of business loans contrasts with the weak pattern of other recent months. Rate structures were lowered in early November to a level consistent with a 5 1/2 per cent prime or base rate; the strength of loan demand at that rate has stiffened resistance to further downward movement. Unlike a month ago, bankers now say they would resist going below their own stated prime rate even on national accounts.

In the past two or three months, supply-demand conditions of savings and loan associations have resulted in a gradual easing of mortgage rates and terms. Net savings inflows are down slightly but continue strong. The savings and loan associations appear to have benefited in November from some reintermediation on the part of savers whose high-yield Treasury notes matured.

Marked declines in conventional mortgage rates occurred in late November in several cities. Points charged on FHA-GI loans also have declined. Most respondents expect further declines in mortgage rates in the next 90 days; the general expectation appears to be of a bottoming out in the 7 1/4 to 7 1/2 per cent area on conventional 75 to 80 per cent of appraised value loans. Many savings and loan institutions make 95 per cent loans at 8 to 8 1/4 per cent, but use of such mortgages varies greatly and the instruments are not viewed with enthusiasm by lenders.

Residential construction remains healthy in the District. Builders look toward strong sales in the spring, particularly of single-family dwellings. In most cities, the outlook is for construction activity in the first half of 1972 to equal or exceed the average 1971 experience. Unless consumer spending greatly accelerates and produces an extreme decline in savings inflows, the savings and loan associations expect to be able to cope with mortgage loan demand in the months ahead.

ELEVENTH DISTRICT — DALLAS

Retail sales in the District were somewhat more sluggish during the 90-day wage-price freeze than during the three months prior to the August 15 announcement of President Nixon's new economic program. This was the opinion of executives at a sample of retail firms in the Eleventh Federal Reserve District. Inventory positions at most of these firms are, at present, slightly excessive. Nevertheless, a large majority of the respondents are mildly optimistic about prospects for sales during the Christmas buying season and on through the first half of next year. However, only a few of the respondents expect employment in their firms to increase during the next seven months. The costs of the merchandise purchased by these firms, as well as retail prices they charge their customers, are expected to rise moderately through the first half of 1972.

In the three months prior to the August 15 announcement of Phase I, the dollar value of total sales increased for nearly three-fourths of the retail firms surveyed, and remained unchanged for the remainder. For about one-fifth of these firms, dollar sales rose substantially during this period. During the 90-day wage-price freeze, however, only half of these firms recorded sales increases, and none recorded substantial increases. Moreover, 10 per cent of the firms indicated that their dollar sales declined during the freeze.

Sales of durable goods by these firms increased moderately both during and prior to the freeze. Hence, the weaker total sales activity reflected the performance of nondurable goods. In the three months ended August 14, sales of nondurable goods rose substantially for 20 per cent of the firms, rose moderately for 30 per cent, and remained unchanged at the other retail stores. During

Phase I, however, nondurable goods sales advanced only moderately for half the firms, remained unchanged for 40 per cent, and declined for 10 per cent.

Four-fifths of the respondents expect total sales of their firms to increase moderately during both the Christmas buying season and the first six months of 1972. Despite the respondents' mild optimism over prospects for sales, most of them believe that employment in their firms will remain essentially unchanged through mid-1972. Almost two-thirds of the firms surveyed consider their inventory level to be excessive, while the rest are currently carrying evenly balanced positions. Most executives also believe that the selling price of their merchandise and the cost of their inventories will increase moderately through June of next year. The profit outlook is somewhat more encouraging. Half of the firms believe that profits during the first half of 1972 will rise moderately, while the remaining half believe that profits will not change.

All of the respondents indicated that the import surcharge and the floating of the dollar in the international exchange markets have caused the prices of imported merchandise to increase moderately. And since August 15, the dollar value of sales of imported merchandise has risen moderately for only 45 per cent of the firms, remained unchanged for 33 per cent, and decreased moderately for 22 per cent. However, the weakness was at least partly attributed to the East Coast and Gulf Coast dock strike.

For the District as a whole, recent data suggest economic conditions are improving. Department store sales were 7 per cent greater in the four weeks ended November 20 than in the corresponding period a year before. Registrations of new automobiles rose significantly in October from their level in September.

Total nonagricultural wage and salary employment in the five southwestern states continued to rise in October as employment increased in both the manufacturing and nonmanufacturing sectors. Although, overall, nonmanufacturing industries increased their employment in October, there was considerable variation from industry to industry. Government provided the primary source of jobs in the region in October. Among the other categories, only construction and trade showed increases in employment. The seasonally adjusted Texas industrial production index slipped slightly in October after recovering in September from a midyear slowdown.

The oil allowable was increased from November to December. In raising the allowable, the Texas Railroad Commission pointed to a reduction in crude inventories in November. But, with imports greater than a few months ago, the Commission held the increase to only a marginal advance. Allowables in other producing states of the Eleventh Federal Reserve District, however, were left at November levels.

TWELFTH DISTRICT — SAN FRANCISCO

Economic conditions in the Twelfth District are basically unchanged. Residential construction continues to be strong and consumer spending is steady. On the other hand, there is no evidence of any upswing in current business capital spending. In our directors' comments on Phase II, the most common reaction was one of uncertainty about the details of the controls and their immediate consequences, but some optimism was expressed about the impact of Phase II on the 1972 economy.

Residential construction is maintaining its pace throughout the District, and demand seems high for existing as well as new houses. Mortgage finance is readily available and mortgage rates are somewhat lower. There is also somewhat greater strength in commercial construction in some (but not all) areas of the District.

This activity in construction has benefited other industries; in particular, the lumber and wood products industry. Production of lumber and related products has helped increase employment in the Pacific Northwest. Similarly, a major producer of builders' hardware reports operations are at capacity in existing plants; he plans the opening of a new plant in early 1972 to meet strong demand.

Consumer spending is continuing at a satisfactory rate in most areas, although consumers are still showing some signs of cautiousness. Consumers are increasing their purchases of durables, and some directors interpret this as a sign of improving consumer confidence. Retailers are looking forward to heavier purchases during the Christmas season. Despite the high level of auto sales, dealers are not confident that the current rate will be sustained and some are expecting a slowing of sales in the next few months.

Business investment intentions have not been revised upwards. Current projects are being carried through, but there does not seem to be any strong incentive to increase investment plans. Inventories are described by some of our directors as being deliberately kept low and geared to sales, as part of a continued cost-reduction effort. Some manufacturers, such as those supplying the construction industry, are doing well, but others report sales below expected levels. For example, a major oil company reports gasoline sales falling below trend, and jet fuel sales reduced because of lagging airline demand.

District banks have been gaining deposits. But, with few exceptions, bankers describe business loan demand as weak, reflecting the moderate pace of business spending. Banks, which have attempted to expand business loans, report that they have had to accept somewhat greater risks. Real estate demand (as already noted) has been strong, and consumer instalment lending has risen. Some banks have increased their efforts to expand their instalment loans. Interest rates in general have trended downward.

The general reaction of our directors to Phase II is one of uncertainty. In particular, there is uncertainty about the details of the price- and wage-setting procedures and, consequently, there is unwillingness to make major decisions at this time. About the long-run consequences, there was no consensus. Some directors felt that the decisions of the pay and price agencies would lag behind market changes and others feared that wage increases would not be dampened by the Pay Board. Many were unwilling to estimate what the consequences of the controls would be, but other directors thought that the controls would produce expectations of less inflation and that this would have favorable effects on economic activity next year. Overall, Phase II was greeted with less enthusiasm than Phase I, because its duration and character are more difficult to assess.