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CURRENT ECONOMIC COMMENT BY DISTRICT

Prepared for the
Federal Open Market Committee
by the Staff

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SUMMARY

The concensus of the reports by the twelve Federal Reserve Banks is that the economy is in a sidewise movement with few signs of strength in any sector. Businessmen have generally become more cautious with respect to plans for the remaining months of the year. Instead of an early vigorous recovery as envisaged by some in earlier reports, business leaders now view the outlook less optimistically. Profits have declined and many firms have responded with cost cutting measures, including employment cutbacks, reduced inventories, and in some instances a reduction in planned capital investment.

Most Districts report "sluggishness" in sales with few optimistic comments. Although total retail sales appear to be holding their own, the volume is generally below expectations, and inventories are being evaluated carefully. Consumer durables are generally the sector hardest hit, with television sets and large appliances moving very slowly. Both New York and Minneapolis mention retarded sales of newer clothing fashions, while St. Louis and Boston indicate that the shoe industry is facing declining sales. Several Districts report that consumers are switching to lower quality merchandise in response to rising prices. The lower sales in some lines were apparently offset by a continued uptrend in sales of food and a few other products, such as steel, domestic oil, and automobiles.

Most Reserve Banks report that although labor markets are relatively weak, unions have won major wage increases. Unemployment appears to be rising slowly. Most reductions in labor usage are taking place through normal attrition, unpaid vacations, and shorter workweeks. Some of the unemployment,

however, has resulted from plant closings and layoffs. In Richmond, skilled labor is reported in short supply. Unemployment of skilled workers is reported by both Boston and Chicago.

Rising prices, expectations of higher prices, and wage costs continue to plague most business respondents despite the weaker labor market. There is virtually total agreement that prices are rising and will continue to do so as labor unions continue to secure higher wages. This factor was mentioned by more than half the Reserve Banks. Cleveland specifically indicated the high construction wage settlements, which point to further increases in home prices. Price "shading" is reported by some Reserve Banks, but such practices are apparently of only limited extent. Nevertheless, cautious optimism is expressed by some that the fight against inflation is making progress, and one bank reports prospective weakness in livestock product prices in the coming months.

Reports of the Reserve Banks are varied concerning credit demands. There is increasing caution on the part of lenders with respect to both large and small borrowers. Over half the reports mention the rising concern by commercial banks for borrower liquidity. Philadelphia reports a more comfortable feeling by businessmen with respect to liquidity while San Francisco reports neither improvement nor worsening of liquidity conditions.

Although most firms are carrying out announced expansion programs, there has been a decline in new announcements. Nearly every District indicates that capital spending is expected to decline in the coming year.

Caught between wage and salary hikes and a more-or-less constant level of demand, there is increasing pessimism regarding recovery of business profits.

FIRST DISTRICT -- BOSTON

Cautious optimism over the prospects for a sustained economic recovery is now more apparent among our respondents than at the time of the last Red Book report. Nothing in the way of substantive new information was detected, however.

For the most part, District I commercial bankers continue to report a good, and improving deposit picture. While conditions in the banking sector remain very tight, things are much improved from earlier in the year, and respondents report satisfaction with the orderly pace of developments over recent months.

The level of manufacturing activity in the region shows no signs of significant change in either direction, with luxury consumer items and housing-related products continuing to show the greatest weakness. Manufacturers uniformly report an improved availability of parts and other inputs, as well as shrinking backlogs of orders. Several of our directors report a somewhat improved outlook for corporate profits in the second half of the year in the sense that the sharp declines of the first half are not likely to be repeated.

The severe localized unemployment associated with the shoe, textile, and tool industries continues to worsen, and businesses of all types seem to be experiencing a marked increase in the rate of job applications by skilled employees. With the exception of automobiles -- which are picking up noticeably retail sales remain generally sluggish.

Professor Eckstein remains optimistic. Second quarter GNP revisions have now been run through the DRI model, and cause no significant change in the forecasts for coming quarters. $980 billion is now suggested as the likely nominal GNP for the year. Eckstein sees the housing comeback as developing more quickly than anticipated, and expects third quarter starts to run a seasonally adjusted annual rate of 1.45 million units. Unemployment is expected to rise slowly to a maximum of 5.4 per cent in mid-1971. Eckstein asked to be recorded as very dubious that the basic cost-push element in the economy has been slowed. He sees no proof of any abatement, and attributes the Spring respite in wholesale prices to sensitive materials and foods, not to basic industrial inputs.

Professor Henry Wallich is similarly satisfied with the current economic position, although perhaps for different reasons. He sees the current trend of interest rates and monetary aggregates as acceptable, and would recommend no alteration of current monetary policy. On the real side, he expects only a modest decline in business fixed investment next year, and assesses the prospects for a housing recovery as good. He expressed the hope that the economy will continue to simmer at about current levels for the next 2 or 3 quarters rather than pick up momentum, stating that inflationary pressures will otherwise soon be out of hand again. He also offered the neutral observation that time is running out for the Administration, from the point of view of political timing. If the economy were to fully recover by late 1971, it is unlikely that unemployment will have dropped to normal levels by the Fall 1972 elections, given the lag in that series. He does not suggest current policy be altered on these grounds, however.

SECOND DISTRICT -- NEW YORK

Sentiment was mixed among Federal Reserve Bank Directors regarding the business outlook and inflationary pressures. Consumer spending was assessed by leading retail merchants as showing few signs of real strength.

The chairman of a large manufacturing corporation believes that anxiety among businessmen has moderated somewhat, and does not think plant and equipment spending will be depressed for very long. A banker from upstate New York reported that people in his locality seem more optimistic about the business outlook than two or three months ago. He noted they are not hesitating to request bank credit, and remarked that a number of national business firms operating in his area are making strong efforts to hold their workers through such techniques as spacing vacations.

The upstate banker thinks "the worst is over" so far as a liquidity crisis is concerned. However, the head of a big merchandising enterprise reported that there is considerable concern in the Rochester area about liquidity problems, and that more business failures are expected in the coming months. He noted that many jobbers, in many fields, have informed foreign manufacturers they are unable to pay for goods ordered earlier for future delivery. The financial situation of retailers is also a source of worry to domestic suppliers.

Retailers belittled the significance of the substantial July increases reported in the press for some retail chains. They commented that most of the reported strength reflected consumer response to very intensive "off-price" promotions, and that much of the big jump in year-to-year figures resulted from the opening of many new stores. Lower-priced stores, catalogue business, and bargain basements are continuing to do comparatively well. An example was cited of a new store that opened around the end of July with a basement division occupying 15 per cent of the area; this would normally have been expected to account for 10-15 per cent of total sales but actually was accounting for 35 per cent. Style goods are "deader than a church mouse," with drastic fashion changes considered a factor in the sorry situation. Sales of television sets and large appliances are also very slow. One nationwide retailer reported that the only geographic areas where business is not poor are New England and "stable agricultural areas" such as Idaho and South Dakota.

The representative of a retail organization that had released July figures showing a very large year-to-year increase commented that his organization regarded consumer confidence as being at an all-time low and was expecting this confidence to drop lower yet. He and other retailers mentioned lay-offs as well as depressing noneconomic news as factors influencing consumer confidence and producing the mental attitude that is leading to a higher savings rate. Although the retailers have seen no beneficial effects on sales from the ending of the tax surcharge and the increase in Social Security payments, two of them made special mention of what they regard as a slight improvement in the collection situation.

As for expectations concerning inflation, one Federal Reserve Bank Director questioned how inflationary pressures could be slowed if wages are rising at their "current rates." Another Director suggested there has been some improvement in the war against inflation "if you close your eyes to some of these recent wage settlements." A third, from upstate New York, noted that despite the very low unemployment rate in his area, two major labor contracts had been settled recently without strikes and with "reasonable" wage increases, and declared he had detected a definite trend "among the public" toward more optimism regarding the battle against inflation.

THIRD DISTRICT -- PHILADELPHIA

Intelligence for this report was obtained from our Board of Directors, from city bankers, and from a preliminary tabulation of returns from a poll of large manufacturers in the Third District. The major findings are: (1) capital expenditures are likely to be sluggish into 1971; (2) some pick-up in business activity is expected towards year end; (3) concern for liquidity positions of firms is still widespread.

Although the outlook for capital expenditures is mixed, the majority of respondents to our August survey of large manufacturers in the District expect no change or a decline in capital expenditures six months out. One large firm in the chemical industry plans to hold 1971 capital expenditures to this year's level. The paper industry continues to be plagued by excess capacity. Allowing for price increases, real capital investment plans for 1971 are even more modest than these projections would suggest.

No one with whom we talked is very optimistic about the level of business activity in the months immediately ahead. One Director reports a slowdown in commercial orders for electric storage batteries. He reports that new orders are running 10 per cent below a year ago. Another Director reports that firms in the paper industry are being caught in a tightening cost-price squeeze. The chemical industry generally is in the doldrums. Nonetheless, a majority of large manufacturers in the District are expecting some increase in new orders, in prices paid and received, and in the general level of business with respect to capital outlays in 1971. Lack of enthusiasm, however, with respect to capital outlays in 1971 suggests that expectations of any upturn in business activity are on the modest side.

As we reported last time, the feeling is widespread that the economy is in a more comfortable position insofar as liquidity is concerned. Nevertheless, quality of the borrower's credit has assumed more important dimensions in the past several months. A number of people with whom we talked thought it is premature for the Federal Reserve to begin to unwind from the position it adopted and announced after the Penn Central insolvency. Several of the bankers with whom we talked believe that many commercial banks are overdue in reassessing their own liquidity positions.

Two of our Directors who recently returned from Europe report that businesses there are experiencing troubles similar to our own. In England, for example, there is a widespread fear that many businesses may be pricing themselves out of the market.

FOURTH DISTRICT -- CLEVELAND

The limited data available for July suggest that economic activity in the District remained at about the improved June level. Steel production for the third quarter, largely reflecting demand from auto companies, is expected to be slightly above the second quarter after allowance for the normal summer slowdown. Several local labor-management disputes in the Cleveland area have been settled at high cost. District bankers report they expect loan demand to remain strong and money market conditions to stay comfortable in the immediate future. Several of our Branch Directors expect the economy to remain sluggish in the foreseeable future.

Economic activity in the District improved significantly in June after the termination of major strikes, and preliminary and limited data suggest that activity remained at about the same level in July. The District's insured unemployment rate was essentially unchanged in July, and steel production rose moderately. Economists in the steel industry report that auto companies have placed orders at normal levels for steel deliveries for July, August, and September, despite auto strike possibilities. Auto firms regularly place a normal level of steel orders before contract negotiations, and this year will ask steel firms to take finished steel into inventories if a strike materializes in mid-September. Furthermore, if a strike occurs, production should not decline as much as shipments because inventory building will probably occur at the mills late in the year. Trade sources report that auto companies are unable to get commitments for Japanese steel to be delivered next year. Apparently, Japan will not accept steel orders above the voluntary quotas, and will not divert steel to automotive companies from regular customers. Steel industry economists in our area report export demand is declining rapidly.

Striking sheetmetal workers and plumbers in Cleveland settled their disputes at the end of July and in early August. Only one major union -- pipefitters -- remains on strike, but this is enough to keep construction at a reduced level in the Cleveland area. The principal unresolved issue is the hiring of minority workers. A $3 per hour increase over three years (raising journeyman rates by 1972 to $9.41 for painters, $10.20 for iron workers, and $10.81 for sheetmetal workers, for example) appears to be the pattern of settlement accepted by all of the other construction crafts in the area. The increases will further widen the local-national differential in average hourly earnings for journeymen and helpers in all construction trades (last year, $5.99 in Cleveland and $4.78 in the nation).

Economists and senior investment officers at several of the largest banks in the District were recently surveyed informally regarding their current views and expectations about the economy, the banking situation, and money market conditions. Almost all of the respondents indicated they expect the economy to remain sluggish during the second half of 1970, although most of the economists look for a modest increase in real activity. All of the major banks in the District are experiencing strong loan demand and demand is expected to remain brisk over the foreseeable future. Respondents felt that the present comfortable tone of the money market would continue and that funds would be readily available to banks at interest rates equal to or slightly below current levels. One investment officer from a large bank reported that they had just reduced the rate on 60-89 day money to 7 3/4 per cent and would now pay a uniform rate across the board in the 30-89 day maturity range. The same bank anticipates another reduction in the CD rate in the near future. All of the banks are much more concerned about the credit worthiness of borrowers than formerly, and expressed the view that this concern would persist.

Several of our Cincinnati Branch Directors, at a meeting of the Board last Monday, commented about the continued sluggishness of the economy. One Director, representing a major electrical equipment firm that produces jet engines, consumer durables, and a broad range of electrical products, mentioned that the firm's internal forecast projects continued sluggishness and limited real growth during the remainder of 1970 and for most of 1971. The firm also expects profits to remain under considerable pressure. Another Director, who is associated with a large machine tool firm, reported that machine tool order backlogs are down substantially, and will probably remain at reduced levels for some time.

FIFTH DISTRICT -- RICHMOND

Surveys of businessmen and bankers in the Fifth District indicate general agreement on the following points: (1) continued weakness in manufacturers' shipments, but some improvement in new orders; (2) improved retail sales and considerable improvement in automobile sales; (3) continued weakness in employment and shortened work weeks, as well as further increases in unemployment; (4) further upward pressure on prices and wages, especially coal prices; (5) some improvement in construction activity; (6) weaker demand for bank loans; (7) increased evidence of cutbacks in planned capital spending; and (8) difficulty in reducing excessive levels of business inventories.

While District manufacturers report their shipments to have slipped further, some improvement in volume of new orders and backlogs of orders is reported. A mixture of reports is common, however, within most manufacturing industries important to this District, and the slight improvement is due to fewer reports of further declines rather than to any significant resurgence of orders.

Recent improvement in retail sales, especially in automobiles, is reported. Reports from West Virginia, however, indicate that business has been seriously affected by the current coal miners' strike. Manufacturers' inventories, while apparently being reduced somewhat, are still reported to be higher than desired.

The District employment situation apparently remains weak. While some further employment declines are reported in textiles, chemicals, metals, and electrical equipment, the declines do not appear as widespread as they were two or three months ago. The length of the work week, however, is reportedly still decreasing in manufacturing industries.

Reports of increasing unemployment are common throughout the Fifth District, and available labor supplies are generally regarded as adequate. Respondents in manufacturing as well as trade and services report skilled labor to be in relatively short supply, but they feel that there are adequate numbers of unskilled workers available.

Reports indicate that, on balance, prices continue to rise in the District. Coal, fabricated metal items, and electrical machinery are among the District's manufacturing industries in which prices are reported increasing. Large increases in coal prices are of considerable concern in the region because of implications they have for electric utility rates as well as other services. Few instances of actual declines in list prices are reported, although respondents continue to report evidence of price shading. Continued upward pressure on wages is reported in nonferrous metals and furniture manufacturing.

Residential construction, which has been severely depressed in the District, is reported somewhat improved in recent weeks. Though still on the down side, some improvement is reported in residential building activity in certain areas of North Carolina, Virginia, and West Virginia, and in the Baltimore area. Nonresidential building, which has fared better in recent months, apparently is continuing to improve throughout the District generally.

Loan demand of all types at banks in the District apparently has failed to keep pace with last month's reported rise. Demand for business loans is reported essentially unchanged, and consumer loan demand has increased only slightly. Increases in mortgage loan demand were reported to be significant in May and June, but began to taper last month, and were only marginal in the most recent four-week period.

The number of respondents reporting that they expect further decline in general economic activity diminished substantially in the most recent survey. Evidence of optimism, however, remains spotty, and apparently no general expectation of an immediate recovery exists yet in the Fifth District.

Respondents in the District have been far from unanimous in their evaluations of their capital spending plans. While some respondents have indicated reductions, planned capital spending apparently has not been substantially reduced in recent months. The latest survey, however, indicates somewhat more widespread reductions than before, especially in textiles, chemicals, and furniture manufacturing.

Inventories in manufacturing and in trade and services remain on the high side. This is reported in such manufacturing industries as textiles, chemicals, furniture, metals, electrical machinery, and building products. Efforts are being made to reduce inventories or to hold them at present levels.

SIXTH DISTRICT -- ATLANTA

This report is based on a special poll made of ex-Directors, a telephone survey of selected retailers, and reports of the Directors from the only Board meeting in August. The main findings emerging from the survey of ex-Directors were: (1) price shading was not widely practiced; (2) there was significant business retrenchment, and only isolated instances of improved production following reduced operations; (3) cancellations of capital spending plans were few and announcements of new ones moderate; and (4) there was a lack of consensus on business prospects, and reportedly few increases in loan repayment schedules at banks. Directors serving on the Birmingham Branch Board confirmed many of the same findings for their own area. Most of the retailers that were specially polled expected no upsurge in consumer buying.

Conforming to the conclusion drawn from last month's reports of present Directors, only a few of the ex-Directors knew of instances of price shading from official indices. One who did notice this practice mentioned discounts in certain plastics. Another reported price discounts for capital equipment items used in textiles. A large apparel manufacturer mentioned price reductions on heavy inventory stocks. All ex-Directors, however, reported recent and significant price increases by suppliers.

Almost virtually universal mention was made of business retrenchment, taking the form of production cutbacks and of tightening-up in employment practices and expense cutting. These practices extended to the rapid growth areas of Florida. In one Florida area, even the telephone company reportedly had joined other companies in retrenching. One ex-Director observed, however, that expense-cutting and employment reductions were limited to firms with significant profit declines.

In manufacturing, excess inventories reportedly have proved troublesome only in isolated instances. One large apparel manufacturer who had experienced inventory troubles reported that many retailers were afraid to stock the new fashions; therefore, manufacturers were slow to build inventories.

Only a few ex-Directors mentioned increases in the level of manufacturing operations after a period of reduced operations. One noted that his company was getting over its cutbacks and shortly would be in a position to increase production. Another mentioned that several large contractors who build manufacturing plants throughout the United States reportedly had an increase in backlogs.

Few could come up with specific instances of cuts, cancellations, or postponements in outlays on new plant and equipment, although several mentioned stretch-outs and delays or cancellations in commercial and large construction projects. A far greater number cited significant announcements of new or expanded plans for capital investment but, generally speaking, these were only on a moderate scale.

Attitudes toward economic prospects varied widely, with about an equal division between those expecting an upturn in the near future and those seeing recovery delayed until the winter and next spring.

Several bank Directors answered affirmatively to whether requests were being made of them to alter loan payment schedules because of a cash squeeze. However, the number of such requests cited was small.

The number of increases in loan demands coming from borrowers to carry inventories and accounts receivable or to replace former financing from nonbank sources was also small.

Directors now serving on one of our branch Boards confirmed the ex-Directors' reports of production cutbacks and layoffs and the go-ahead on previous plans for new plants. In the soil pipe market, there are indications that closings will continue. Similarly, another company is reducing its operations because of an order cancellation by Penn Central. On the other hand, an influx of orders in cast iron pipe has surprised most manufacturers. While mention was made of various new plant announcements, one Director observed that "there was more caution evident in project planning than was prevalent in 1969."

A special contact made of retailers indicated that while they expect increases in consumer buying, no upsurge is likely. Generally speaking, they expected sales over the next four months to range from no gain from a year ago to 3 per cent.

SEVENTH DISTRICT -- CHICAGO

Confidence in the overall stability of the financial markets appears to have strengthened in the past few weeks, despite some problem areas indicated below. Convincing evidence of a significant uptrend in total output and employment is still lacking, however.

Last week's 7.5 per cent Treasury Note offering which attracted thousands of small investors to the Chicago Reserve Bank aroused widespread concern among banks and savings associations that feared large losses of savings deposits. Interest in the issue was sparked by an article originating in a Chicago newspaper that also appeared in papers in New York and Houston. At present, large Chicago banks indicate that the first reports of the impact on their savings departments were exaggerated. Savings associations, on the other hand, apparently have raised their estimates of the volume of withdrawals used to buy the notes and expect August to be a red month in contrast to normal experience.

Some smaller banks complain that their deposits and earnings have been adversely affected by the lifting of Q ceilings on large CDs in the 30-89 day maturities. Some large banks find the supply of funds available for investment in certificates ample, but are reluctant to pay the prevailing 8 per cent rate.

Overall loan demand apparently has eased somewhat since midyear. There are reports of banks de-emphasizing consumer loans, with greater apprehension as to the quality of this paper.

There are widespread complaints over the slowness of payments on receivables by business creditors, but it is generally recognized that, in most cases, the situation reflects the high cost of funds and restricted liquidity, rather than actual distress.

Price increases for durable goods continue to be about as numerous as in recent months, and there is no clear evidence of a diminution of the rate of rise of prices of finished goods. Rising costs and unsatisfactory volume are causing transportation firms to push regulatory authorities for appreciable increases in rates in hopes of improving earnings.

Job markets continue to soften as indicated by unemployment compensation claims, and reports of restricted hiring practices. Increasingly, skilled workers such as machinists, teachers, and other professional types are listed among those seeking work. Lists of unfilled job openings are the smallest since the early Sixties.

Despite the improved labor supply picture, wage and pension demands continue large and are backed by militant worker organizations in state and local governments as well as in factories, utilities, and transportation companies. Local strikes are frequent and prolonged. The likelihood of a major strike this Fall, not only in the auto industry, but also in the farm and construction machinery industries, is taken virtually for granted.

Demand for construction equipment and for various types of industrial equipment remains disappointing. In the case of consumer durables, demand for furniture and TV sets remains depressed, while demand for most household appliances has improved in recent months, and is surprisingly strong in view of the continued low level of housing starts.

On the bright side, some of our Directors associated with food merchandising, recreational vehicles, home maintenance products, and laundry equipment report that sales have been excellent and above budgeted levels. Farm equipment purchases increased from a year ago in June, the first rise recorded in 1970. Some centers producing auto parts are experiencing a revival of activity as 1971 models go into production.

Complaints of increased foreign competition are more prevalent both for producer and consumer goods. A shoe factory that started operations in an Illinois town in 1968 has ceased operations, blaming import competition. Resort business in vacation-oriented areas is said to be poor. A number of older manufacturing plants in the District have been closed recently because of Government pressures to renovate facilities to reduce pollution. The outlays required to comply were deemed excessive.

EIGHTH DISTRICT -- ST. LOUIS

Expectations of an early upturn in business activity in the Eighth Federal Reserve District have dampened in recent weeks. An increasing amount of skepticism with regard to business recovery forecasts for later this year stands in sharp contrast with an earlier more optimistic attitude. More comments of "belt-tightening" are noted as an increasing number of firms plan a reduction in their work force, mostly through attrition, although a few are laying off some employees. The financial agencies report some easing in credit demands relative to supply, but no major declines have been noted in rates charged to borrowers.

A few months ago most of the officials interviewed were looking "across the valley" to the time when a resumption of the uptrend of recent years was anticipated. Since there is little indication that the uptrend will soon be resumed, businessmen appear to have become resigned to a substantially slower rate of expansion. One major exception to the downtrend is commercial banking, where deposits and earnings are reported up, with promising future prospects.

Sales at all levels have been disappointing in recent weeks. Department store sales have been well below expectations since late July. A number of manufacturers, including shoe and box companies, likewise report a low sales level compared to other recent years. Of those interviewed, only the beer company officials reported sales conforming to trend patterns.

Great concern for inflationary tendencies continues. Especially worrisome in the face of a business slowdown and declining profits are the rising wage costs. With the decline of expectations of an early upturn and no relief in sight from the current profit squeeze, business has now begun a number of belt-tightening operations. Retail stores report a closer scrutiny of inventories than heretofore. Most firms are either holding constant or are gradually reducing their work forces. The reduction is primarily by attrition, although a few firms reported some layoffs in recent weeks. The major manufacturing industries still indicate no reduction in long-run expansion plans; however, some postponement in security sales for financing expansion plans has been noted.

The real estate financing agencies report that funds for financing home building and purchases are somewhat more plentiful. They add, however, that this is not the result of larger inflows of savings, but instead reflects the slowdown in demand for such credit. Builders report little demand for large homes.

Although the prospects for business expansion and new plant construction have declined in St. Louis and other large Eighth District centers, expansion continues at a healthy pace in the outlying areas, especially in the southern portion of the District where earnings of smaller companies continue at satisfactory levels.

The outlook for agriculture is mixed. Cattle feeders in the Eighth District are making little or no profit. Hogs have been profitable during the past year, but the prospects for the rest of this year and early next year are less promising. Although broilers are unprofitable at the moment, the situation can change rather rapidly for broiler producers. Egg and milk producers are doing quite well. Crops are very late and much land was not planted, but with a late frost a high level of crop production is still possible.

Prices of meat and other livestock products are likely to average somewhat lower in the year ahead than in the past twelve months, pointing to somewhat less upward pressure on food prices.

NINTH DISTRICT -- MINNEAPOLIS

Ninth District business economists feel that the national economy is turning around and that a pickup in consumer spending will lead to improved business conditions during the latter part of 1970. A vigorous recovery, however, is not anticipated, and the rate of inflation is not expected to slow appreciably. Although they do not foresee large increases, reports from bank directors and officers reveal that District retailers expect their sales to improve during the second half of the year. Manufacturing sales, on the other hand, are expected to continue sluggish. Corporate profits in the District have suffered and Ninth District firms are cutting costs in order to restore earnings. Recent large wage concessions to construction workers and Teamsters are impeding efforts to cut labor costs. Several cases of unwanted inventory accumulation were reported in the District.

The consensus of opinion among local business economists is that the economy is turning around and business conditions will improve during the latter half of 1970. They do not, however, expect a vigorous recovery, and one economist described the current slowdown and expected recovery as being "saucer" shaped. He said that the current slowdown has not been as rapid or deep as in earlier post-World War II downturns and that the recovery will not be as sharp as in previous upturns. The rate of inflation is not expected to slow appreciably and interest rates are not expected to fall significantly before the end of the year. They also look for businessmen to continue to revise downward their capital spending plans this year. A major Minneapolis scientific instrument and ordnance manufacturer, for example, reduced its original increase in capital spending plans by 20 per cent. These economists do not think that total Government spending will change noticeably. Consequently, they see the stimulus for recovery coming from consumer spending. A business economist representing a national retailer felt that consumer confidence would be recovered during the last half of the year. He also stated that consumers financially are in better shape than in previous downturns and it will be easier for them to resume spending.

In spite of their relatively optimistic outlook, they felt that the economy was not out of the woods yet. One economist, for example, stated that another "Penn Central" could have a disastrous effect on business activity.

Reports from bank directors and officers confirm local business economists' expectations that retail sales will improve during the second half of the year. They do not look for an unusually large increase in retail sales, but they do expect it to be better than during the first half. Women's apparel and automobile sales are big unknowns. Reports disclose that a major Minneapolis retailer is having trouble selling midi-length styles. A report from one director indicates that consumers are buying cars now to avoid the price increases on 1971 models this Fall. District manufacturers responding to our latest industrial expectations survey feel that the rate of advance in District manufacturing sales will continue sluggish during the remainder of 1970.

In responding to a question on corporate profits, bank directors and officers indicated that profits in the Ninth District suffered or at best held steady during the second quarter, although there were notable exceptions. In response to this situation numerous examples of cost cutting were cited. An economist for a large national manufacturer stated that attitudes have changed in his company on what constitutes a necessary cost. One large brewery in the Twin Cities cut its current advertising budget by $800,000. District employers have curtailed their utilization of labor through layoffs and overtime reductions, and a large Minneapolis computer manufacturer instructed each employee to take ten days of unpaid vacation before the end of the year. Cost cutting is also manifesting itself in reductions in capital spending and inventory cutbacks.

Although reports indicate District businessmen are trying to cut inventories, several cases of unwanted inventory accumulation were reported. One large Twin City manufacturer's inventory increased because of overly optimistic sales projections. Reports reveal that the large retailers and a national mail order house have accumulated inventories because of the trucking strike. They are receiving this summer's seasonal merchandise late and are being forced to cut its price to avoid carrying it over.

One factor, however, that will impede cost cutting efforts by District businessmen is the recent large wage concessions granted to the construction workers and Teamsters. As a result of these settlements, bank directors indicate that unions in their areas are becoming very aggressive in their wage demands, making the settlement of some current negotiations difficult. One director reports that construction companies are cutting overtime because of the large wage settlements.

TENTH DISTRICT -- KANSAS CITY

The effects of the national economic recession continue to be felt in the Tenth District. Weakness appears to be fairly widespread, both geographically and by type of business, and there is a general air of uneasiness and apprehension. Although activity remains fairly strong in much of the Rocky Mountain, Nebraska, and Oklahoma areas, unemployment, strikes, rapid increases in personal bankruptcies, and a slowing down in payment of accounts were referred to frequently by Board members, bankers, and other businessmen. In addition, the existence of hot weather and a number of exceptionally dry areas in this agriculturally oriented region give rise to locally gloomy moods and pockets of especially slow business activity.

Most commercial banks reported some success in efforts to improve their liquidity position during the past month. Country banks generally enjoyed increasing deposits because of an excellent wheat harvest and a large influx of Government payments. City banks have had a slower growth rate during this period, with all of the increase being in time deposits. Demand deposits have declined, with decreasing individual, corporate, and U. S. Government demand accounts in city banks more than offsetting a slight increase in interbank accounts.

Loan demand continues to remain strong in city banks, but is generally nominal in country banks where deposits have increased rather sharply. City banks report many requests from corporate borrowers to back their commercial paper 100 per cent with lines of credit. These city banks believe the commercial paper market has stabilized and these lines will not be called upon if additional catastrophes can be avoided.

Several large banks in the Kansas and Western Missouri region reported increasing collection difficulties and a marked increase in voluntary individual bankruptcies. The voluntary bankruptcies were most frequent among credit card users. In these cases individuals tend to maximize their borrowings from all sources, including credit cards, and then file for bankruptcy. This region includes Kansas City, which continues to be plagued with a prolonged construction strike, now in its fifth month. The slowdown in the aerospace and air transport industries also has had the severest impact on the Kansas-Missouri region.

Commercial and industrial construction activity appears to be slowing in the District, thus supporting the notion of reduced business fixed investment spending. Several large firms have reported cutting proposed capital investment plans substantially during the past few months to make sure that they would live within their cash flow. Although firms may not be able to do all the capital spending they would like, there continues to be a need to replace and update equipment in order to improve productivity - and such spending received first priority. While business construction is off, homebuilding appears to be showing some evidence of recovery.

The petroleum industry is confronted with a unique problem. Until recently, imported crude could be delivered on the east coast at substantially lower prices than could domestic crude. This price differential discouraged domestic exploration for oil. With the recent difficulties in the mid-east, tanker rates have increased by as much as 300 per cent, and imported crude now sells at about 75 cents per barrel above domestic crude on the east coast. Thus, domestic crude prices are under pressure, and at least one oil company has announced price increases in the Tenth District.

Business is slow for District farm implement dealers. Inventories are relatively large, and cases of price cutting are not uncommon. Collections on credit sales are reported to be noticeably slower than last year.

The interrelatedness of Tenth District economic activity with both national and international business conditions is illustrated by the experience of a Kansas City manufacturer of bottling and automatic vending equipment. This firm's total business is about unchanged from a year ago, with increasing international business about offsetting a definite decline in domestic sales. The decline in domestic sales is attributed to reduced overtime and lower employment in factories with vending machines, as vending machine operators drop routes and defer the purchase of new equipment. There is some concern within the firm that their growing international business will be hurt by retaliations against U. S. restrictions on imports.

The aircraft industry is having trouble from production down through the transport phases. Unemployment in Wichita, where the aerospace industry is important, is reported in excess of 10 per cent. Tulsa also reports difficulties in the industry. The air transport industry, which is important in several District centers, reports continued problems in revenue and unemployment. Although pleasure travel appears to be holding up reasonably well, business travel has been off sharply. Most airlines have found it difficult to operate much above year-earlier levels and, with the introduction of the 747's which were contracted for on the basis of an average 10-15 per cent increase in passenger traffic, it has been difficult to meet costs. Preliminary data indicate that passenger traffic in July improved. But substantial improvement over an extended period of time will be necessary to solve current air transport problems.

ELEVENTH DISTRICT -- DALLAS

The responses of corporate executives of 15 of the larger firms in the Eleventh District to questionnaires in late July and early August provided the basis for much of this report. They indicated that business sales are slightly ahead of a year ago, and inventories of most firms are "about right." Some excess capacity is reported. Capital spending apparently peaked in 1969 and is currently declining. Capital spending is expected to increase somewhat in 1971 but to remain below the current-dollar level of 1969. Employment cutbacks are reported by more than half of the responding firms, but wages and salaries are up considerably. Hurricane Celia hit the West Gulf Coast of Texas and caused damage estimated in excess of $500 million.

Most of the corporate executives reported that sales were a little higher so far in 1970 than in the same period a year ago. One electronic firm indicated that sales this year had lagged behind the level of a year ago, and another noted some softness in their recent orders. One firm in the computer industry reported that sales so far this year were up from a year ago but weakness is expected in the months ahead. One firm particularly noted an increase in price consciousness among their customers.

Although sales have not been particularly strong, most of the firms indicate that they are about in line with expectations. This would suggest that the business slowdown was correctly anticipated by most. Because the correct sales trend was anticipated by most firms, current inventory levels are considered "about right" by the majority. Three firms did indicate that their inventories were somewhat too high at the present time.

More than half of the firms represented in our sample project capital spending for the year 1970 to be less than in 1969. The dollar value of capital spending by these firms will likely be down about 14 per cent in 1970 from the 1969 level. Much of the weakness in capital spending apparently stems from a trimming back of earlier plans. Half of the respondents indicated that the dollar value of their capital appropriations for the second half of 1970 was less than earlier preliminary plans. Not a single firm reported that capital appropriations for the second half of this year would be larger than their preliminary plans. These declining capital spending plans are consistent with the report of "a little" excess capacity at four firms while one reported much excess capacity. There were no reports of capacity shortage. Some of the decline in capital spending from the high 1969 level is accounted for by electronic and computer firms that have been affected by the trimming of the defense budget, as well as by the overall business slowdown. Another major factor in the capital spending decline is the tapering off of construction by a large national gas pipeline company. The lack of new gas supplies has reduced their need to expand the transmission system. The only real strength in 1970 capital spending comes from one electric utility and some oil drilling and refining firms.

Capital spending for 1971 for this group of firms is now planned to be up slightly from the expected 1970 level but still about 7 per cent below the realized 1969 level in current dollars. Two-thirds of the firms actually expect capital outlays to be less in 1971 than in 1970. A substantial increase in capital spending is projected by a large oil company.

Every firm responding to this questionnaire reports that employee wages and salaries are up this year. The most common increase was 6 to 7 per cent while the range was from 3.5 to 8 per cent. More than half of the firms have cut back their employment level this year with the cutbacks ranging from as low as 1 per cent to as high as 25 per cent. One firm indicated that all of its work force reduction had been achieved by gradual attrition rather than outright layoffs. Employment cutbacks were most noticeable among the electronic and computer firms.

Hurricane Celia struck the western Gulf Coast region of Texas on Monday, August 3. Damage estimates range from $500 million to $1 billion. Banking services were halted for two days and then reopened on a limited basis. About 3 per cent of the U. S. oil refining capacity is located in the area struck by the hurricane. None of this capacity can operate until electric power is restored. Some of the plants suffered wind and fire damage that may take considerable time to fully repair. More than 250 small businesses in the Corpus Christi area were destroyed by the storm. Federal and state disaster aid is being made available to the affected area.

TWELFTH DISTRICT -- SAN FRANCISCO

Twelfth District businessmen are talking increasingly in terms of "running a tight ship" and "putting their house in order." With the Penn Central example in mind, corporate directors are much more careful than heretofore in reviewing the financial operations of the firms with which they are affiliated. In the words of one corporate director, "I have recently participated in discussions which were more searching, more extended, and more concerned than any before in my memory." Western firms generally are tightening their credit controls, holding down inventories, and making every effort to economize.

Retail sales remain spotty, especially in those areas which have been affected by aerospace and construction cutbacks. Consumers are neglecting higher-priced merchandise in favor of cheaper lines -- or in favor of saving. In Southern California, for example, appliance sales continue weak (especially TV and stereo) and auto sales are very slow (except imports and cheaper used cars).

Pacific Northwest, Southern California and Arizona aerospace firms report continuing layoffs, and Oregon mobile home manufacturers report increased credit problems and sharp cutbacks in order backlogs. Food manufacturers report a narrowing of profit margins in almost every line, since the need to meet competitors' prices makes it difficult for them to offset current wage increases. Lumber firms report a slight strengthening of lumber prices but not plywood prices. Petroleum firms say that the industry's logistics, here as elsewhere, have been distorted by the disruption of Middle East oil supplies.

Agricultural conditions were generally reported favorable, but with local spottiness. Commodities whose prices were indicated as strong (or good compared with last year) include potatoes, apples, wheat, and cattle, and harvests (or harvest prospects) are bright. On the other hand, the outlook is pessimistic for processing vegetables, strawberries, and some grains.

Most bankers are encountering a mixed picture in loans and deposits. Some banks in Southern California and Arizona report heavy loan requests for interim financing on industrial properties. A Pacific Northwest bank recently increased its credit lines to several large transportation and manufacturing firms, but refused requests from several finance firms for increased credit accomodation. No bank reported an unwelcome degree of loan decline.

For the economy as a whole, liquidity conditions generally remain tight -- neither improving nor worsening to any significant degree -- although District bankers report a number of problem cases. Several "go-go" land development firms in Southern California have encountered serious liquidity problems, which forced them to sell off subsidiaries to raise funds to meet their credit requirements. Liquidity problems have also been severe for some auto dealers, residential builders, and lumber brokers in the Northwest, as well as for small airlines and heavy equipment suppliers in Alaska which had expanded operations in anticipation of a quick start on the now-delayed Alaskan pipeline. Some firms in Southern California and elsewhere are "riding their suppliers," taking 60 days to pay accounts that were formerly on a 30-day basis.

In summary, Twelfth District businessmen report a continuation of the sluggish business conditions and difficult liquidity conditions of the recent past. Recent developments have led business firms to adopt a cautious attitude towards buying inventories or hiring new workers, and have led consumers to postpone purchases of high-quality or big-ticket items. Few respondents anticipate a major shift in business conditions (in either direction) over the next several months.