

CONFIDENTIAL (FR)

CURRENT ECONOMIC COMMENT BY DISTRICT

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Federal Open Market Committee
by the Staff

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SUMMARY

Opinions expressed by bankers and businessmen in the twelve Federal Reserve Districts indicate that the more pessimistic economic outlook which had emerged last month was currently still in evidence, with some brighter spots--notably in residential housing--appearing here and there. Economic recovery was generally expected to be sluggish and more prolonged than had been anticipated earlier. Holiday retail sales so far were characterized as only fair to disappointing. Most manufacturers contacted reported unchanged or somewhat lower output and orders than last month, and in general looked for only a moderate pickup in the coming months. Concomitantly, there were further increases in unemployment in most Districts and additional reports of trimming of plant and equipment outlays. At the same time, it was generally felt that little or no progress was being achieved in curbing inflation, and sentiments for the adoption of an incomes policy or for other additional action by the Administration appeared to be growing.

A cautious consumer attitude remains in evidence. With the holiday season getting under way, sales have begun to pick up. Most retailers, however, look for business to be about the same as last year--in some instances worse and in others significantly better. Thus, reflecting the difficulties in the aerospace and timber industries, sales in the Seattle area were particularly depressed. Virtually all retailers contacted in the Boston District reported very disappointing Christmas sales, while in Philadelphia the physical volume of sales in large department stores were down 10 percent from a year ago. On the other hand, retailers in some states--Colorado, Michigan, Wisconsin, Montana--look for a significant improvement over last year's holiday sales. As in previous months, "down grading", and "bargain hunting"

remained in evidence, and higher priced items continued to perform poorly.

Industrial production remains weak. Most manufacturers contacted reported no change or some decline as compared with last month in output, sales, and new orders and, in general, look for only a moderate pickup in the coming months. Further slowdowns were evident in the machine tools, electronic, and business equipment industries (notably in the Boston and Chicago Districts) and in the aerospace and timber industries (San Francisco), but the weakness also extended to other industries. Some rebound in December was expected in the Cleveland and Chicago Districts, which had been particularly hard hit by the General Motors strike. However, reports from the steel industry in the Cleveland District reveal that the release of steel stockpiled for General Motors has so far been smaller than expected. Moreover, those steel economists that were contacted felt that inventory stockpiling by steel users against the possibility of a strike in the steel industry next year would begin later than during previous strike-hedging periods, with the "big push" coming only late in the pre-strike period. The Minneapolis Bank's industrial expectation survey, for the first time in 13 surveys, showed a year-to-year decline in District manufacturing sales. On the other hand, considerable optimism was expressed in the Chicago District with respect to prospects for all major classes of consumer durable goods; capital goods producers in that District, however, were generally more apprehensive than a few months ago.

The slowdown in industrial production was reflected in a further weakening in the employment picture. Further layoffs and short time were evident in most Districts, with areas where particularly depressed industries--such as the aerospace, timber, machine tool, and certain nonferrous metal industries--loom large in the local economy being particularly hard hit.

Unemployment among white collar workers and professionals continues to rise. For example, a professional engineering society in the Minneapolis District reported that 10 percent of the engineers in the Twin Cities were out of work. On the other hand, the rate of decline in employment was reported to be slowing down in the Richmond District, while reports from the Chicago Bank suggest little further change, with a rise in employment in consumer durable goods and construction industries offsetting potential layoffs in other sectors.

With respect to plant and equipment outlays, there was some evidence of further trimming or stretching-out of original plans. However, since manufacturers have now been cutting back on their original planned capital outlays for several months, the rate of reduction appears to be tapering off. On balance, the outlook is for little change in such outlays from current levels over the next six months.

One bright spot in the overall economic picture was provided by actual and prospective developments in residential construction, with most bankers and businessmen expecting a good to strong recovery in this sector.

On the price front, scattered price concessions by manufacturers were reported in some Districts. Further strong upward pressure on prices, however, was widely anticipated in the face of increased labor costs. In this context, several Districts reported that bankers and other businessmen feel the GM settlement will affect forthcoming labor negotiations. Durable goods producers in the Chicago District with negotiations still pending are expecting to be under great pressure to follow the GM pattern, while in the Atlanta District, the aluminum industry is reported to be fearful it may have to settle on similar terms.

The majority of respondents thus look for inadequate growth and inadequate moderation of inflation. Against this background, several Districts report growing sentiment for stronger action by the Administration. The Philadelphia Bank reports a feeling among directors and others that an incomes policy is worth trying, sentiment for wage and price controls was expressed by directors of the Atlanta bank, while a number of directors and others in the New York District felt the need for additional action by the Administration to solve the employment-inflation problem.

FIRST DISTRICT -- BOSTON

Area business conditions show a marginal deterioration from a month ago, continuing the trend that became apparent early this fall. With very few exceptions, the scattered elements of optimism reported to us stem from the housing and construction sector, or product and service lines associated with it. New England financial markets show no change in basic conditions, with loan demand stagnant in all categories and deposit flows running at very satisfactory levels.

With the exception of downtown Boston, area thrift institutions are experiencing fairly good reflows. While the most common residential mortgage rate remains at 8 1/2 percent, further reports of local rate cuts are turning up, with the most important occurring in the metropolitan Providence area, where rates have now declined 1/2 to 3/4 percent since last summer.

Our Class A directors report that mortgage demands are strong in most areas on both existing and new properties. One director stated that his bank is now loaned to its legal limit on mortgages, but could loan a great deal more if it were permitted to do so. Each of our Class B directors noted that housing related subsidiaries (paints, calcium fillers, etc.) had constituted the strongest element in their overall operations for some months now.

With scarcely any exceptions, area retailers are reporting very disappointing Christmas sales. A check with New England's two largest department store chains show dollar sales over the period November 1 to December 7 running slightly behind last year. This has exerted a severe squeeze on both firms in light of their substantial cost increases during 1970. In manufacturing, another rash of lay-offs and short-timing seems to be breaking out, following a two-month absence of such reports. The machine tool industry

once again figures heavily in these slowdowns, but they extend to such diverse lines as electrical machinery manufacturers and greeting card producers.

Among our academicians, Professor Tobin had little to add to his earlier comments in October and November. While his primary goal would now be accelerated fiscal stimulation on the expenditure side of the budget, he did caution the FED not to back off from its recent expansionary efforts. Most of the rate declines of the last two months have been due to weakness in the economy in his view, and he would not let them deter the System from pushing for a further easing of conditions.

Professor Wallich expressed concern that a \$1,070 billion GNP target for 1971 is excessive and that the implied necessary rate of growth, if achieved, would create a momentum which would carry us well beyond any acceptable employment goals. Wallich does feel that continued monetary and fiscal stimulus are entirely proper right now in light of the gloomy second half of 1971 that is shaping up. He is also fearful that we may not get the employment effects we expect in 1971, explaining that the concentration of large productivity gains early in recovery may negate the average relationship expressed in Okun's law.

Professor Eckstein continues to feel quite comfortable with his November 16 forecast of \$1,043.8 billion GNP in 1971, assuming a continued money supply growth of 5 1/2 to 6 percent. While conceding that his interest rate expectations for 1971 are proving excessively gloomy and must be revised, he continues to view the short-run outlook as very poor, based on all recent evidence. He, too, would endorse further monetary and fiscal stimulation. With respect to the latter, his forecast shows Government expenditures over the next year running \$0 to \$3 billion below the amount necessary to achieve

balance in the high-employment budget. He would prefer to see them stepped up enough to put the probable error on the deficit side.

Professor Eckstein expressed irritation at the recent revision of money supply figures, stating that--for planning and forecasting purposes--these annual revisions are analogous to the Department of Defense misestimates of Vietnam costs in the mid-1960's. He concluded that, if the System is serious about using monetary aggregates as a principal target, it would do well to put more thought and money into the collection and definition of its money supply figures.

Professor Samuelson was unavailable for comment this month.

SECOND DISTRICT -- NEW YORK

Opinions expressed by Federal Reserve Bank Directors and other business leaders point to relatively good, albeit not spectacular, retail sales over the Christmas season, but little change in the sluggish capital expenditure picture that has emerged in recent months. Continued strong upward pressures on wages and prices are widely expected, and while most of those questioned were less than enthusiastic over the use of wage and price controls, many felt the need for additional Administration action in this area. The Directors felt that liquidity remained a problem for certain firms.

With respect to consumer spending, retail sales in the Rochester area, which last month had been characterized as "terrible", were now reported by the President of a department store in that city to be better than during past Christmases. The President of an Ithaca, N.Y. bank found retail sales in that city to be reasonably good, with four out of five businesses doing better than expected, while the President of another upstate bank saw sales in his area as "looking good". The President of a large New York City department store, who in recent months had been more optimistic than other retailers contacted, was somewhat less sanguine this month. His firm's business had been very good in September and October, but flattened out in November. Nevertheless, he did feel that "the best part of the game was still ahead", and that business would gradually pick up in December. He was "certain" that the dollar value of his firm sales over the Christmas season would exceed last year's. He was not as certain, however, that the increase in dollar terms would be large enough to offset the rise in prices.

Little new information on the plant and equipment picture emerged

from the discussions, with the outlook about unchanged from last month--namely, some cutback from original plans, and an increased proportion of outlays going into environmental control. The Chairman of the country's largest manufacturer of electrical equipment estimated on the basis of orders for capital goods on his firm's books that plant and equipment outlays would increase nationwide by only two or three per cent next year, with the entire increase due to price inflation.

Sentiments regarding prices and wages developments were fairly gloomy. It was felt generally that the General Motors wage settlement would have a strong impact on wage demands and settlements in other areas. The Chairman of the electrical equipment firm saw nothing in sight to keep unit labor costs from rising sharply in the next two or three years, and he believes that the rise in productivity this year was a "one shot deal" and won't be repeated, and that the country has "built-in inflation". Concern over the size of wage settlements and over continued upward pressures on prices was also expressed by several directors and other business leaders.

Most directors and other business leaders were less than enthusiastic over the use of wage and price controls. However, several were relatively open minded toward this approach, while many of the respondents felt additional action on the part of the Administration to limit further wage and price increases was needed. The Chairman of the electrical equipment manufacturer reported that the Business Council, which he headed until recently, had made it clear to President Nixon that Council Members don't want wage and price controls because they are convinced they will never work. One director, however, commented that the time was approaching when wage and price controls must be adopted, and another director felt that, while controls would not be workable over any extended period, such controls might

have a useful psychological effect for a short period. A partner in large investment banking firm noted that incomes policies have failed all over the world where they have been tried, but felt it was up to the United States to seek to find a solution to the problem of full employment without inflation.

The directors in general felt that liquidity was still a problem for certain firms. Two upstate bankers stated it was a serious problem for the marginal, smaller companies. The Chairman of the Board of a large manufacturing concern felt the problem was "spotty" but also affected some sizable companies, while another director stated that liquidity problems were "serious" in the airline, aerospace, and electronic industries and that it would be 18 months before some companies in these industries could "see daylight".

THIRD DISTRICT -- PHILADELPHIA

There is general agreement among directors, bankers, manufacturers, retailers, and business economists in the Third District that the economy will remain sluggish through the end of the year. For 1971, there is cautious optimism for a mild pickup in business activity. However, few people that we talked with believe that the "worst of both worlds" situation will improve much next year. The consensus is that both unemployment and inflation will remain at unacceptable rates throughout the year. Because of this feeling among area businessmen, there is a growing willingness to try an incomes policy.

The level of business activity is expected to remain flat or decrease slightly through the end of this year, according to regional manufacturers. Our latest reading of business sentiment in the District shows that most area manufacturers experienced either no change or actual decline in sales and new orders for the month of November. For December, the consensus view is for no change in these key variables.

Looking ahead to 1971, however, optimism remains for at least a mild upturn in the economy. Most manufacturers say they expect volume to increase over the next six months. However, because the pickup in the economy is expected to be slow, area manufacturers are holding the line on capital spending plans. On the whole, the outlook for spending on new plant and equipment is for no change during the first half of next year.

Business and bank economists from the Philadelphia area also see no more than a mild pickup in the economy next year. They see housing and state and local spending as strong sectors next year, with defense outlays and

capital spending as weak sectors. From their vantage point, they see the consumer as neither bull nor bear in 1971. Rather, they see consumption as only a "so-so" sector for next year.

Consumer sentiment in the Philadelphia area remains low. Dollar sales in large department stores continue to be down slightly from a year ago. In terms of physical volume, area department stores report that sales were off 10 percent last month. There was a two-day spurt in sales following Thanksgiving. But, for the most part, only bargain basement items sold. Higher priced goods simply are not moving so far in December, "sales have been terrible", as one retailer put it. There is near unanimity that Christmas sales will be poor. Further, area retailers see little encouragement in the outlook for early 1971.

Banks in the District report weak loan demand. One consequence of this weakness has been some relaxation in what up to now has been a highly restrictive policy with respect to loans. For example, until recently one of the largest banks in the District required that one of four men approve any loan over \$10,000. Now, the ceiling has been raised to \$500,000. Despite this kind of relaxation in loan policy, area bankers remain sensitive to the creditworthiness of prospective borrowers, and the consensus among bankers seems to be that there will be no fundamental change in lending and investing behavior until expectations about the strength of the economy and about the stance of monetary policy are changed. With regard to monetary policy, District bankers interpret the most recent lowering of the discount rate as a technical move which they had anticipated.

Another consequence of the weakness in loan demand is the sluggish earnings that some banks say is shaping up for the fourth quarter. Most

bankers also anticipate a drop in earnings for 1971. One large bank in Philadelphia reported that only 5 to 6 percent of its officers would be getting year-end raises.

There is widespread impatience with the current strategy against inflation. However, there is more disagreement now than a few weeks ago whether inflation or unemployment is the number one problem. One board member, for example, is critical of the way the recent "inflation alert" was handled. He thinks the President ought to be directly involved in spotlighting inflationary wage-price decisions. Another director believes that the Fed ought to resist the political pressures which are building up to ease monetary policy further. He believes that the Fed ought to stand firm until inflation is brought to heel. Other directors, however, are becoming increasingly concerned with rising unemployment. One director, for example, said that in his home county the sale of food stamps is up appreciably. Another director thinks that unemployment may be a more serious problem than inflation.

Although there is disagreement about whether unemployment or inflation is the number one problem, there is a growing feeling among directors and others that an incomes policy is worth trying. One director, for example, thinks the recent CED recommendations have merit. This board member is particularly disturbed that some top officials in the Administration rejected the CED proposal almost out of hand.

FOURTH DISTRICT -- CLEVELAND

Our latest survey of District manufacturers indicates that business activity in November was the weakest in any month thus far in 1970. Both capital goods producers and General Motors suppliers reported declines in a number of key areas of activity included in the survey. A rebound of moderate proportions is anticipated in December, although recent declining tendencies in employment are not expected to be reversed. Activity is beginning to pick up in the steel industry, but the full thrust of the inventory stockpiling is not expected to be felt until the second quarter.

The indirect effects of the General Motors strike were apparent on employment and unemployment in the Fourth District in November. (District manufacturing employment was down 10 percent from November 1969, while the insured unemployment rate was three times higher than the year-ago level, 3.9 percent versus 1.3 percent.)

The strong recovery in residential construction contracts continues to be a source of strength in economic activity in the District. A spokesman from General Motors Corporation informed this Bank (confidentially) that, as of December 7, only eight plants had not signed contracts, and four of those plants were working without contracts. Of the four plants still inoperative, three are located in the Fourth District (one is in Cleveland and two are in Cincinnati). Two economists with large steel firms in the District reported some improvement in new orders, a substantial proportion of which call for delivery in February. Both these economists reported that releases of stockpiled steel for GM have been smaller than the steel industry had expected. About half of the steel that the mills have been holding for GM will be shipped in December and the remainder in January. Both steel

economists believed that inventory stockpiling would begin later this time than during the previous strike-hedging periods. Inventories held by steel users are not expected to rise appreciably until February, with the big push coming late in the pre-strike period (July 31 deadline). Where possible, steel consumers are expected to hedge with foreign orders for delivery after August 1.

An economist for a large diversified manufacturing firm (auto components, electronics, and defense products) reported that his firm expects an upsurge in new orders in the first quarter of 1971 as GM production expands. On a broader scale, he indicated a strong belief that the upturn in auto output and some buildup in steel inventories as a hedge against a steel strike will bolster industrial production and lead to some modest improvement in the unemployment situation. These developments, he feels, will improve consumer confidence and stimulate consumer spending.

On the financial side, one of our directors, who is the chairman of one of the largest banks in the District, reported that the demand for loans remains strong and that the bank is not going to expand its municipal bond portfolio. This director noted that maturing issues will be replaced, but beyond that "we have enough municipals". The continued strong demand for loans includes a number of construction loans--hospital financing and plant construction loans--and requests for increased lines of credit from both old and new customers. Of particular interest are the request for extensions in credit lines from "captive" auto finance companies that expect an increased volume of credit demands as a result of the reduction of auto financing by sales finance companies. Ford Motor Credit Company, for example, is attempting to increase its nationwide credit line from \$600 million to

\$1 billion. The economist and a senior investment officer at another large bank in the District reported that the demand for loans remains weak and that the bank has completed acquisition of a modest amount of municipal bonds, mainly in the one- and two-year maturity ranges.

FIFTH DISTRICT -- RICHMOND

Surveys of businessmen and bankers in the Fifth District indicate general agreement on the following points: (1) continued weakness in District manufacturing activity including shipments, volume of new orders, and backlogs of orders; (2) some improvement in retail sales except for automobiles; (3) slight improvement in the employment picture in the retailing and service sectors, but further weakness in manufacturing employment; (4) some price declines in manufacturing but continued price advances on retail items; (5) continued upward wage pressure; (6) slight improvement in residential building activity; (7) tapering of demand for bank loans, especially in the business loan category; and (8) a guarded but favorable outlook for future business conditions.

Although reports are mixed, Fifth District manufacturers on balance continue to report that shipments, new orders, and backlogs of orders are down. Important producers in such industries as furniture, textiles, and chemicals report declines, while other reporters in metals, machinery, coal, and electrical equipment indicate no change or some improvement.

Reports show some improvement in retail sales in the past four weeks, though it is not clear whether the improvement is greater than seasonal expectations. Businessmen in trade and services as well as the District's bankers report improvement. Automobile sales, however, are an exception. Reports indicate substantial further decline in this area during the past four weeks, reflecting the effect of the reduced output.

Manufacturers and retailers report some further increase in inventories, and both groups continue to report that current inventory levels are higher than desired.

Some further declines in employment are reported by District manufacturers in such industries as synthetic fibers, fabricated metal products, and electrical equipment. Additional reductions in the length of the workweek are also reported by some manufacturers. A number of strikes continue to have an influence upon the District's employment situation. Retailers report an increase in employment and in the length of the workweek as seasonally expected.

District bankers continue to report that employment is down in their respective areas and that available labor supplies are somewhat higher, but the proportion of bankers reporting a worsening employment situation has dropped since the November survey. On balance, the latest survey indicates that the manufacturing sector is the weak part of the District's economy as far as employment is concerned, with some of the effect attributable to strikes. Some slight improvement may be occurring in other sectors.

Manufacturers report some declines on balance in prices during the past four weeks--principally among producers of nonferrous metal products. Also, reports of price increases have dropped significantly since the November survey. Retailers, however, continue to report some price increases. Both manufacturers and retailers report the continuation of upward pressure on wages.

District bankers continue to report on balance that residential construction activity in their respective areas is down, but the proportion reporting increases has risen significantly since the survey of four weeks ago. Nonresidential building is reported to have increased somewhat during the past month, as it has for several months.

Business loan demand at District banks is reported down during the past four weeks, continuing the decline reported last month. Consumer loan demand and mortgage loan demand are reported off slightly at District banks, reversing the moderate increases of the past several months.

The outlook of the survey respondents remains favorable. The proportion of respondents expecting improvement in general economic conditions continues significantly higher than the proportion expecting a worsening of conditions. Sentiments are mixed, however, and comments received from reporters indicate a higher degree of optimism among those in retail trade, services, and banking than those in manufacturing industry.

A number of District manufacturers have cut back capital spending plans in recent months, and most of the manufacturing reporters are apparently satisfied with current plans. Many feel, however, that they are operating at production levels which are less than optimal for their present plant and equipment.

Excessive finished goods inventories continue to be a problem for District manufacturers in textiles, furniture, metals, and metal products. Retailers also indicate that inventories remain at higher levels than they desire.

SIXTH DISTRICT--ATLANTA

The economy of the Southeast is marking time. Although layoffs continue to dominate the employment news, there are enough bright spots in the District's economy to keep it on an even keel. Construction of low-income housing and road building is active, and a slow but steady flow of announcements of new plants or plant expansions is encouraging. A soon-to-be-released survey indicates Tennessee businessmen have a cautiously optimistic outlook. On the other hand, numerous announcements of further price increases have appeared. There is some sentiment among our directors for wage and price controls.

The aluminum industry is fearful that it may have to settle for a package similar to the GM contract in its upcoming labor negotiations in spite of the fact that the industry is in the doldrums. Aluminum exports are off. One large producer has gradually reduced its labor force from 6,800 to 5,500, 1,000 being released in the last year. A producer in the New Orleans vicinity has recently shut down one of its lines, idling 125 aluminum workers.

Layoffs are also occurring in such industries as chemical, paper, airlines, and aircraft. A chemical firm in south Louisiana is idling 800 employees, including administrators and supervisors. A north Florida paper producer is temporarily cutting its production--affecting 680 workers--and a southern Mississippi paper mill has gradually been reducing its work force. An aircraft R & D Center will be dropping 300 employees by the end of the year. In Florida, 200 employees of an airline were laid off because of a slowdown in business and tourist traffic. The weakness in the job market for college-educated

people is underscored by a decrease in campus recruiting, especially by aerospace and defense-related firms and Federal agencies.

Newspapers in the District have been carrying reports of price increases, and one paper decried the October increase in consumer prices in an editorial entitled "Up, Up and Away". Papers have recently highlighted price and wage increases in the following areas: white collar wages, freight rates, proposed Atlanta bus fares, intrastate bus fares in Georgia, Atlanta food prices, and proposed phone, utility, and milk prices. However, some articles have called attention to lower interest rates. For example, one article stated that Tennessee taxpayers saved about \$4 million in interest costs because of lower interest rates on bonds. Also, it has been reported that differences in bids by construction subcontractors have been very small, indicating keen competition.

The sluggish pace of economic activity has slowed the growth of revenues to state and local governments. As a consequence, these governments have begun to cut spending. For example, Georgia's budget for the current fiscal year was based on an anticipated revenue increase of 9.5 percent. But November receipts ran only 1.3 percent above the year-ago level. This prompted cost-cutting measures in all areas of the state's government.

The fire on the Shell Oil platform in the Gulf is more serious than the similar Chevron fire, because there are more wells on the platform and the prevailing currents at the site are toward the Coast. The Chevron fire resulted in a moratorium on well digging which depressed economic activity along the Louisiana and Mississippi Gulf Coasts. It is likely that those industries and localities which depend upon offshore oil drilling will again be adversely affected.

On the bright side, production of light fixtures at a large plant in Mississippi is stabilizing after a gradual decline. In Florida outlays for road construction are increasing and two bond issues have recently received cabinet-level approval. Alabama's expenditures on roads will be about 25 per cent greater this year than last. A tire plant in Alabama has returned to production after being closed for more than a month. Those apparel plants specializing in new styles are doing very well.

Furthermore, new plants are opening or have been announced for producing modular homes, metal products, chemical cellulose, travel trailers, and plastics. A director from south Alabama reports that the outlook for new plants and plant expansion in his locality is better than at any time during recent months.

Reasons given by Tennessee businessmen for their cautiously optimistic outlook include: "a lowering of interest rates", "improving credit collections", "an increasing investment capital supply in the state", and "expected reversal of the decline in the national economy". Many panelists, however, believe that several months will pass before these factors take effect and, thus strong expansion will not occur before midyear at the earliest. Rising costs, compared with resale prices, are identified by the panel as by far the most critical issue facing Tennessee businesses at present.

Low-income residential construction has been active. For example, in Birmingham and Chattanooga, construction has recently commenced on two large residential projects for low-income families. In a rural area of Alabama, 99 percent of the homes financed by the Farmers Home Administration this year have been in the low-price range. Last year, only 50 percent of

the homes similarly financed were in the low-price range. Although the 235 program is evidently responsible for many housing starts, three builders are reported to be leaving this type of construction because inspection regulations have added to costs. There has been a softening in the market for luxury condominiums in south Florida, with most buyers looking for units below \$35,000.

SEVENTH DISTRICT -- CHICAGO

Many segments of the Seventh District economy are now reviving in response to the return to work of GM strikers in the second half of November. The agreement at Ford yesterday, December 7, removes another element of uncertainty. Other producers of durable goods with negotiations still pending will be under great pressure to follow the established pattern.

Aside from the strike influences, there appears to be little change in the basic trend of activity. Further declines in employment and output in business equipment industries probably are being offset by increases in output of consumer durables and materials and components for residential construction. Markets for labor, and for commodities, continue to become more competitive. Price increases are less frequent, and significant price reductions for custom-built business equipment are said to be offered in negotiation, although not publicized.

Projections of gross national product of 1971 by well-known forecasters in the Seventh District range from \$1,030 billion to \$1,055. (Beryl Sprinkel offered \$1,050 at a luncheon today.) Expected gains in real output range from 2.5 to 4 percent, while expected increases in prices range from 3.5 to 4.5 percent. Some forecasts, not most, see an appreciable decline in the unemployment rate in the second half of 1971.

Businessmen and bankers appear to accept the general tone of the forecasts--inadequate growth and inadequate moderation of inflation. They expect their profit margins to be under heavy pressure, with dollar totals increasing about in line with volume.

Considerable optimism prevails (at least is expressed) over 1971 prospects for output and sales of all major classes of consumer durables,

including appliances, TV, furniture, and autos. A record 10 million-car year is frequently suggested.

Warm weather in recent weeks (a record 70 degrees on some days in the Chicago area) is blamed for continued sluggishness of retail trade since Thanksgiving. A number of stores have already started sales on winter coats. Because unseasonal weather reduces traffic through the stores, sales of all types of goods are said to be depressed to an extent.

Aside from farm equipment and utility apparatus, producers of business equipment, and components for business equipment, are more apprehensive than a few months ago. Orders for machine tools, tools and dies, gears, drives, and forgings have been very weak. Layoffs and salary cuts are continuing. Hunger for new orders has induced price concessions. On the demand side, many recent corporate budget meetings, we are told, resulted in capital appropriations cutbacks. Such decisions, not irreversible, sometimes set back the "on stream" target date for new facilities already under way.

Employers of organized labor complain of the lack of interest of labor unions in aiding productivity gains. At a recent discussion in Detroit, the head of the UAW, while discussing the problem of rising absenteeism at some length with a business oriented audience, stated: "Let's face it. It's the same in the auto industry as elsewhere. Nobody gives a damn any more."

In the Chicago area the supply of new office building space threatens to outrun demand. Large new buildings are under construction, and others are scheduled to start, following demolition. But current studies for future projects give negative results. After the present wave of building is completed, a dry spell of at least three or four years is foreseen.

Income of District hog farmers is being reduced by further price weakness for hogs. The sharp run-up in corn prices, 20 percent higher than last year in November, is also affecting the profits of cattle farmers, although cattle prices have been relatively firm. Twenty percent lower corn yields in Illinois and Indiana this year were caused by leaf blight and spring flooding.

Loan demand at commercial banks continue very weak, despite the prime rate cut. Time money is readily available at sharply lower market rates. Nevertheless, banks are very cautious in lengthening maturities and have maintained stiff quality standards on new loans. Meanwhile, insurance companies are seeking new investments more aggressively as net policy loan disbursements continue to decline. Mortgage money for houses is somewhat easier, but rates and terms have not eased much. There are sentient comments on the "very grave" financial position of various large stock brokerage firms.

EIGHTH DISTRICT -- ST. LOUIS

With the exception of some anticipated gains in home building, the Eighth District business outlook continues generally unchanged from a month ago, according to a sample of businessmen. Most economic activity is viewed as being slow with little change foreseen in the near future. Retail sales are sluggish with no indication of an early upturn. This relatively pessimistic outlook made the manufacturing firms less expansion minded than heretofore. In sharp contrast to the general outlook, however, those in the home-building industry are quite optimistic. The increased availability of credit and slightly lower interest rates are beginning to provide stimulus to the industry, resulting in expectations of increased activity in the months ahead. Most manufacturing firms contacted indicate that capital spending plans are being trimmed somewhat or drawn out over a longer period than anticipated when originally developed. In many instances, investment in new plants has been matched by early closing of older units where production is less efficient. High wage settlements are apparently stimulating modernization of plants and equipment, and investment for this purpose is expected to continue at a high level.

Respondents indicate that total employment may pick up moderately after the turn of the year. However, efforts to trim wages continue, and with the expected number of new entrants into the labor market no reduction is foreseen in the unemployment rate.

Poor weather conditions for crop harvesting have contributed to a pessimistic outlook in some rural communities in the southern part of the District. Excessive rainfall has delayed harvesting of both cotton and soybeans, tending to reduce both the quantity and quality of these crops in

Arkansas and Mississippi.

Retail sales continue to fall behind expectations of a few months ago. Department stores report fewer shoppers and later Christmas shopping than normal. Collections on instalment sales are more difficult with the rise in unemployment. Greater caution is therefore being exercised in planning for spring inventories. In contrast to the generally pessimistic outlook for manufacturing and retail sales is the increased optimism expressed by those in the home construction and building materials industries. Both direct labor costs and prices of building materials are up, but apparently demand has risen faster than costs since building activity is on the upswing. One contributing factor is the increased liquidity of savings and loan companies and banks. Some insurance credit is likewise returning to this market with the decline in demand for funds to finance new shopping centers, etc, where the lender receives in addition to the fixed interest rate a percentage of gross sales or gross rental although rates on home mortgages remain relatively high, other credit terms have eased and loans are easier to obtain.

NINTH DISTRICT -- MINNEAPOLIS

Ninth District employers apparently are continuing to feel the effects of weak economic conditions, and are still paring work forces and reducing production schedules. Results of our latest quarterly industrial expectations survey reveal that District manufacturers are not anticipating any significant sales increases over the next six to nine months. Consumer spending, for the most part, is still weak, although some directors felt that retail sales were picking up in their areas.

Area employers apparently are still in the process of reducing their work forces and adjusting their work schedules. The largest layoff over the last month occurred at Honeywell, Incorporated, where an additional 341 workers were separated because of a continuing reduction in defense spending. Seventy-five workers were laid off by a film-processing manufacturer in the twin cities, and a furniture and flooring manufacturer in upper Michigan furloughed forty-five workers because of a lack of orders, reportedly because of the slowdown in school construction. In addition, directors and officers of the Bank felt that overtime work for the most part was nonexistent and were either aware or had heard of cases where employers had reduced work-weeks to less than five days. A local professional engineering society reported that 10 percent of the engineers in the twin cities were out of work.

These further cutbacks in employment are consistent with District manufacturers' expectations regarding their sales. According to the results of our latest industrial expectations survey, taken during the first two weeks of November, area manufacturers have revised downward their sales expectations during this quarter and the first quarter of next year. Following a year-to-year sales decline of 3.7 percent during the third quarter, their

sales in the fourth quarter to be about 1.3 percent below a year ago. This is the first time in 13 surveys that District manufacturing sales have shown a year-to-year decline and is the first time that District manufacturers were anticipating lower sales than a year earlier. On the brighter side, District manufacturers expect their sales in the first quarter of 1971 to be up 1.3 percent above a year earlier and then to exceed the year-earlier level by 4.2 percent in the second quarter. Although these sales gains imply no significant recovery in District manufacturing activity, this is the first time in a year that manufacturers expect their sales to strengthen, even weakly, over the forecast period.

Also on the brighter side, one of our directors who attended a conference sponsored by the First National Bank of Chicago stated that bankers are generally optimistic regarding business conditions in 1971. According to him, only 10 percent of the 1,100 bankers from all over the country who attended the conference felt that business would weaken further next year. Of those attending the conference, 45 percent felt that interest rates would decline during 1971.

Consumers are still watching their expenditures very closely, but there are some scattered indications that consumer buying may be strengthening. Directors from Michigan, Wisconsin, and Montana for the most part felt that Christmas buying was up from a year ago, and one director noted that traffic has been extremely heavy. On the other hand, one twin cities director felt that consumer buying attitudes had not changed in the past month or so and that consumer spending was still very sluggish. Retail sales during the Thanksgiving weekend, which are usually taken as an indicator of the Christmas sales season, were described as "very disheartening" by one major Minneapolis retailer, and many retailers in Minneapolis-St. Paul feel that consumers will

remain cautious throughout this buying season. A director from South Dakota felt that consumer buying attitudes are still very conservative. This relative pessimism was reflected in lower sales for both soft goods and durables and has been chiefly caused by the recent large decline in livestock prices.

The directors of this Bank feel that District state and local government construction expenditures next year will not differ markedly from this year. Local legislators, however, have not yet formulated their plans. A few directors were able to cite specific large planned expenditures, but most commented that communities in their areas apparently were not planning major construction improvements. In some cases, public facilities were already adequate while, in others local legislators either are reluctant to impose higher taxes to finance the construction of public facilities or have been turned down by the voters in recent bond issue requests. Primarily in Montana, they are stymied by statutory ceiling rates that they can pay for borrowed money.

TENTH DISTRICT -- KANSAS CITY

The economy of the Tenth District continues to show signs of only sluggish growth, according to recent observations of bank directors and businessmen. Many feel that a modest revival of business activity is likely to occur during the first half of the coming year. In a survey of the larger retail stores in the Tenth District, retail sales during the current holiday season were said to be running about the same or slightly better than a year ago. Consumers were reportedly remaining cautious in their buying behavior and demonstrating a high degree of price awareness. Retailers generally expected only a modest rise in their sales volume over the next few months.

In the majority of the retail stores surveyed in the District, retail sales were about at the same level recently as a year ago. Only in the Colorado area, where business activity has been less affected by the current slowdown, were sales reported to be well above year-ago levels. Throughout the District, sales of home furnishings, television sets, and other "big ticket" items were not doing well, although exceptions occurred whenever these items were promoted on the basis of attractive prices. Those products reportedly moving well were the traditional Christmas gift items, such as small electrical appliances, women's sportswear and accessories, and men's furnishings.

All retailers surveyed indicated that consumers were being very price conscious in their buying behavior. While still demanding quality, consumers appeared to be very responsive to price promotional ads, and were shifting their purchases from higher to lower priced items. Reflecting this shift, "budget" store sales have been markedly above year ago levels.

In addition, many retailers indicated that with price competition being keener lately, retail prices appeared to be rising at a somewhat slower rate than previously. One further indication both of consumer and retailer price consciousness was the admission by some respondents of resort to deeper price markdowns than was the case a year earlier.

Most of the retailers contacted expected a modest rise in the volume of retail sales in the first quarter of 1971 relative to a year earlier. In the Colorado area, where retail sales have been stronger recently than elsewhere in the District, respondents were more optimistic in terms of the outlook. In this area, expected first quarter gains relative to a year earlier were in the range of 4 to 5 per cent. In other areas of the District which have been harder hit by the economic slump, retail sales are expected to show little or no gain over the next few months. In fact, the general tenor of most of the views expressed about the near-term outlook for retail sales could best be summarized as being cautiously and guardedly optimistic.

Reflecting these cautious views about consumer buying intentions, many directors and businessmen expect the District economy to remain somewhat sluggish throughout the upcoming winter months. A moderate pick-up in District business activity is then expected in the second quarter. A director who is active in the construction industry indicated that while his firm expected a slow first quarter, orders already on his firm's books portended good activity throughout the remainder of 1971. A director representing a major farm implement manufacturing company reported that while current sales have slowed down from last year's level, his dealers are optimistic about sales for the near future. The view that general business activity

would pick up moderately in the spring also was supported by a representative of a major airline company who indicated that his company was projecting good growth in revenue traffic miles for 1971 as a whole.

ELEVENTH DISTRICT -- DALLAS

The major portion of the data for this report was gathered in a survey of fourteen of the larger savings and loan associations in the Eleventh District. The associations surveyed reported: (1) Most associations had recorded deposit inflows since November 1969, with the weighted average rate of inflow of 4.0 per cent (2) The majority of associations had recorded increases in loans ranging from 2 to 15 per cent, yielding the weighted average increase of 4.4 per cent since November of last year (3) Commitments at most of the institutions surveyed were up substantially over last year (4) Nearly two thirds of those surveyed had recently reduced their rate on home mortgages, with the most quoted rate in the range of 8 1/2 per cent (5) About half of those surveyed felt that residential construction was being limited by huge construction costs (6) About half of the associations are now making loans on mobile home purchases, although these are fairly new loan programs (7) Most report that the price range of homes being constructed has risen somewhat in recent years, with the largest volume being constructed in the \$20,000-\$30,000 price range.

General economic conditions continued to show a very moderate upward trend in the Eleventh District. Unemployment in Texas continues to remain well below the national average, while industrial production has edged upward slowly in recent months. Eleven out of the fourteen savings and loan associations surveyed had recorded fairly substantial deposit inflows since November of last year. Deposit inflows ranged from 2 to 15 per cent, with many in the 7 to 8 per cent range. Moreover, twelve of the fourteen showed an increase in loans over the period since November 1969, with eight

of these associations recording annual growth rates for loans in excess of 5 per cent. Most of the associations had commitments exceeding those in November 1969, with four of the associations showing commitment levels more than twice those of November of last year. Of the associations surveyed, nine reported that they had reduced the rates they charged on home mortgages. Most of these had reduced their rates by 1/4 to 1/2 per cent in recent months. The majority of the associations reported a current quotation of 8 1/2 to 8 3/4 per cent on home mortgages. Rates varied somewhat, with some associations charging 1 to 1 1/2 per cent origination fee. The 8 1/2- percent rate was typically on "prime" or "good conventional 80 percent" loans. The majority of those surveyed felt that residential construction is being limited somewhat by construction costs. However, several felt that reduced interest rates might offset a portion of this high cost of construction. Should rates decline and additional mortgage money become available, most felt that only a very limited amount of demand for housing would continue to be deferred because of construction costs. However, one respondent noted that he expects the main volume of home building during the next five years to continue under the FHA or HUD programs. Half of those surveyed reported that they are now making loans on mobile home purchases. Since this type of loan is relatively new, only a few of the associations were able to supply figures on their volume of mobile home paper outstanding. Most of those participating in mobile home financing estimated that only a small portion of their deposit inflow will be channeled into such paper. One association estimated that in the future, about 6 to 8 per cent of its deposit inflow would go into mobile home financing. The majority of those surveyed indicated that homes in the price range of \$20,000 to \$30,000 constituted the largest volume of homes being currently constructed in their areas. Most indicated

that the general price range of homes being constructed had risen substantially (20 percent plus) since 1967. However, three of the respondents indicated that a greater number of lower priced homes are being built now than in 1967, so that the proportion of higher priced homes being constructed has declined. A number of those surveyed indicated that, as funds become available, both short-term and long-term interest rates should decline and there should be an increase in the number of homes being constructed in all price ranges.

Current levels of economic activity within the Eleventh District seem to indicate that the regional economy bottomed out sometime late this summer and is now showing a very moderate upward trend. Modest gains in industrial production have been made, as the decline in durable goods manufacturing was more than offset by high levels of nonmanufacturing and oil activity. The decline in durable goods was due mainly to declines in transportation equipment and machinery. The return of the auto workers to the GM assembly plant at Arlington, Texas, should have a positive effect on durable goods production; however, this may be partially offset by further downward adjustments in the aerospace industry. As a whole, industrial production in Texas during the first ten months of 1970 has shown a significantly smaller increase than in previous years.

There have been recent modest gains in employment in the District, with the unemployment rate for Texas running substantially below the national average. However, projected growth in the labor force is expected to outstrip gains in employment. Construction--particularly nonresidential construction--has shown some improvement in recent months, while department store sales in November were up only 3 per cent over the same month last year.

TWELFTH DISTRICT -- SAN FRANCISCO

The general consensus of businessmen and bankers in the Twelfth District is that there has been no major improvement in the pace of economic activity. There have been some favorable factors, lower interest rates, for example, but the impact has not been sufficient to produce any major change in spending plans.

The principal problem area in this district remains the Pacific Northwest where the aerospace and timber industries are depressed. The most severe unemployment is centered in the Seattle-Tacoma region due to the cutbacks at Boeing. In Seattle, retail sales are below those of last year and vacancy rates are high for both commercial and residential property. In both Oregon and Washington, the timber industry shows no sign of recovery and individual mills are continuing to lay off employees. The aerospace cutbacks are also a significant factor in California's unemployment. Although the aerospace and timber industries have the most obvious difficulties, there remains a widespread weakness across the district in manufacturing of all kinds. Firms report that they are continuing to hold back on orders and in some cases reducing employment. In Arizona, layoffs in manufacturing continue, in contrast to a rising trend in employment in other sectors. In Southern California, one banker, after surveying local industrial parks, reported a noticeable increase in the number of buildings either empty or up for lease. There is no evidence of any shift toward rebuilding inventories. Policy is still directed at keeping inventories down and keeping production geared to actual orders.

Investment plans show a mixed pattern. One major oil company reports it is carrying on its capital projects in conformity to its long-term

investment plan. Another local firm which is a supplier for the construction industry has deferred all of its expansion plans until there is a recovery in its orders. On balance, investment expenditures are continuing, but at a moderate pace.

Retail sales, apart from those of automobiles, have been steady. They are above those of last year in most areas, again with the exception of Seattle. The reduction in the prime rate has been regarded by most banks as a reaction to money market trends and therefore any other changes in their policies have been marginal. Some banks are rebuilding liquidity while others are attempting to expand their loans. In some cases, banks are making loans to customers whom they previously would have turned down, while other banks are looking for prime borrowers without otherwise changing their lending policies. For nonprime loans, the rate decline is not in proportion to the cut in the prime rate, principally because nonprime rates had not been increased in proportion initially. Some rates on loans are being cut immediately, others as they are renewed, according to the individual bank's policy.

The banks as a whole expect mortgage rates to fall even more slowly. In some instances this is because demand remains high, while in others the rates had already fallen somewhat. In contrast to mortgages, rates for interm construction loans in California have declined by approximately one percentage point. Part of this decline is due to the easing of other rates, but part is due to increased competition by real estate investment trusts whose activities have been growing.

District bankers generally report improved liquidity positions and they are responding on the liability as well as the asset side. Some are cutting their CD rates while others are reducing their Eurodollar borrowings.

The prime rate reduction has had only a minor impact on the businesses of our nonbank directors. They are, of course, pleased to pay lower interest rates but none reported that their investment plans have been affected by the lower cost of funds. Some said they might be prepared to carry more inventories than otherwise, but there were just as many who were making no change. The general reaction was that the prime rate reductions were beneficial in principle to the longer-term business outlook. Businessmen remain cautious and are continuing to try to keep costs under close control. The most common assessment of future trends is for only a gradual recovery in 1971.