CONFIDENTIAL (FR)

CURRENT ECONOMIC COMMENT BY DISTRICT

Prepared for the
Federal Open Market Committee
by the Staff

August 18, 1971

TABLE OF CONTENTS

SUMMARY*

According to the Reserve banks' reports, the economic recovery still appears to be proceeding quite slowly in most districts, with the industrial sector particularly sluggish. Strikes and strike-related effects have further dampened economic activity in some districts. The slow pace of the expansion has not yet generated renewed inventory accumulation. Retail sales are rising in some districts, but are slowing in others. The brightest spot continues to be residential construction. No improvement was noted in the employment situation. Prior to the President's imposition of the wage-price freeze, the bank reports indicated no slackening in the pace of inflation. In the financial sector, all the banks reported that business loan demand was slack and that flows into consumer savings accounts had slowed noticeably. Only three banks included reports on the reactions in their districts to the President's new economic policies. Initial reactions were highly favorable.

Durable goods manufacturing appears to be the most sluggish sector. The Boston, Richmond and Cleveland banks reported that new orders are weak in capital goods industries and backlogs are shrinking. The St. Louis bank noted that while orders are quite low for steel and durable goods manufacturers, nondurable goods producers are optimistic. A number of banks mentioned that suppliers to the construction industry were experiencing very good sales.

The construction sector is reported as booming in all districts except New York. Nonresidential building, as well as housing starts,

*Prepared at the Federal Reserve Bank of Boston.

was robust in a number of districts. The San Francisco bank reported that residential construction is providing the principal stimulus to the district's economy. Heavy construction activity was cited as a major reason for low unemployment in several areas within the Atlanta district.

Half the banks reported that retail sales were rising in their districts. The San Francisco bank, however, noted that retail sales were only holding steady and the Atlanta bank reported that sales have moderated recently. In the New York district, retail sales varied from trendless to slowing.

There does not appear to be any strengthening of inventory spending. The Richmond bank reported a substantial increase in the number of manufacturing firms decreasing inventories and that both trade and manufacturing inventories were still at higher than desired levels. Inventory cuts by industrial firms were also expected in the Cleveland district. Sluggish retail sales were cited by the San Francisco bank as restraining inventory investment. The St. Louis bank reported that steel producers expect steel inventories to be run down over the next six months, depressing their production levels. The Cleveland bank reported the beginning of coal stockpiling in anticipation of an October strike in the coal industry.

Strikes and strike-related effects were depressing economic activity in several districts. Coal mining areas in the Richmond district have been hurt by the rail strike and the slowdown in the steel industry. The copper strike is reported to have affected economic activity in Maryland, Utah and Arizona. The San Francisco bank noted that the rail strikes especially hurt shipments of agricultural products, while the dock strike is affecting a widening number of industrial and agricultural producers in the twelfth district.

No improvement in the employment situation was noted by any of the Reserve banks. The employment situation was described as unchanged by the Richmond, Dallas, and Chicago banks and as weak by the Minneapolis bank. The Chicago, Cleveland and New York banks reported high unemployment in steel producing areas, with layoffs continuing during early August.

Continued inflation at recent rates was mentioned by a number of banks. The Atlanta and Dallas banks reported that retail prices were expected to continue increasing at recent rates. A survey of purchasing managers by the Kansas City bank (made before the President's August 15 speech) found concern about the near-term prospects for any slowing in the rate of inflation. In the Minneapolis and Cleveland districts, concern was reported over the inflationary effects of the steel settlement and announced steel price increases. The Minneapolis bank reported that a number of price and cost increases have already been instituted as a result of the steel price hikes.

In the financial sector, the demand for business loans was generally reported as sluggish. The Richmond, San Francisco and Chicago banks, however, reported either good or improving demand for business loans in sections of their districts. Most banks also reported a considerable slowing in the growth of time and savings deposits. Fears of disintermediation were mentioned by the Kansas City, Chicago and Atlanta banks.

Only a few banks contacted their respondents after the President's speech. Philadelphia reported that directors, bankers and businessmen in the third district, while surprised at the magnitude of the policy changes, were overwhelmingly in favor of them. Businessmen noted problems in implementing the wage-price freeze, but their general mood was one of cooperation and optimism. Initial reaction in the Chicago district among bankers and businessmen was also generally favorable. Only one bank director in the Boston district was available for comment. He was very enthusiastic about the new policies, although he noted some problems in implementation for banks. As a result of the President's speech, the Boston bank's academic respondents were generally encouraged by the prospects for breaking inflationary expectations and achieving a more stable international monetary system.

FIRST DISTRICT - BOSTON

The economic recovery appears to be very weak in most business areas, but especially in the capital goods industries.

Most of our directors reported no change from the sluggish business outlook that they had reported last month. Industries like precision bearings, superalloys, and machine tools which are tied to investment spending are still very weak, backlogs are shrinking and new orders are either not higher or only slightly higher than a year ago. Similarly, military aerospace orders are declining as are backlogs. Orders for commercial aircraft engines are also being stretched out or in some cases cancelled. Products connected with the housing industry, like gas meters, are doing very well. The settlement of construction labor contracts has also opened up business for a supplier in the nonresidential building market.

Consumer sales continue to be the best business area. A conglomerate manufacturer of a large variety of consumer goods reports sales up 10 to 11 percent from last year. Products for the home sewing market are particularly strong. As a result of rising sales volume, inventories are being allowed to rise. Of all the directors spoken to, this was the only indication of an easier inventory policy. And even this director stated that in other lines of his business, inventories were being kept at low levels.

Despite the moderate rate of domestic auto sales, tire sales are doing very well as a result of a good pickup in demand for replacement tires and production of the 1972 models. This supplier to the auto industry was the only director to mention that business had been affected by the rail strikes in July. Lack of supplies caused his company to close 3 of its 6 plants for up to a week at the end of July.

Another pessimistic note for domestic auto sales: a Ford dealer in our district, who had the second largest sales of any Ford dealer in the nation, gave up his franchise in July because "he saw the handwriting on the wall" for domestic autos.

A bank director reported that while the bank is flush with deposits - a 20 percent gain over last year - the only demand for funds is for mortgages. Both business and consumer instalment lending is very sluggish.

Of our academic respondents, only Paul Samuelson and Eli Shapiro were available for interviews before the President's speech. According to Professor Samuelson, the most discouraging aspect of the present economic situation was the stubborness of, almost the re-ignition of, the cost-push, administered price inflation. Samuelson emphasized strongly that it was a seller's inflation, not associated with a too rapid growth of real output. Some kind of incomes policy was urgently needed. "Whatever it is, I'm for it." Eli Shapiro was opposed to the President's doing more than his recent increased willingness to jawbone by periodically showing his alarm. To do more, he argued, is administratively too difficult to be effective. On inflation, Shapiro viewed the evidence as extremely mixed.

Samuelson described the behavior of real output as "anemic." He expected its future path to run at or below the "fashionable forecasts." He found some encouragement in the 5.8 percent July unemployment figure, but was worried about the effect of the steel layoffs on the August rate. Shapiro attached little importance to the July figure. Anticipating a "good" fourth quarter, he expected unemployment to peak in the third quarter. By a good fourth quarter, he explained, he meant a real growth rate of at least 4 percent and perhaps as high as 5 percent.

Shapiro believed monetary growth rates of 10 to 11 percent ran a substantial risk of encouraging inflation. He advocated moving in the direction of a 6 percent rate of growth. Feeling no need for additional monetary or fiscal stimulus, Shapiro's basic policy position was to give the present policy course a little more time.

Although we tried to contact all our respondents again after the President's talk, only Samuelson, Shapiro and one bank director were available to comment on the President's new economic policies. The bank director felt the President's policies were "exciting and radical." He hoped that the meetings in September would turn into another Bretton Woods and that a new international monetary system would emerge which would 1) control Eurodollar movements and 2) not entail a return to gold. He foresaw some difficulty in administering rates for non-prime rate borrowers but concluded that the controls must be supported and made to work because this is the only policy we have left to fight inflation.

The response of monetary authorities to the Administration's new economic plans should be analogous to what it was during the Penn Central crisis, Professor Samuelson said. Their role must be to assure everybody that there will be no credit, and no quality of credit, crisis. For the immediate future, the next 90 days to six months, the aim of a 6 percent rate of growth in monetary aggregates may be appropriate, though the Fed should not be preoccupied with any fixed figure and should be prepared to go to 8 to 11 percent. Samuelson noted that the flexibility of exchange rates creates new freedom for interest rates and that the housing market may benefit in the future from the new freedom.

Shapiro emphasized the announcement effects of the recent Presidential actions: the wage-price freeze, "the firmest form of jawboning," would help to break inflationary expectations, inducing more consumption out of a given level of spendable income; the tax reductions and import tax will stimulate auto sales and business fixed investment, while discouraging imports; and the suspension of convertibility is "a measure of our earnestness" that this Administration is tired of debating the adjustment process and reform must occur in September. He anticipated that the dollar will open at a discount but will recover and that some form of wage-price regulations must persist through the summer of 1972. The new stimulus reconfirmed Shapiro's earlier view that the Federal Reserve can move toward a 6 percent growth rate in the money supply.

SECOND DISTRICT - NEW YORK

The pessimism regarding the economic outlook that had been expressed by the directors of the New York Bank and of the Buffalo Branch last month was still evident, and perhaps intensified, this month (before the Administration announced its new measures). In general, the assessment was for no significant change in consumer attitudes, while some directors believed there had been an actual scaling back of buying intentions; business inventory spending was not expected to strengthen in the near future; no noticeable improvement in labor market conditions was foreseen and most of the directors felt that a general economic upturn would gain momentum later than had been generally expected.

Concerning consumer spending, the Buffalo Branch directors viewed retail sales activity as relatively better than a year ago, but with no discernible trend either up or down. The New York Branch directors were somewhat more pessimistic. A director from Rochester had had recent discussions with a cross section of New York City department store executives, who reported a slowdown in consumer spending in recent weeks and were generally pessimistic regarding the immediate future. The chairman of the board of a nationwide manufacturing concern believed that consumers were exhibiting caution and more selectivity regarding both price and quality, and saw consumer reluctance showing up particularly in discretionary spending, such as that for travel. Other directors also thought there had been a scaling back in consumer buying plans.

One director, the president of an upstate New York bank, commented on construction activities. He referred to the recent experience, which he felt was fairly typical, of a general contractor in his area who builds schools, factories and other nonresidential structures. This contractor, after many years of good business, now had few orders, a development that the contractor attributed to high construction costs, particularly wages.

With respect to business inventory spending, several directors expressed the opinion that such outlays would continue to be sluggish, largely because of more stringent inventory controls as part of cost-reduction programs.

No noticeable change in the unemployment picture was expected by the Buffalo Branch directors. They believed that layoffs in the steel industry would offset employment increases in the auto industry and in seasonal construction.

All the Buffalo directors expressed concern about the expected further erosion of the steel industry's competitive position in both foreign and domestic markets as a result of the recent steel wage and price developments.

Regarding this country's foreign trade in general, the Rochester merchant who is on the New York board noted that sales of imported goods have been increasing steadily. Another director expressed the opinion that the continued deterioration in this country's exports was due chiefly to high prices resulting from high labor costs, while a third director found our recent adverse trade balance surprising, since European countries were also experiencing a high rate of inflation.

To assess recent developments and expectations for the next two months, in commercial bank savings and consumer-type time deposits and in loan demands, nine District Banks were contacted August 11-13, five in New York and four out of town. The majority of the banks reported that the strong increase in their deposits in the first five or six months of this year had been replaced by a "slow attrition," and most of them expected the attrition to continue or the rate of advance to flatten out. At a majority of the banks, demand for commercial and industrial loans had been "weak" or "lusterless" recently, and the banks expected only seasonal fluctuations over the coming months.

As regards the general business outlook, all the directors, both of the New York Bank and the Buffalo Branch, were relatively pessimistic concerning near-term developments, with some directors noting that they thought a strong upturn would take longer than they had previously anticipated. Several directors expressed (before President Nixon's August 15 address) a lack of confidence in the Administration's economic program.

THIRD DISTRICT--PHILADELPHIA

President Nixon's shift in economic policy has been well received by directors, bankers and businessmen in the Third District. Most however, expressed surprise at the comprehensiveness and magnitude of the policy changes. Some businessmen candidly admitted that the wage-price freeze will cause management problems they had not consciously thought much about previously; nonetheless, the general mood appears to be one of "cooperating" rather than "complaining."

The reaction to the President's speech has been overwhelmingly favorable in the Third District. Typical of some of the responses are: "Delighted to hear it," "Best thing we have had so far," and "Necessary." The general feeling is that the new policy actions will go a long way towards restoring confidence in the economy. One large retailer said he believes consumers would be spending more because of the psychological uplift. A banker reported that his board of directors gave the "go ahead" to a new building in light of the President's actions. Several manufacturers indicated that the size of the proposed investment tax credit would cause them to review their capital spending plans. Another banker predicted that interest rates would go down because inflationary expectations will likely subside.

Although many people we contacted felt the President "had to do something," few anticipated the extent and boldness of his actions. Most expected some additional stimulative measures from the fiscal side; but not including something like revocation of auto excise taxes. Likewise, some form of wage-price restraint seemed probable to them, but not an all-out freeze. Also, the few who had had time to think about the floating dollar and excise tax on imports were stunned.

Several executives, although previously advocating wage and price restraints, said they really had not thought much about the management headaches they would face in the event of a freeze. These problems, they said, are now coming into sharper focus. But, despite the confusion and headaches they believe lie ahead, the general mood is one of cooperation and optimism.

FOURTH DISTRICT - CLEVELAND

The general theme of the remarks of our directors at meetings of the Cincinnati Branch board on August 9 and of the Cleveland board held on August 12, was that there is strengthening in some areas of the economy, but that the pace of activity in the industrial sector generally remains sluggish. Concern was expressed about the persistent inflationary pressures and about the effect that recent wage settlements can be expected to have on prices. Several directors reported that, in contrast to their domestic experience, demand for their products in international markets has remained extremely strong.

The particular areas of strength cited by the directors were in housing-related glass products and auto-related products. Demand for tires has remained particularly strong for several months. One director noted some recent signs of strength in the firm's consumer-oriented products, and another director reported an increase in sales of glass-ware and plastic products at the retail level, reflecting the fact that retailers have completed their inventory reductions in recent months and are now buying from the company once again. Another director commented that coal sales, which have been depressed for several months, picked up recently as major coal users began some stockpiling in anticipation of a possible strike in that industry (the union contract terminates on September 30). The consensus of our directors was the demand for almost all kinds of capital goods has remained sluggish, reflecting the lackluster performance of the economy. Particular areas of weakness cited were machine tools, computers, and railway equipment.

The directors remain seriously concerned about inflation and inflationary expectations, and particularly about the effects that the settlement in the steel industry would have on prices, and about the built-in inflationary effect that the cost-of-living escalators will have in the future.

Results of our August 16 survey of District manufacturers corroborate the views of our industrial directors regarding the sluggish pace of manufacturing activity. On balance, firms are experiencing no improvement in new orders, and they are still working down their backlogs. Employment and hours are both being reduced. Inventory reduction is expected to be particularly heavy in August, as the largest percentage of firms since 1967 anticipate a cutback in stocks.

The steel industry, of course, is exerting a major dampening influence on the District's economy. Insured unemployment rose sharply during July with the District's rate up 0.7 of a percentage point between the first and last weeks of the month (compared with a 0.2 point rise in the nation). During the first two weeks of August, the steel industry was continuing to lay off workers. Among the steel industry economists we contacted, one expressed the belief that unemployment in his industry is currently at its peak. But he added that some workers are on vacation, and it is not known how many could be placed on layoff status (thereby raising unemployment) when the vacations run out. Another steel industry economist thought there would be further layoffs, especially among white collar workers in the industry. Estimates of steel production in August call for a seasonally adjusted decline (from the July level) ranging between 36 percent and 46 percent. One economist said August could be the lowest shipping month for the industry, excluding strike years, since 1939.

On the financial side, several banker-directors reported strong loan demand in recent weeks. One director, associated with a large bank, reported that loan commitments were up considerably from a year ago, with part of the increase in real estate and part in the commercial and industrial category. This director also pointed out that the increased cost of funds to the banking system will keep upward pressure on the prime rate for the near term.

A telephone survey of large banks in the District revealed that most banks have observed a more-than-seasonal slowdown in consumer-type time and savings inflows. Bankers expect the rate of growth to slow slightly further. Most banks also expect little near-term improvement from the year old sluggish condition of business loan demand. Large loans to large customers are expected to remain flat, in part because of the expectation that funding of corporate debt will continue. Some banks have had requests for increases in contractual revolving lines of credit, apparently reflecting business attempts to improve liquidity. But the banks did not expect the increased credit lines to be drawn upon.

FIFTH DISTRICT--RICHMOND

Our latest survey of businessmen and bankers suggests an extension of the recent moderate pace of business recovery, although the manufacturing sector may have weakened slightly in the recent past. Construction activity continues robust, bankers report strong loan demand, and retail sales are apparently continuing the recent upward trend. But manufacturing respondents indicate a sluggish pace of shipments, new orders, and backlogs. Little or no change is reported in the level of employment or of prices.

Survey responses indicate that District manufacturers have experienced no change in the level of shipments since the last reporting period. The diffusion of responses suggests some decline in both new orders and backlogs. Also, there was a substantial increase in the number of firms reporting a decline in inventories. Nevertheless, manufacturers believe that current levels of inventories are high relative to desired levels. The rail strike and the slowdown in the steel industry have apparently exerted a dampening effect on District industrial activity, especially in the coal mining areas of West Virginia and Virginia. Also, a strike in the copper industry closed down a large copper producing plant in Maryland.

Respondents indicate further increases in retail sales. A majority of banking respondents reported that automobile sales had increased in their areas. Our latest survey, however, shows consumer loans rising at a somewhat slower pace than in June and early July. As in the case of manufacturers, trade inventories are also considered larger than desired.

Little change is evident in the District employment situation. The majority of respondents reported that employment remained the same in their areas, and the number reporting decreases in employment was approximately equal to the number reporting increases. The survey indicates that District firms, especially the trades and services group, are still experiencing upward wage pressures.

Strong demand for loans of all types is still apparent in the District. The number of banking respondents reporting increased demand for business and mortgage loans was larger than it was in the previous survey. District bankers report some recent weakness in consumer savings deposits but attribute this weakness entirely to seasonal factors.

Respondents report continued strength in residential and non-residential construction. Several mentioned specifically a sizeable increase in construction of apartment buildings while others noted that commercial and industrial construction was exercising a favorable impact on business in a number of areas. Some areas are also apparently benefiting from new interstate highway construction.

District cash receipts from farm marketings during January-May were three percent below those a year earlier. Crop production prospects on August 1 were generally higher than a year ago.

The banking community remains mildly optimistic regarding prospects for the immediate future, although somewhat fewer respondents expect further improvement than was the case in our July survey. Generally, the consensus among both bankers and other businessmen appears to be that recovery will continue at the recent moderate pace.

SIXTH DISTRICT--ATLANTA

This report is based on three special surveys, all of which were concluded prior to the President's speech of August 15. The surveys indicate that businessmen, bankers, and retailers expect slow growth and inflation in the coming months. The retail sales outlook is mediocre, partly because of uncertainty among consumers. A slowing in the growth of consumer time and savings deposits is expected to continue. Business loan demand is reported moderate, and no strong upswing is foreseen.

In the past few weeks, a survey was made of businessmen and bankers located in areas experiencing either high or low unemployment. Businessmen located in areas experiencing high unemployment cite defense and aerospace layoffs, sluggish manufacturing growth, poor consumer sentiment, and rapidly growing labor forces as causes of high unemployment. In only one of the surveyed areas, Miami, did an interviewee anticipate substantial improvement in economic conditions during the next few months. On the other hand, none of those surveyed expect their economies to deteriorate further in the near future. In Miami, a large increase in consumer liquidity was mentioned as the source of a potential consumer spending boom. A banker in another high unemployment area, however, thought that it would take a great turnaround in consumer sentiment to dislodge savings.

Businessmen and bankers in low unemployment areas cite either construction booms or a stable economic base as a reason for low unemployment. In areas such as Jackson, Mississippi; Macon, Georgia; and Jacksonville, Florida, a surge in construction is leading strong economic advances. Such stable employers as state governments and universities are cited as reasons for low unemployment in other areas. None of the interviewees from low unemployment areas foresee significant changes in the prosperous conditions of their local economies during the next few months.

A sampling of retailers indicates that sales increases have moderated recently and that price markups continue. Only modest retail sales gains are anticipated for the fall. Inventories are reportedly "on target." Price increases from suppliers continue but not at an accelerating rate. Retail price increases are expected to continue at a brisk pace. As a result of the steel price increase, a rather large price increase is anticipated for appliances.

Bankers through the District are detecting a slight slowing in the growth of consumer time and savings deposits. The growth of 90-day maturity deposits--often called golden savings--has held up better than the growth of passbook savings and CD's. The slower growth of consumer time deposits was mentioned as a reason for aggressive bidding for large negotiable CD's. One major bank in the District has increased its negotiable CD's--as a result of a concerted effort--by more than 60 percent since May.

Bankers cannot agree upon the reasons for the slower growth in consumer time deposits. Several bankers think it is because of the rise in market interest rates, especially as reflected in the AT&T preferred issue and the latest Treasury refunding. Other banks feel that consumers are becoming increasingly aware of the higher rates paid by S&L's. Others cannot explain the slower time deposits growth, only noting that the accumulation of consumer deposits in the last year has been very large.

Most of the banks interviewed expect the slower growth in consumer time and savings deposits to continue. There are some fears of disintermediation, especially when 5 3/4 percent, two-year CD's mature early next year. Banks in several areas are expecting time and savings deposits to be used to pay private school tuition next month.

No substantial change in the strength of business loan demand is expected in the next few months. One banker reports that businesses would like to enter into term loans with seven-to-eight-year maturities. This banker said he was reluctant to make such loans, but when he did, the loans always contained a variable rate clause.

SEVENTH DISTRICT--CHICAGO

Initial reaction of Seventh District bankers and businessmen to the wage-price freeze and other actions and proposals of the Administration announced on August 15 appears to have been generally favorable. Producers of motor vehicles and business equipment are especially pleased, mainly because of proposed tax changes. An academic economist with a wide following, however, called the freeze "cosmetic rather than therapeutic," but the more common reaction is that the Nation's economic problems--the wage-price spiral, unemployment, and the trade balance--were not diminishing, and that strong words and actions were needed. Sentiment is bolstered, perhaps only temporarily, by the thought that "something is being done."

Opinions expressed by a group of economists representing major District businesses and financial institutions at a recent meeting were relatively optimistic. Increases of $100 billion in GNP were foreseen for 1972--a rise of more than 9 percent from 1971, about 5 percent price and 4 1/2 percent real. Inventory building is expected to accelerate in the fourth quarter, and plant and equipment spending is expected to revive by mid-1972. Managers in the various organizations are generally more bearish than economists. Cautious policies on capital expenditures, inventories, and hirings could change if orders and profits improve.

Employment conditions appear to have stabilized in the District, except for the hard-hit steel producing areas. Layoffs in most areas are about balancing new hires. Workers of all types and skills are in ample supply throughout the region. Unemployment in the automotive centers remains very high with no sign of early improvement. Strike activity is much less evident than at any time this year.

Retailers appear to be fairly well pleased with recent sales volume. Inventories are reported to be in good balance, and orders for some household durables are said to be picking up.

Although orders for most types of business equipment remain depressed, trucks are selling well--especially light and extra-heavy trucks. Demand for both construction and farm equipment is significantly ahead of last year. Foreign sales of these products are down, however, both in developed and in underdeveloped nations.

Orders for steel are at very low levels currently. The drop in orders and output is much steeper than in 1968, and greater in the Chicago area than in the Nation, although steel consumption is up to expectations. Large inventories, heavy imports still to come, the belief that proposed price increases will be postponed, and the fact that mills are not financing customer inventories (as in 1968) are said to be responsible. In contrast, Detroit area production is holding up well.

Chicago area steel mills have begun to recall some of the 30,000 workers laid off in early August as primary operations, shut down for the strike deadline, are reactivated. Monday, however, the mayor of Gary, Indiana (heavily dependent on steel) reported that his city had a 30 percent unemployment rate--far above the state labor department estimates. The mayor wants federal help.

Home building continues strong in the District. Analysts now expect almost 1.9 million starts this year, and almost as many in 1972, if federal programs are pushed. A major producer of building materials states that three price increases have "stuck" this year. Factories of this firm are on three shifts, and customers have been placed on allocation.

Sales of industrial chemicals have picked up vigorously in recent months after a slow start earlier in the year. Prices of these chemicals have increased slightly, and further increases are expected in 1972 as supplies tighten up. Chemical prices had declined sharply in the late 1960's.

Reports from the corn belt indicate that blight damage has not been severe, and that a record harvest is anticipated. If present trends continue, the corn crop will be largely out of danger in two to three weeks. Business loan demand at commercial banks remains moderate, but some banks have noted a recent improvement. The commercial paper market is competing vigorously with banks to supply short-term business funds. The volume of new corporate security issues is expected to continue to decline (except for utilities), but most analysts think long-term interest rates will not fall significantly. Inflows of funds to passbook savings accounts have slowed, and some individuals are "disintermediating" again. Banks are having difficulty placing CD's of more than 90 days because investors wish to remain short.

EIGHTH DISTRICT - ST. LOUIS

A moderate uptrend in business activity continues in the Eighth Federal Reserve District according to a select group of businessmen. Retail sales continue to expand in most of the larger centers. Orders from manufacturers have been spotty in recent weeks, but were generally higher on a seasonally adjusted basis than earlier in the year. The employment situation is generally unchanged from a month ago. There has been a pause in the rate of savings growth and interest rates have continued to inch upward. Some banks, however, still indicate a higher than desired level of liquidity and are aggressively seeking business loans.

Although retail sales remain sluggish at major department stores in St. Louis, other District centers report sharp increases. One of the major St. Louis outlets reported early August sales to be a continuation of the rather dismal level in July. Another reported some slight improvement of sales in August from the July level but well below sales in June. In contrast to this experience, major retail stores in both Memphis and Louisville reported sharp gains in sales in July and August from previous months, on a seasonally adjusted basis, and from year-ago levels. One of the leading Louisville firms reported that August-to-date sales are up 12 percent from year-ago levels. Similarly, total retail sales in Memphis have in recent months exceeded year-ago levels by 15 percent according to an official of a large department store.

The outlook for manufacturing activity ranges from pessimistic to quite optimistic, depending on the type of product. Manufacturers of software and products associated with home construction report optimistic levels of sales and orders. On the other hand, steel producers and replacement durable goods manufacturers are generally pessimistic in their outlook for the next few months. Steel producers report large inventories in the hands of consuming firms and low production prospects for the next six months while the inventories are being reduced. After the current inventories are depleted, the outlook for steel is more promising. The replacement market for durable manufacturers is reported as being generally soft but improving slowly.

Nine of the businessmen interviewed reported significant changes in employment prospects. Some layoffs which have occurred in steel industries have apparently been offset by new hirings by manufacturers of home building and allied products. Most of those interviewed, however, reported little change in number of employees, which indicated that new hirings only slightly exceeded the number leaving the firms.

Savings flows into financial institutions have continued to decelerate from the very high rates of last spring. The slowing has been most pronounced at commercial banks, but a slower rate of savings growth has also been observed at savings and loan associations. An occasional increase in rates paid to savers has been announced in recent weeks. Some banks which lowered the rates paid on passbook savings last spring have recently raised their rates back to Regulation Q ceilings. Rates on loans also continue to creep upward. Nevertheless some banks continue to aggressively seek business loans.

NINTH DISTRICT - MINNEAPOLIS

Judging from the responses of the directors, recent developments in the steel and rail industries will lead to higher costs and prices for goods coming into or produced in the District. The timing of these cost and price increases will vary, with some already having taken place and more to come between now and the end of the year. Labor demand throughout the District is still relatively weak, although a few directors thought that business activity was generally good. Consumer savings flows to District banks have slowed down since midyear, and bankers are anticipating only minimal increases over the next few months. Business loan demand is expected to follow normal patterns over the next several months.

A number of directors were aware of price and cost increases that had already been instituted as a result of the recently announced steel price hike. An equipment dealer in Upper Michigan, following the steel price rise, raised the price of fencing even though it had been purchased earlier this year. One Montana director said that a steel fabricator in his area would try to raise prices on his products to pay the costs of holding excess inventories, but the fabricator was not sure that competition would permit the higher prices to hold.

In addition, price increases can be anticipated in a number of steel-using products between now and the end of the year. One director stated that reinforcement steel prices had risen about 5 percent, but that he had adequate supplies to hold the price on his concrete products until the end of the year. At that time, though, the steel price increase along with a 10 percent announced price increase for cement and higher wage costs would force him to take a long, hard look at these prices.

Another director said that a heavy equipment manufacturer in his area had stockpiled enough steel earlier this year to last until December, at which time he would have to raise prices. Farm machinery prices are also expected to rise early next year, partially because of the recent rise in steel prices, but also because the relatively strong farm income situation is leading to a stronger demand for machinery.

Despite the rise in the District help-wanted advertising index, the directors of this Bank generally feel that the demand for labor has not increased significantly over the last few months, and for the most part, only seasonal hiring is taking place. A few directors felt, however, that business activity was good in their areas. Tourist traffic seems to be up throughout the District, and spending by farmers has improved because of the good crop prospects.

Since midyear, consumer-type time and savings deposits at selected Reserve city and country banks have been experiencing only seasonal or weak expansion in contrast to rapid increases earlier in the year. The slowdown was attributed in part to an increasing awareness of alternative higher return investments on the part of savers, increasing competition from government securities and higher offering rates at S & L's in some parts of the District. Expectations are that changes in consumer savings and time deposits will range from only minimal increases to moderate runoffs during the next several weeks, with any significant declines occurring toward year-end, if short-term rates continue to climb and if consumer reluctance to spend continues to dissipate.

Business loan demand is expected to follow its usual seasonal advance during the next several months, and there are no sectors which stand out as being especially conducive to large-scale expansion in the District. Areas mentioned as possible sources of moderate strength were real estate, public utilities and interim nonresidential construction financing. Bankers are also expecting some increase in loan demand for inventory replacements at both the wholesale and retail levels.

TENTH DISTRICT - KANSAS CITY

In the Tenth District, concern remains high over the pace of inflation and the near-term prospects for any improvement, based on a telephone survey of a number of purchasing managers. Respondents expressed a sense of frustration at current policies to deal with inflation, but most were ambivalent at the usefulness or desirability of an approach involving controls.* In contrast, the agricultural sector was marked by increased concern over the likelihood of declining farm prices in the months ahead.

The moderate improvement in District economic activity reported in the last Red Book continues to be confirmed by reports from directors and District bankers, although business loan demand has weakened further. At the same time, some loss of strength in deposit flows has been noted in recent weeks and expectations of some disintermediation are not uncommon.

A telephone survey of a sample of purchasing managers elicited the view that there had been little change in the pace of inflation. In fact, a few, such as relatively large users of steel and steel products and rubber users, indicated that there had been some quickening of the pace.

One firm, a large purchaser of chemicals, did report that, for the first time in several years, two successive quarters have gone by with no renegotiation of prices on large annual contracts. However,

---

*The telephone survey of purchasing managers was conducted prior to President Nixon's August 15 speech on economic policy changes.

other chemical purchasers indicated that there was no abatement in the rate of price increases for chemicals. For these firms, most recent increases in cost of materials stemmed primarily from higher freight charges. A number of other firms also cited higher freight charges as the principal reason for increased prices to them. Most of the purchasing managers queried said that their firms would try to pass higher materials costs on to consumers. However, one did indicate that they hoped to absorb some of the higher costs of materials by selling more high-margin items.

In the course of their remarks dealing with price trends, the purchasing managers expressed a sense of frustration at current policies to deal with inflation. However, when asked about controls, most were ambivalent at the usefulness or desirability of such an approach. Though one respondent said that he would favor a price freeze and a strict review of all wages, and others were in favor of some form of incomes policy, most purchasing managers were wary of controls. Their major objection was that any system of price-wage controls would undoubtedly require, in their opinion, a massive addition to government bureaucracy. Also, some indicated that past experience illustrated that controls had loopholes and served only to postpone wage and price changes. Even among those who indicated that they would not like to see wage and price controls used at this time, there was little confidence expressed that present economic policies would be able to contain or roll back inflationary forces.

Recent developments in the agricultural sector of the economy tend to confirm earlier reports in the Red Book about the likelihood of declining farm prices in the months ahead. At the same time, farm equipment business in the District is reported as quite soft. The prospects for record production levels of corn, grain sorghum, and wheat point to a substantial drop in grain prices this fall. In this connection, two directors referred to the fact that corn prices already have fallen sharply. While such developments might serve to dim income prospects for crop farmers, lower feed costs would benefit the livestock industry. With improved feeding margins, feeder cattle prices may spurt upward by yearend. If this encourages producers to carry their animals to heavier slaughter weights, and to expand breeding herds, slaughter prices may well fall somewhat below projected levels for next spring and the rest of 1972. Thus, in the year ahead, it is conceivable that farm prices could serve as a source of stability in the overall wholesale price index.

Deposit flows into Tenth District banks have not been as strong in recent weeks as in the first half of the year. This is true both for demand deposits and consumer-type time and savings deposits. However, net inflows of large CD's have strengthened somewhat at several banks. Larger banks (weekly reporting) in the Tenth District experienced a net decline in consumer-type time and savings deposits in July, although those bankers contacted did not seem to feel that the situation was as bad as might have been expected. The reason most frequently cited for declining deposits was increased Treasury bill rates, although some also detected an increased tendency to draw on savings to finance purchases. District bankers apparently are expecting some disintermediation to occur in the next few months. The contact at one large bank indicated that his bank has a large volume of consumer-type CD's maturing in September, and, under certain conditions, they could experience a large outflow.

Residential mortgage and construction loan activity at District banks continues strong. In addition, consumer instalment loans, such as for home remodeling purposes and for automobiles, are showing further steady growth. Aside from residential construction loans, however, the commercial and industrial loan picture appears to be rather spotty. In fact, both recent data and discussions with District bankers suggest that business loan demand may have weakened further in recent weeks.

ELEVENTH DISTRICT--DALLAS

Respondents at a sample of retail stores in the Eleventh Federal Reserve District expect business activity to pick up moderately over the next six months. Relatively few, however, were even mildly optimistic about improvement in the employment picture in their areas for the near term. Recent sales at these stores were somewhat greater than during the comparable period last year, with summer sales being greater than anticipated. Nevertheless, inventories are still higher than this time last year and a little higher than some would like. Virtually all indicated that wholesale prices for inventories, as well as retail prices they charge their customers, have risen moderately over the last six months. Moreover, nearly all anticipate that both wholesale and retail prices of their goods will rise by about a like amount in the next six months.

About two-thirds of the respondents reported that sales recently were above those a year ago, with a few indicating that the increase has been substantial. The increase was attributed by most to greater demand, improved internal operations, and expanded facilities. On balance, the importance of "big ticket" items and the most expensive "top of the line" items in total sales has not changed materially since a year ago. At least at these outlets, the consumer apparently has not become more economy-minded in past months.

All of the stores surveyed ran special summer sales. A little over 60 percent indicated that the sales volume exceeded their expectations and was greater than during the summer sales last year. Most respondents indicated that the number of items on sale and the price reductions this year were comparable with those last year, although about

30 percent reported greater number of items and larger price reductions in this year's sales.

Even though sales have been up recently, almost 80 percent have inventories equal to or greater than those a year ago. Moreover, just more than a third of the respondents felt that their current inventory levels are a little too high. Nevertheless, all of the respondents are planning to keep their inventories at present levels or actually increase them slightly over the next six months (exclusive of changes for seasonal reasons). A few pointed out, however, that anticipated increases in inventories will probably reflect higher prices rather than greater unit volume.

Regarding price increases, nearly all of the respondents experienced a moderate rise in wholesale prices of inventories over the last six months. Moreover, the majority indicated that salaries in their stores have risen from 5 to 10 percent during the last year; and, on balance, the number of people employed has also risen over this period.

In light of these increased costs, almost 90 percent of the stores surveyed have raised their retail prices in recent months. And in view of the near unanimous feeling that wholesale prices will continue to rise about as rapidly in the next six months as in the last six months, most respondents are planning to increase retail prices of their goods moderately further in the near term.

District data continue to show a modest recovery in economic activity. Total nonagricultural wage and salary employment in the District states rose 0.2 percent in June above the May level. Most of the growth came in manufacturing--an employment area that still lags behind year-ago levels. Car registrations in the four major reporting areas in Texas showed a sharp 21 percent gain for June and are running much stronger than a year ago. Similarly, department store sales continue to show strength in consumer buying. The seasonally adjusted Texas industrial production index dropped slightly in June mainly due to a cut in crude production. Texas crude production allowables were reduced to 66.2 percent for August, the fourth consecutive month of such reductions. Recent rains have broken the drought, and progress is being made in efforts to control the outbreak of Venezuelan equine encephalomyelitis.

TWELFTH DISTRICT - SAN FRANCISCO

Business activity in the Twelfth District has shown only modest expansion in recent weeks, with rising residential construction continuing to provide the principal stimulus in the economy. This in turn leads to greater demand for the products of the lumber industry on the Pacific coast. Consumer spending remains at a stable level but is showing comparatively little growth. This characteristic of only very slow growth at present also is reflected in the views obtained from bankers and businesses concerning current and prospective demand for business loans, although there are some regional differences in this regard.

Construction activity continues to be a source of strength in most parts of the District. Housing starts are higher in Seattle, Portland, and in the major markets of California. Bankers note an accompanying increase in the demand for real estate loans despite the recent rise in mortgage rates. The only evidence of overbuilding reported involves multiple-units. In southern California, for example, some new apartment projects have been reduced. Nonresidential building is showing a recovery, particularly in government construction projects.

The continued expansion of housing has benefited other related industries. The lumber industry in the Pacific Northwest is continuing to expand production. Construction suppliers report heavier sales and they are hiring more workers. One major hardware supplier has increased its work force by 5 percent and put some of its plants on overtime.

Consumer spending is steady rather than growing. In some areas, appliance sales are higher but there are other reports of sluggish sales activity. According to one director, June retail sales in California of one national chain are below average compared to its sales in the rest of the Nation. A major oil company reported that its gasoline sales in June were 4 percent below those of a year ago. Heavy advertising seems to be necessary to stimulate retail buying and, overall, the pressures to build up retail inventories are weak.

Strikes have hindered the economic expansion. In particular, the railroad strikes have caused problems to shippers, especially of agricultural products. Similarly, the copper strike had hurt activity in Utah and Arizona. Of continuing concern is the dock strike in Pacific coast ports. This strike is affecting a widening number of industries and agricultural producers throughout the District.

Directors of our Head Office and Branches were asked to comment on the current and prospective demand for business loans and a few additional banks also were contacted in this regard. The predominant reply among bankers is that they expect business loan demand will continue to run at about its current rate in the next two months. Current demand is variously described as "soft," "weak," "flat," and in some instances, "moderately good" to "strong." Regional differences are apparent in the replies.

Current and prospective demand is reported generally to be "moderately good" in Oregon, Utah, and Idaho where unemployment rates are lower than in some other areas of the Twelfth District. Lumber production in Oregon is rising as a result of the increase in residential construction and mills are stocking logs in preparation for the winter season when logging operations are curtailed. Loans to food processors in that area are also larger than a year ago. In Utah, the strengthening in loan demand reflects a gradual expansion in the economy on a broad front.

Bankers in California and Washington are less optimistic with respect to business loan demand, which reflects in part the relatively higher levels of unemployment in those areas. Within California, there seems to be slightly more optimism in the Los Angeles area than in San Francisco. Two major banks headquartered in southern California reported that business loan demand is rising at a moderate rate and probably will continue to do so in the next few weeks. Other banks in northern and southern California characterized their loan demand as stable or flat and reported little prospect of significant growth in the near future. In nearly all cases, banks did not think that repayment of loans from the proceeds of flotations had been a significant factor in restraining the growth in their volume of business loans outstanding.

The reports from directors associated with nonbanking firms seem to substantiate the predominant view obtained from bankers that no significant upsurge in business loan demand is likely to occur in the next few weeks. With the exception of one or two firms which plan some plant expansion that will be financed initially by bank credit, the remaining enterprises do not foresee in the near future any change in their need for bank credit.