

CONFIDENTIAL (FR)

CURRENT ECONOMIC COMMENT BY DISTRICT

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SUMMARY

Current comment by businessmen and bankers, as reported by the 12 Reserve Banks, continues to emphasize weakness in overall business activity and to focus on such problems as unemployment, rising costs, declining profits, inadequate liquidity, and excessive inventories. In most Districts, however, the general tone of the comment is less pessimistic than a month ago. While some Reserve Banks report a further softening of activity through June and early July, most indicate a growing consensus among businessmen that the worst of the latest decline has passed and that the economy is now bottoming out. Expressions of concern over the state of corporate liquidity continue numerous and apprehensions over the possibility of serious financial disorders persist. But on both counts, fears appear to be distinctly less pronounced than at the time of the last FOMC meeting.

Of the 12 Reserve Banks, Boston characterizes the tenor of business comment in its District as "markedly more optimistic than a month ago" and is joined by Atlanta in emphasizing elements of strength in the local business picture. Cleveland also notes a marked improvement in June, attributed mainly to the termination of strike activity, but indicates a distinctly pessimistic outlook for July and for the near-term future. In the remaining Districts, comment on current conditions is predominantly bearish. St. Louis, which last month characterized current conditions as "good," now reports "some dampening of optimism in recent weeks." Reports from Minneapolis and Dallas also suggest some further softening of activity as compared with a month ago. As for the outlook for the rest of the year, sentiment in most Districts appears to be veering increasingly towards a belief that recovery from the current decline will be gradual and that only a modest business expansion can be expected.

Comments on business spending suggest some further cutbacks or stretch-outs in capital plans of manufacturers and retailers. Specific reference to such cutbacks or stretch-outs is made in the reports from New York, Atlanta, Cleveland, and St. Louis, with Chicago noting declines in the orders of capital goods producers. The St. Louis report, which indicates cutbacks only among retailers, is notable for its contrast with the bullish outlook for capital plans reported by that District in the last Redbook. Boston and Richmond continue to report no substantial evidence of any significant scaling down of capital plans. About half the Districts indicate some degree of inventory excess, with four reporting inventories as higher than desired while others say that businessmen are actively holding the line on inventories. Cleveland's latest survey shows a sizable reduction in stocks in June and San Francisco reports that business demand for inventory loans has fallen off.

Consumer demand is indicated as less than buoyant in a number of Districts, although New York notes that retail buying seems fairly well sustained. San Francisco reports that personal bankruptcies are increasing and that retail sales in the Twelfth District are likely to decline. An apparent increase in the rate of saving by consumers is noted in the Philadelphia District, while Minneapolis and Richmond report some downgrading in the quality of consumer purchases. Other Districts describe the demand for automobiles as concentrated mainly in the less expensive models.

Comment on the employment situation is most bearish in St. Louis, Chicago, and Minneapolis, where major firms are said to have stopped all hiring or to be considering additional layoffs. Philadelphia also expects further increases in unemployment and San Francisco reports the continuation of serious unemployment in the Pacific Northwest, with some increases in layoffs in Southern California and Arizona. But in the Boston, Cleveland, and Richmond Districts

the employment situation appears to have stabilized and no significant further cutbacks are expected. Atlanta also reports "no serious deterioration" in prospects for employment.

Some instances of price shading are reported in all Districts except Boston, although some Districts indicate that the practice remains fairly rare. Only Richmond and Dallas report widespread price shading. Most frequently mentioned items on which some shading is noted include industrial goods, such as some chemicals, lumber, steel, and nonferrous metals. Other items cited are synthetic fibers, glass, lubricants, and large capital items. Among consumer goods, automobiles and large appliances are mentioned. Some easing of prices is evident, especially in the New York District, but Chicago reports that some prices are higher and Cleveland says that most prices are "firm or firming upward." San Francisco and St. Louis report that inflationary expectations continue strong among businessmen.

Most District reports mention corporate liquidity as a serious problem, but none describe it as critical. Several reports state that demand for bank loans by business continues strong. In two Districts, some finance companies and industrial firms that have been squeezed out of the commercial paper market are finding accommodation at commercial banks. The squeeze on corporate profits is also listed as a continuing problem in a majority of Districts. Firms reportedly have had little success in containing rising costs, and the expectation of continued wage pressure apparently is widespread among businessmen.

FIRST DISTRICT -- BOSTON

The general tenor of the comments offered by our respondents for this Red Book is markedly more optimistic than a month ago. A definite easing appears to have developed in the commercial banking sector, while our contacts in both the academic and manufacturing spheres now seem more convinced that the economic slowdown is bottoming out. In line with this general outlook, we were able to find no reports of price shading at any level of business activity.

All of our banking directors report that commercial loan demand has declined considerably since the historic highs of late spring, and they characterize deposits in all categories as holding at good to excellent levels. One banker director reports moderate success in the large CD area following the relief given in June. He also reports, however, that his institution is having to nurse along an unusually large number of outstanding commercial loans on which firms have fallen behind due to severe liquidity problems.

Layoffs have definitely abated among the New England region's industrial producers, and, while the near-term profit outlook continues dim for firms in this sector, signs of any major cut-backs in capital expenditure plans for 1971 have yet to develop. This is apparently explained by the continuing production capacity problems reported by several of our respondents in manufacturing, and their expectations for even heavier demands over 1971. Relative to the earnings picture in New England manufacturing, our contacts uniformly report rather poor or no success in passing along their cost increases. With lower internal flows and continued stringency in external financing arrangements, these firms are scrambling hard to maintain plant and equipment investment at the desired high levels.

Reports on retail activity in the region are rather more mixed, with some areas reporting satisfactory volume and others reporting very slow sales. The impression emerges, however, that in almost all areas, retail sales of consumer durables have been hit hardest by the slowdown.

Professor Henry Wallich still expects a nominal GNP for the year of \$980-983 billion, the same figure he mentioned earlier in the summer. He expects declining interest rates to combine with a slowing of the rate of inflation to produce a substantial increase in the quantity of money demanded. Thus, he concludes the system should reasonably pursue a 6 percent rate of money stock growth over the rest of 1970. Professor Otto Eckstein concurs in this outlook for GNP, now forecasting \$982 billion for the year. He feels that recent developments have largely offset each other in terms of overall economic impact. On the negative side, he attaches importance to the decline in construction contracts and the sharp drop in prime defense contracts. He further expects manufacturing investment to be well under current levels next year. On the plus side, however, are the final cessation of the truck strike, the turnaround in auto sales, and the largest jump in history in utility appropriations.

The one major difference between Wallich and Eckstein seems to be their outlook on the future course of unemployment rates. A month ago, Professor Wallich cautiously suggested we might reach 5-1/2 percent by year-end. He now is suggesting that something in the range of 5-1/2 to 6 percent seems quite likely. Professor Eckstein, on the other hand, looks for very little more than 5 percent unemployment by the end of this year, with 5-1/2 percent not being reached until the end of 1971, if at all. Using Okun's law, Eckstein points out that a year-end figure of 6 percent unemployment implies an increase in the GNP gap of 3 percent over the next two quarters, a prospect which he considers very unlikely.

SECOND DISTRICT -- NEW YORK

In the Second Federal Reserve District, Directors of the Federal Reserve Bank and other business executives saw some signs that prices were easing, indicated they believed the recent stretch-out of capital spending plans would continue into 1971, and expressed the opinion that, in general, inventories were higher than business firms desired. While it was thought the current strains in the financial markets did not pose a serious immediate threat to business activity, considerable concern was expressed regarding business liquidity.

Only two of the Federal Reserve Bank Directors who attended the early July meetings at New York and Buffalo were aware of any price shading by manufacturers, but more directors mentioned other signs of an improvement in the overall price situation. These included announced price cuts, particularly at the retail level, as well as price shading at the retail level by giving the customer greater value. With regard to under-the-counter price adjustments, it was reported that Bethlehem Steel Corporation had taken a strong position against such a marketing practice. As for announced cuts by manufacturers, one director noted receiving an announcement of a three percent reduction in the price of cans for packaging beverages. At the retail level, there has been considerable price cutting by automobile dealers as well as by other retail outlets, with the aim of either reducing inventories or building sales volume.

Retail store sales reportedly were holding up well, except at downtown stores and during night shopping hours. Sales apparently were being bolstered by aggressive merchandising. The head of a large chain observed, however, that retail stores need an increase of three to three and one half

percent in volume to bring profit up to last year's level. Contributing to this need were higher costs stemming from increases in wage rates, in shipping charges, and in shoplifting.

The directors were virtually unanimous in believing that the more cautious capital spending pattern that apparently has developed in recent months will continue into 1971. New programs were being "very carefully reviewed," and many projects were being slowed down or indefinitely deferred. However, projects for which commitments are too far along to be canceled or postponed are being completed, as probably will be projects designed to cut production costs and increase productivity. Although an upstate New York banker remarked that there were no signs of cutback in his area, he observed that most of the capital spending there was on construction for municipalities and school districts, for which firm contracts had been arranged "long ago." On the other hand, a community college construction project for which bids were recently obtained may have to be canceled because the bids are so far above the original estimates.

The few comments made on the inventory situation suggested that inventories were higher than were desired. A New York banker commented that inventories in general are eight to ten percent above a year ago, and that increased inventories were particularly evident in the soft goods area. The chairman of a large manufacturing firm observed that inventories were high mainly because business "is not selling goods as fast as desired," although special factors such as the recent truckers' strike in Chicago had contributed to the buildup, as had "a new permanent inflation factor" that has been built into inventories.

Most directors seemed to believe the current strains in the financial markets did not pose a serious threat to business activity at the

present time, although the head of a large New York City bank declared he thought there would be "adverse" effects, but was unable to judge whether these would be "serious." Despite the near-consensus that there was no immediate threat, a number of directors and other business executives did indicate concern regarding financial developments. A banker from upstate New York noted that many businessmen who have long-term financings in the offing are attempting to arrange standby intermediate or short-term credits as possible alternative solutions to their financing needs. An investment banker commented that his firm had been marketing four-to-five year securities for many clients, and that if inflation is not halted, he sees "an end to public financing of debt issues." A large retailer observed that small manufacturers were in serious shape with regard to liquidity; they cannot borrow as easily as very big concerns, and at the same time big retailers are slower in making payments to them than in the past, inasmuch as the discount for prompt payment is less than the cost of borrowing money. Customer payments to retail stores were also noted as slower than usual. The head of a New York academic institution declared the long decline in the stock market had cut gifts to private educational institutions and had drastically reduced the market value of holdings of endowed institutions. Finally, a Wall Street man "guessed" that only 300 of today's 500 New York Stock Exchange member firms would survive the next six months, but regarded mergers, which he believes will accelerate, as desirable.

An upstate New York banker commented there is still "considerable" demand for credit in the Rochester area, particularly for real estate projects, but the head of a giant insurance company observed that the demand for "new money" was "somewhat depressed" and that requests for policy loans had "leveled." This insurance company, it was noted, is moving in the direction of real estate

investments and equity participations. The chairman of a large mutual savings bank remarked, late in June, that although official figures indicate a recent pick-up in deposits at thrift institutions, there is no evidence of such a movement in New York City. He thought that most of the deposit money that was being withdrawn was probably going into bonds. He also indicated he was not sure his bank benefited from the use of merchandise premiums, and said he would favor their being banned by the supervisory authorities.

THIRD DISTRICT -- PHILADELPHIA

This report is based on comments of our Board of Directors as well as results of a poll of large manufacturers in the Third District. The major findings are: (1) the downturn in the economy is bottoming out, although no pick up in business activity is expected until late in 1970; (2) price shading is only "spotty" and not widespread; (3) fears of a financial panic have abated, but could be revived quickly.

There is widespread sentiment that the worst of the downturn for production and sales is over. But there has also been a general reappraisal of when the economy will begin to trend upward again. Six months ago, the prevailing view was for a mid-year recovery. Now the dominant opinion is for a flat economy through the third quarter with only modest expansion during the fourth.

In part, expectations of a delayed recovery are based on the continuing apprehensiveness of consumers. Bankers contacted, for example, point to recent savings trends. Quarterly withdrawals of savings which usually follow interest postings did not occur in early July. In fact, for several months, the volume of individual savings has increased substantially. Further, there has been a definite move toward liquid savings instruments, for example, away from CD's to regular savings accounts. People are just cautious and want to have ready access to their savings, several directors concluded.

As for unemployment, the prevailing view is that the worst is not behind us. This appraisal is supported by reports from large manufacturers in the Third District. While most manufacturers anticipate stepped up levels of production in the coming months, they do not expect a proportionate increase in their payrolls.

Price shading appears to be quite limited. Two directors say they know that discounting is occurring in some sectors of the textile industry. Another director indicates there is below-list-price selling in the paper and chemical industries. Still another director, though, who is knowledgeable about chemical markets, says he is unaware that price shading is taking place. The remainder of the directors can point only to general rumors of discounting, but know of no concrete examples.

There is an across the board feeling among the directors that the economy in recent weeks has moved back from the brink of a liquidity crisis. At the same time, however, no one believes that we're out of the woods yet. One banker, for example, reports an increase in requests to alter loan repayment schedules for firms caught in a cash squeeze. Another director believes there is still much confidence-building to be done before we have completely weathered the storm.

FOURTH DISTRICT -- CLEVELAND

Economic activity in the Fourth District improved in June, partly reflecting the termination of major strikes. The results of our most recent survey of manufacturers indicate that a more than usual seasonal decline in business conditions may develop in July in the district, although the bunching of plant-wide shutdowns for vacations at this time of year makes the data unusually difficult to interpret. Our directors remain generally pessimistic about the near-term economic outlook, although some of the industrialists feel that economic conditions may be a little better now than in previous months. In response to our question about price developments, we received a few reports of price discounting, but the consensus of our directors and a limited sample of business economists in the district was that prices will remain firm because of strong upward wage pressures.

The improvement in economic conditions in the district in June was largely the result of the resumption of production and shipments following work stoppages in the area. The seasonally adjusted rate of insured unemployment for the district declined in June, and at month-end was approximately halfway between the pre-trucking strike level of March and the peak reached in mid-May. Steel ingot production in the district recovered in June after having declined in April and May. The Bank's most recent survey of manufacturers in the district (expressed in the form of diffusion indexes) show rebounds in new orders and shipments during June, and a sharp decline in inventories. Employment stabilized, after declining since last autumn. For the month of July, most survey participants anticipate seasonal declines in all of the areas of activity covered by the survey, except prices. A moderate easing in the rate of increase in prices is generally anticipated in July. The decline in the diffusion index

for shipments of manufacturers for July is the largest in the six-year history of the series and is more than seasonal.

The comments of our directors about current economic conditions stressed the continued softness of domestic business, offset in part by strength in overseas business. Overall, the directors were of the opinion that the recovery would be slow and moderate. Several of the directors expressed a strong conviction that wage increases will continue large and profits will remain depressed. With regard to capital spending, one director reported that the petroleum industry is in an over-capacity situation and that his company is making plans to reduce capital spending over the next twelve months. Another director felt that the psychological attitude of management in many firms was extremely pessimistic and, as a result, capital expenditures will be delayed or postponed, especially spending for computers and related information system equipment.

One director mentioned that new orders for commercial electronics products and TV components had been unusually weak for several months, but had made an impressive rebound in late June and early July. He also reported that automobile components were very strong, as the auto firms attempted to build up inventories in anticipation of a prolonged and difficult strike beginning in September. A director from the glass industry said new orders in certain lines had declined recently because customers were attempting to hold down inventories.

With respect to prices, only a few instances of price shading were reported. An economist from the chemical industry said price discounting was no more than usual, up to now, but he felt that discounting would increase later in the year. Economists from the plastics and glass industries said prices for many lines were soft, with selective shading from list prices. For the most part, however, both our directors and business economists in the district

emphasized that prices were firm or firming upward from previously discounted levels. One director commented on the recent increases in list prices of tires and said that they hope to make some of the price increases stick. (Discounting from list price at both dealer and retail levels is a normal feature of the tire business.)

In Cleveland, transit workers have been on strike since July 1, and garbage collectors struck a few days later. A significant number of building trades have been on strike since May, and most major construction projects are at a standstill.

FIFTH DISTRICT -- RICHMOND

Information obtained in the Fifth District, through surveys of businessmen and bankers and from directors, indicates substantial agreement on the following points: (1) further weakness in new orders and backlogs of orders in manufacturing; (2) further declines in automobile sales and continued weakness in retail trade generally, but somewhat improved consumer loan demand; (3) continued softness in the employment situation, but fewer declines reported than previously; (4) numerous instances of price shading in retail, wholesale, and industrial prices; (5) continued slump in residential construction, but slight improvement in non-residential building; (6) little evidence of significant capital spending cut-backs; and (7) continued excessive levels of business inventories.

District manufacturers report further weakness recently in the volume of new orders and in backlogs of orders. Durable and nondurable goods producers alike report declines with the weakness centering in such industries as hosiery, synthetic fibers, cotton textiles, building materials, electrical equipment, and furniture. Current shipments are also reported to be continuing on the down side, which has been characteristic of district industry during most of this year.

Some optimism in the outlook for retail sales is reported, although currently, sales levels continue sluggish. Automobile sales have reportedly suffered a further decline. Some instances of quality downgrading by consumers are mentioned, although they are not widespread.

Respondents report inventory levels to be significantly higher than desired, both in manufacturing and in retail trade. Retailers report inventories have declined somewhat, but manufacturers report some recent increase.

The employment situation, though remaining basically weak, shows some evidence of having stabilized. While some further declines are noted in electrical equipment and metals, proportionately fewer respondents are reporting continued declines. Further slight cuts in hours worked, however, are reported, both in manufacturing and in trade and services.

On the unemployment side, respondents in manufacturing and in trade and services report local supplies of skilled labor to be less than adequate. They feel, however, that unskilled labor is at least adequate currently, and in some areas, more than adequate. Generally, respondents have not indicated significant further increases in unemployment, although they consider that the problem remains serious.

While respondents in trade and services report significant further increases in the prices they are receiving, manufacturers indicate some tendency toward a leveling off of prices. Instances of price shading are reported to be fairly common at both the wholesale and retail levels. In the industrial category, large capital items are reportedly being cut substantially below list prices. The same is apparently true in non-ferrous metals and synthetic fibers--two industries important to the Fifth District. Upward pressure on wages reportedly is continuing strong, particularly in textiles, furniture, and metals.

Little change is reported in the severely depressed residential construction field. Non-residential construction, which has fared somewhat better, is reported to have improved slightly, particularly in West Virginia.

Bankers report some recent improvement in the demand for business loans and consumer loans. They report, however, that the demand for mortgage loans has tapered off somewhat during the last four weeks. Demand for bank loans in the Fifth District does not appear to have been affected significantly by recent developments in the commercial paper market.

Opinions expressed in the district indicate that the pervasive element of uncertainty about the future course of the economy, which has been characteristic of businessmen's and consumers' outlooks in recent months, may have subsided slightly. Evidence is still lacking, however, that it has been replaced by any significant degree of optimism.

Manufacturers, overall, report their productive capacity to be somewhat in excess of current needs, and there are reported instances of curtailment of capital spending plans. On the other hand, there are numerous instances of increased plant and equipment investment in the hosiery, synthetic fiber, and non-ferrous metals industries, while public utilities outlays continue heavy. Reporters in the Fifth District have consistently failed to indicate any clear tendency over recent months to cut back capital spending plans.

Respondents continue to report inventory levels to be excessive across the board, and firms apparently are making deliberate efforts to hold inventories to present levels or to reduce them. Manufacturers are reportedly trying carefully to avoid inventory build-ups which may later cause production cut-backs and associated layoffs of experienced employees.

mostly because of large condominium and residential complexes. Announcements of large apartment projects continue to be made, such as a 484-unit project in Atlanta. In Birmingham, it is reported that a larger supply of mortgage money is available for FHA and VA loans, and a limited amount of money is available for conventional loans for the first time in several months.

Reports of reductions of work forces continue to come in, but Tennessee directors report that some previous cuts have been restored, such as an increase from a four-to a six-day week at a textile plant.

Reports of cut-backs in capital spending plans are increasing. South-Central Bell has reportedly cut back its 1971 spending plans, as have many firms in the industrial areas of the district. The Jackson State College incident has reportedly resulted in some postponing of plant locations in the Central Mississippi area, and new plant locations have been occurring at a reduced rate in Georgia. Admist reports of a successful tourist season, several large recreation projects have been announced or undertaken. In the Central Florida area, already bracing for the opening of Disney World, Busch Gardens has announced a multimillion-dollar expansion, and a \$24-million Florida Expo project is slated for the East Coast. In addition, construction has recently commenced on a \$25-million "Opry Land USA" in Nashville. The Louisiana, Mississippi, and Alabama Gulf Coast areas have received some encouraging economic news. A division of Litton Industries located on the Mississippi Gulf Coast has been awarded a \$2.4-billion contract for construction of destroyers. While some of the funds for the project are still subject to congressional approval, the contract is expected to result in an increase of 8,500 jobs along the Mississippi and Alabama Gulf Coast. Economic activity along the Louisiana Coast has stabilized as preparation is taking place for renewed oil leasing.

In the banking sector, a large Atlanta bank has become the third in the city to purchase a mortgage company. In this case, the mortgage company services mortgages totaling \$240 million. One district bank reported to be receiving deposits withdrawn from New York City banks which had loans outstanding to Penn-Central.

SEVENTH DISTRICT -- CHICAGO

Businessmen and economists in the Seventh District appear to accept the view that the decline in real GNP has about ended, but most anticipate an extended plateau at current levels of activity. Labor markets are generally weaker, and producers of capital goods components report a softening of tone in incoming orders. However, no significant production declines are expected. Business sentiment is described as "languid," and several businessmen have pointed out that, "it has been a long time since there has been any really good news."

There are few indications of price shading. A major farm equipment manufacturer indicates that there is some price softness at the retail level. It is reported that large lot purchases of home appliances, carpets, etc., by housing developers have been at lower prices, but a representative from the home laundry appliance industry contends that there has not been any shading of prices even on large lot sales. Our directors from manufacturing industries report that almost all suppliers are posting higher prices and that, "materials prices are going through the roof." A major motorcycle manufacturer is quoting new model prices consistent with an expected five percent annual rate of increase in materials prices and doubts that this will be enough to cover the actual increase.

The settlement of the truck strike has not added perceptibly to optimism in Chicago. The large size of the contract settlement is disturbing to many. Concern with the possibility of an auto strike remains but it is mentioned less frequently in discussions since no one has anything new to add.

SIXTH DISTRICT -- ATLANTA

According to reports from directors and others, there is no serious deterioration in production and employment in any area. Only one director mentioned fear of a liquidity crisis. While several instances of price shading were cited, evidently there has been no great increase. Reports of economic softness are being countered by news of strength. Lockheed continues to reduce employment by about 800 monthly, but Gulf Coast shipyards should soon be substantially increasing employment. Weakness in construction expenditures in some areas is being offset by large projects underway or planned in others.

Any increase in price shading apparently has been only modest. We were told that shading is difficult to detect because it often occurs in subtle forms such as services and transportation charges. An example of a subtle price shading is provided by the Florida orange juice industry. For a six-week period, virtually all small producers--supplying about 40 percent of the market--are giving a 30-cents per case promotional allowance to retail stores. It is widely understood that the retailers spend a good deal less than the allowance on promotion. Isolated incidents of shading have been reported on reinforcing steel and fabricated aluminum products as well as lumber and furniture. A large corporation has reported receiving lower prices from suppliers, particularly in paper and lubricants. A fiberglass boat manufacturer reports lower prices from suppliers of resins and chemicals.

Residential construction remains in the doldrums in some areas such as Nashville, and strikes are slowing down large projects in Atlanta, Knoxville, and the Gulf Coast. However, a South Florida director reports building permits for residential units in May exceeded 2,000 for the first time in four months,

A major construction equipment producer reports that it has stopped all hiring. Retirements and quits are not being replaced. A capital goods components producer indicates that it is considering alternative layoff schemes.

There is now a clear indication that the export market for steel will weaken, according to a major midwestern steel company. Prices in Europe are falling and are likely to continue to decline. During the first half of this year, steel exports offset declines in domestic shipments, primarily to the auto industry. If there are no labor difficulties in the auto industry, it is now expected that increased steel demand for autos will offset the softening in export sales and some weakness in capital goods. So far, steel orders have tended to weaken, but no more than would be expected during an auto change-over period.

Since May, auto production has been running above year ago levels. The trend is encouraging to many. Truck sales have been looking better with one major manufacturer indicating that the lighter trucks, or those on the lower end of the price range, are selling the best. Several industry representatives are now arguing that it is the sluggishness of the economy rather than the truck strikes that has been the major factor in a less bouyant sales picture for large trucks.

Domestic air traffic in June was below last year, and the second quarter as a whole was very poor. But international air travel has held up well since foreign travel decisions were largely made prior to the first half decline in the economy. Foreign travel is thus expected to be down next year.

Cost cutting programs are still in force. Advertising outlays are being cut back sharply. A firm that does engravings for large national advertisers reports the slowest order pattern since 1961.

Estimates of corporate earnings are still declining. A number of companies are reporting sharp drops in profits from European operations. Second quarter earnings of major airlines were up from the first quarter, but still very poor as compared with last year.

Loan demand is still reported strong by district banks and is being bolstered by the shift out of commercial paper. Several finance industry spokesmen argue that there has been much mis-information about commercial paper--in particular, the failure of many to understand the short maturity of the paper and to realize that the paper is not always fully covered by bank lines.

Savings flows into banks are better than last year. No net outflows are being posted.

A major capital goods components manufacturer reports that its 3-5 year investment planning decisions assume no significant decrease in money costs. Most banks and businessmen continue to talk about the prospect of heavy credit demands from corporations, municipalities and states, and the federal government. The "illiquidity" of banks and nonfinancial firms is mentioned frequently.

EIGHTH DISTRICT -- ST. LOUIS

There has been some dampening of optimism in recent weeks regarding the business outlook in the Eighth District. Although directors of this Bank and its branches and other businessmen in the district generally believe that the period of business slackening is about over, they are increasingly doubtful about the strength of the upswing after the trough has been passed. Some retail firms report a reduction in the planned rate of capital spending, and pessimism with respect to business profits has, if anything, increased following the wage settlement by the Teamsters Union. A few manufacturers now indicate that some worker layoffs are in prospect in an attempt to hold down labor costs. Most of those interviewed expect inflation to continue at or near current rates.

Typical of the comments by businessmen relative to the current economic situation was that economic activity has leveled off or that we have probably bottomed out. Concerning the rest of 1970 and early 1971, however, there was less expectation of a vigorous recovery than was expressed in the prior month. An official of a large manufacturing concern stated, "I am not as certain of the outlook as I was a month ago. I don't see how we can work out of this spiral of inflation." Another reported that sales compared with a year ago were up six percent in the first quarter, down one percent in the second quarter, and are expected to remain about unchanged in the third and fourth quarters.

Prospects for employment are likewise down from expectations of a month earlier. Most firms interviewed indicated that no major layoffs were in prospect. One large shoe manufacturer, however, reported plans for reducing employment sufficiently in the months ahead to offset wage and salary increases--i.e., labor costs are to be held constant. The labor market presently is described as "loose." Although jobs are available, there is a little longer interim between jobs.

Although most manufacturing firms are tenaciously holding on to capital spending plans, and these plans call for future rates of spending in excess of rates during the past year, a few cutbacks are being reported in the retailing business here. Realized sales have in some instances dropped below expectations, and some firms are taking a second look at expansion programs.

Rising cost expectations continue to dampen the profits outlook for business. The Teamsters Union wage settlement, which was higher than anticipated by management generally, was a further depressing influence on profit prospects. The chief executive officer of one firm reported that these rising costs will eventually have a depressing influence on business investments.

The agricultural situation as reported in the Eighth District is generally favorable for crop production. Meat products are expected to be somewhat more plentiful in the second half of the year than in the first half, and prices for meat animals at the farm level may be slightly lower. Thus, the farm sector may have a retarding influence on the rate of increase of consumer prices in the months ahead.

Despite the possibility of relatively stable farm product prices, most persons interviewed expressed pessimism concerning the prospects for any sizeable reduction in the rate of inflation in the months ahead. They cannot see any letup in the rate of increase in costs. One manufacturing firm reported that it is planning to sell its product at a stable price by reducing quality a sufficient amount to offset rising costs.

The business officials interviewed see no problem with inventories. Inventory-to-sales ratios are no greater than a year ago, and inventories are at about planned levels in each case reported.

NINTH DISTRICT -- MINNEAPOLIS

The softening in the Ninth Federal Reserve District which has been evident since early this year appears to have continued through June. Almost universally, district directors, bank officers and leading businessmen felt that district unemployment rose in June and that students were finding either less lucrative summer jobs than in previous years or none at all. Consistent with this deterioration in employment, consumer tendency to downgrade purchases is continuing. At the same time, price shading, especially among retailers, is becoming more prevalent while business failures appear to be on an upswing.

District newspapers in recent weeks have contained numerous articles reporting that labor markets have softened appreciably in their local areas. These articles were corroborated by the observations of the Minneapolis Bank's Directors and officers who are able to cite specific examples of softening. First, job applications are substantially greater than usual; moreover, many applicants have considerable experience and technical skills. Second, some electrical contractors in the twin cities have gone to a 4-day week in order to spread the work. Third, unemployment in the rural areas of the district is rising, partially because people who had left for higher paying jobs in Metropolitan areas are now returning after having been laid off.

The softer labor market conditions have resulted in fewer summer job opportunities for students this year than in the past few years. The two reasons that were most often cited for this lack of job opportunities were that construction and tourism, the two major activities in the district where students usually find work, are operating at lower levels than in the past few years; and a number of employers who are facing squeezes on profits

and liquidity are not hiring summer help as freely as they did in previous summers.

A number of additional cases which indicate that consumers are downgrading the quality of their purchases have come to our attention in the past month. Directors from areas in the district where tourism is a major industry all report that tourist spending is down significantly from a year ago. At the same time, however, traffic seems to be about the same as it was last year. Instead of spending money and attending paying attractions, people are relying more on free accommodations and are traveling with campers rather than staying in motels. Meanwhile, repair shops for automobiles and other durable goods are reporting record volumes of business; a regional parts distribution center for a major automobile manufacturer in the twin cities reports that the demand for automobile parts is so great that its crews are working overtime. Although automobile sales in the district are still at depressed levels, the weakness seems to be centered on the more expensive models while the market for lighter, economy models and used autos appears to be relatively strong.

The greatest evidence of "price shading" in the district is at the retail level. In addition to markdowns on automobiles, the directors felt that retailers were holding sales earlier than usual this summer and were offering larger discounts. One reason given for this was that inventories appear to be larger than desired because of the general slowing in retail sales. Retailers are also concerned that they will "get stuck" with merchandise that was ordered before the truckers' strike and is only now arriving.

There appears to be very little "price shading" for industrial goods, and directors and officers of the bank cited a number of cases where prices have actually risen in the past few weeks. In general the feeling

was that manufacturers do not have adequate margins with which to cut prices. As one director put it, "business is hurting but volume at a loss doesn't help." Another felt that industrial suppliers are beginning to drop unprofitable lines. On the other hand one director indicated that discounts in some construction materials are greater now than they were a year ago. He was careful to point out, however, that list prices have risen during the past year, and as a result, the net effect on prices is not clear. He noted that sales efforts among construction materials distributors have intensified, and that they have improved services including schedules in order to increase their sales.

The slowing in sales along with a decreased availability of funds has led to an increase in district business failures. The three most common characteristics of failing businesses are that they were relatively young firms, were in industries in which entry is fairly easy, and/or were undercapitalized. Of the 21 failures of which one leading district banker was aware, all could be attributed to one or more of these factors. One director observed that the number of failures or near failures in the construction industry has risen in recent months. The primary cause for this is the lack of working capital, a problem which is chronic in the industry, but which has become increasingly acute because of the large number of recent strikes and the slowing in construction activity.

TENTH DISTRICT -- KANSAS CITY

The overall economic picture in the Tenth District remains much the same as reported in the last Red Book, with construction strikes and reduced defense production restricting economic activity in specific areas. Firms participating in national markets are, of course, reflecting and sharing the sluggish performance of the national economy. A survey of Directors and a sample of purchasing managers revealed some evidence of favorable back-pressures on prices paid, particularly on volume orders and longer term contracts, an indication that some suppliers believe prices at least may not continue increasing as rapidly as in the past. In most instances, however, suppliers apparently are not yet engaging in any widespread price concessions or shading of prices from list.

A number of firms included in the survey were relatively large users of metal, especially steel and steel products, but also of copper and brass. Virtually all respondents reported that suppliers of steel were holding the line on recent price increases, and there was little expectation that this situation would change in the near future. Reports from copper users were mixed. For example, one reported that the situation for copper remained tight while another noted some reductions in list prices for particular copper products and an additional shading from list for certain items, such as brass strip. One relatively large steel user, whose overall business is off, has increased its relative use of foreign (Japanese) steel by holding that absolute amount steady and reducing its purchases of domestic steel. Although price differentials between Japanese and domestic steel are apparently diminishing (depending on type), this firm would take still more Japanese steel if it weren't bumping into the voluntary allotment ceilings.

No clear picture emerged from the responses of firms dealing in markets for chemicals and chemical products. One respondent reported chemicals prices going up faster in the last six months. Another noted that prices were lower on some items where suppliers were operating in industries where activity had slowed. A third noted that their request for bids on volume purchases had met with aggressive response from medium-size companies.

Particular industries have their own special situations and special problems. A Kansas City lumber company stated that not only was business here lousy because of the continuing construction strike, but sales to lumber dealers outside Kansas City also were bad, which they attributed to the general economic slowdown and to tight money conditions. They felt that lumber markets generally were weaker with mill prices down although freight charges have been rising. A printing concern reported their commercial printing business to be off somewhat, but their frozen food packages business doing well. According to this source, recently announced price increases for paper were rolled back, failing to hold because of the economic slowdown. But they expect these prices to go up again in the near future, and to hold at that time.

Specialized firms tied to other industries that are in trouble naturally find themselves in trouble. An electrical equipment company which is closely tied to the aircraft industry finds itself with significantly reduced sales, a situation expected to continue until overall improvement in economic activity is reflected in the aircraft industry. This firm sees no improvement in the prices they pay, although deliveries have improved. Another firm, specializing in production of sewage treatment facilities, attributes the slowdown in its business to the inability of local governments to purchase because of "tight money" and a reduced availability of Federal grants.

The prices they pay for everything from janitor supplies to electrical equipment are still rising, and they report no luck in getting price concessions as suppliers continue to stick to list prices.

One thread of optimism regarding prices may be found running through the responses of several of the larger firms in recent months. These firms have observed some leveling off in the prices they pay, and (outside of steel) a little greater willingness by suppliers to negotiate on prices. For example, a large greeting card maker notes that more salesmen are calling in person, and appear to be scrambling for business. Volume discounts are more available, and suppliers seem to be more ready to deal because they are interested in keeping their own plants operating. A metals fabricator reports that, although metals prices remain firm, suppliers of other items are now willing to discuss prices and some price cuts can be negotiated.

A manufacturer of automatic merchandising equipment reports that sellers appear to be more interested now in annual contracts on which they will give a little better price in order to be assured a share of the business. No such concessions were available a year ago, but suppliers seem to be more receptive now. Buyers must work hard for price concessions, but they can be obtained. A similar viewpoint--that the situation calls for hard work by purchasing agents in resisting price increases--was expressed by a representative of a large manufacturer of electronic components and wired carrier equipment. In their view the general economic slowdown has made it possible for purchasing agents to negotiate prices in a better atmosphere and hopefully to do better in controlling price increases on the goods they buy.

ELEVENTH DISTRICT -- DALLAS

Views of head office board members and visiting branch board members were solicited prior to the July 9 board meeting in Dallas. The following conclusions emerged from our informal survey: (1) sales have been weakening for district businesses; (2) there is widespread evidence that merchandise is being sold below posted list prices; (3) the commercial paper market is regarded as relatively stable, but banks have accommodated and expect to further accommodate firms that have been borrowers in the commercial paper market; (4) large CD rates are up at some banks, with rates at a few small banks exceeding 9 percent; (5) corporate liquidity is still a major concern; and (6) loan demand remains strong, matching or exceeding seasonal expectations.

The nonbankers noted that sales appeared to weaken somewhat in their industries in recent weeks. Despite the trend in sales, most respondents noted that their inventory situation had remained satisfactory so that no change in inventory policy had been necessary. There was an indication (confirmed by aggregate data for the region) that petroleum inventories were too high at present, even though sales of the petroleum industry have remained strong. Recent reductions have been made in district petroleum production allowables, particularly in Texas, to curtail crude petroleum mining. The petroleum inventory situation may also improve because a shortage of tankers and reduced Libyan production has caused some strengthening of domestic demand.

The respondents were nearly unanimous in citing that price-cutting from posted list prices had occurred in their industries. It was further indicated that this practice has been on the increase in recent weeks. Price-cutting has probably been one response to the weakening sales reported in several industries. One district banker suggested that a form of price-cutting

had been on the increase in the banking industry. This was occurring through the use of gift premiums, reducing the size of the minimum balance required to avoid a checking account service charge, and other innovative promotions to attract deposits.

A series of questions were asked pertaining to recent developments in the commercial paper market. Nonbankers who have been active in the commercial paper market, either as issuers or as buyers, reported no change in recent weeks in their activity or in their policies toward the commercial paper market. Several bankers in the area, however, noted that they had recently accommodated borrowers who were in the commercial paper market. Of particular note was the recent accommodation by one banker of finance companies that were known to utilize the commercial paper market. In addition, several bankers mentioned that they had outstanding lines of credit to companies that were in the commercial paper market and anticipated some additional activation of these lines of credit in the near future.

Banking respondents to our latest survey noted a generally strong loan demand. All reported loan demand to be either exceeding or matching seasonal expectations. The source of this loan demand is apparently from general business, but large real estate development projects were particularly singled out by one banker.

The recent change in Regulation Q rates for large denomination CD's with maturities of 30 to 89 days has brought mixed responses from district bankers. About half of our survey respondents reported that they had increased their offering rates (usually to the 7 1/2 - 8 percent range, but exceeding 9 percent at a few small banks) while half reported they had not changed their rates. Of the bankers who had increased rates on CD's, only one reported any reduced reliance on sources of borrowed funds, such as Eurodollars, commercial paper, or federal funds. To the extent that additional funds are being attracted

to district banks by the higher CD rates, it appears these funds are being utilized to make new loan or investment commitments and not to reduce reliance on borrowed sources of funds. Some bankers indicated that the recent lifting of CD rate ceilings had given a psychological lift to the financial community. At the same time, however, corporate liquidity remains a major concern of the bankers surveyed. One banker expressed particular concern about the liquidity position of smaller, closely held corporations.

TWELFTH DISTRICT -- SAN FRANCISCO

Overall, the views of our directors have not changed much during the past month. Most of them see a slowdown in the pace of economic activity with no sign of any quick upswing, but few report any feeling that the slowdown will worsen. Both prices and costs are expected to show further increases, and price shading is not widespread. The area with the most severe problems in terms of unemployment continues to be the Pacific Northwest, where both the aircraft and lumber industries continue to reduce employment. Directors who are associated with the lumber industry report that companies are curtailing production, with many firms on a four-day week and usually with only one shift. In Oregon, it is reported, the majority of the small mills have been shut down for over two months and many may never reopen. Even some large firms dependent upon public timber are having difficulties, and one director forecast that some large firms would be out of business by spring.

Another area with above-average unemployment is Southern California. The aircraft and defense industries are suffering the most, but their relative impact on that area's economy is smaller than in the Northwest, and total economic activity in Southern California remains strong. A large electronics manufacturer in the San Francisco area has reduced its workweek in response to a fall in orders. It chose this method of reducing output rather than having layoffs and risking losing skilled employees. Declines in manufacturing, mainly machinery and electrical goods, are also reported for Arizona, where total employment declined for the first time since January. Unemployment is higher in Alaska, in part because of a slowdown in the oil field development.

Prices continue to rise, with the notable exception of lumber and plywood prices. Consumer demand remains steady, although where unemployment is high the sustaining effect of unemployment payments may disappear as benefits are used up. Therefore retail sales may fall more in such areas. Another unfavorable aspect noted by one director is the increase in the number of personal bankruptcies.

Businesses continue to face a squeeze on their profits—especially those now experiencing substantial wage demands. Retailers are described in some cases as reluctant to maintain margins by increasing prices. There is continued emphasis on cutting costs. As part of this trend, bankers report reduced demand for loans to support inventories. In some industries, prospective labor problems add to uncertainty.

The oil industry has some difficulties in controlling discounting of gasoline on the retail level, despite withdrawal of temporary dealer allowances. In addition, it has some supply problems caused by the loss of Arabian crude oil supplies due to the shutdown of the Trans-Arabian pipeline and cutbacks in Libyan oil production. There are also uncertainties about the future need for the production of unleaded gasoline.

In agriculture the picture is mixed. Cattle prices continue to hold, but there is weakness in some areas dependent upon fruits and vegetables, such as Washington and Southern California. The decline in citrus production is not expected to be compensated by higher prices. In Washington, packers are operating at below capacity. But a favorable factor is the recent signing of union contracts by grape growers in the Central California Valley. This signing was in response to the success of the grape boycott, and the resulting settlement of this dispute should improve agricultural income.