A review by the **Federal Reserve Bank of Chicago**

Business Conditions

January 1971

Review and outlook—1970-71

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Review and outlook—1970-71

Output and employment

During December 1970, total spending on goods and services, the gross national product, was officially estimated to have reached an annual rate of $1 trillion. For the year as a whole, spending totaled about $975 billion, 5 percent more than the record for 1969. Civilian employment averaged almost 79 million, up 1 percent. Personal income rose 7 percent to $800 billion. Nevertheless, 1970 closed on a note of disappointment and frustration. There were three main reasons: inflation, unemployment, and strikes.

Increases in spending for 1970 were entirely attributable to higher prices. The general price level rose slightly more than 5 percent, marking the seventh year of accelerating price inflation. Physical output of goods and services was slightly lower than in 1969, the first year-to-year decline since 1958. Some sectors of the economy—residential construction, durable goods manufacturing, and defense-related activities—reported sizable declines in output on a year-to-year basis. Reduced demand for workers, coupled with a rise in the civilian labor force caused unemployment to rise sharply. The unemployment rate averaged 5 percent, compared to 3.5 percent in 1969, and was the highest since 1964. Another matter of concern was labor disputes. Activity was more severely disrupted in 1970 by strikes than in any year in more than a decade.

The region of the Seventh Federal Reserve District was more affected by the slowdown in business activity in 1970 than the nation as a whole. This reflected the greater relative dependence of the Midwest on durable goods manufacturing, both consumer products and producer equipment. Major strikes in trucking and in the auto industry also were more significant here. Cutbacks in defense spending, on the other hand, were much less significant in this area than in the nation.

Competitive job markets

Demand for workers eased markedly in 1970, while the supply increased. In place of labor "hoarding," common in the late 1960s, many employers shortened work weeks and reduced their work staffs. As a result of layoffs and curtailed recruiting efforts, unemployment increased sharply.

From 1964 through 1969, civilian employment in the United States rose more than 10 million, or 15 percent. Annual increases were never less than 1.5 million. During these years the unemployment rate, the proportion of the labor force without jobs seeking work, declined from 5.5 to 3.5 percent. Unemployment rates for married men declined to 1.5 percent, perhaps an irreducible minimum of "frictional" unemployment. Labor force participation rates rose in these years, mainly because more women sought and obtained jobs. Overtime was widespread. Large boosts in wages and other benefits were more the

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result of heavy demands for workers than the efforts of organized labor.

Civilian employment in 1970 averaged only about 800,000 more than in 1969, the smallest year-to-year increase since 1961. During 1970, employment reached an all-time peak of more than 79 million in the first quarter. In the fourth quarter, employment was about a half million less than in the first quarter and was about equal to the level of a year earlier.

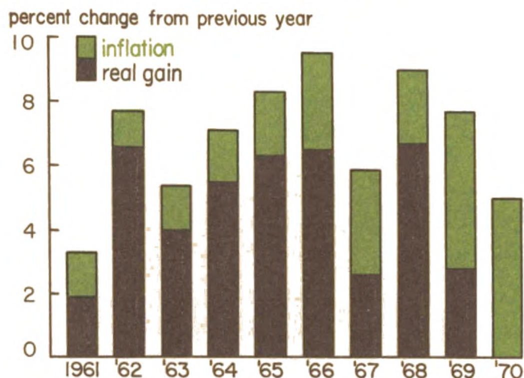
Late in 1970, employment was depressed and unemployment was increased by the auto strike. But the major factor causing the rise in unemployment, up 2 million in December from a year earlier, was the failure of the economy to provide jobs for an expanding labor force.

The increase in unemployment in 1970 was related to the reduction in the armed forces, as well as weakness in the economy. The buildup in military personnel associated with the Vietnam war increased the armed services from 2.7 million in 1965 to more than 3.5 million in 1969. From October 1969 to November 1970, the armed forces were reduced by a half million. Most of the new veterans were young men in the prime working age groups.

Nonmanufacturing employment averaged about 1.6 million higher in 1970 than in 1969. Manufacturing employment, however, averaged 800,000 less. Within manufacturing, declines were concentrated in the durable goods industries, including primary metals, machinery and equipment, building materials, motor vehicles, and aerospace. Construction industry employment also declined in 1970. Sizable increases were reported for the trade and service industries and state and local government. Federal government employment was reduced.

Declines in output and employment in the

Spending growth in 1970 attributable to higher prices



aerospace industries were severe in certain centers on the West Coast, the South, and the East that were deeply affected by cutbacks in military procurement. In the Midwest, military procurement is only about half as important relatively as in the nation.

Decreases in output and employment in the primary metals, machinery and equipment, and motor vehicles industries were the main factors contributing to the easing of labor markets in the Midwest. Except for Michigan, however, unemployment rates averaged less in Midwest states than in the nation. In Illinois and Iowa, unemployment averaged less than 4 percent in 1970. Nevertheless, all major centers experienced a substantial rise in unemployment.

In most nondurable goods industries, less cyclically sensitive than durables, employment either was maintained or declined moderately. Virtually all industries, however, experienced lower profit margins, and attempted to reduce labor costs by eliminating personnel and by restricting new hirings.

Each month the Department of Labor classifies 150 major labor markets in the

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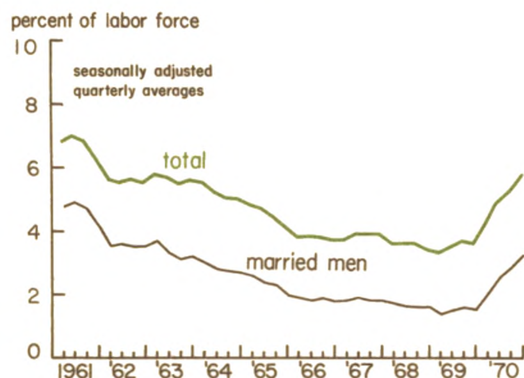
United States—24 of them in the states of the Seventh District—as to the strength of local demand for labor. In December 1970, 17 U. S. centers were classified as having "low unemployment," with less than 3 percent of the local labor force seeking jobs. A year earlier, 59 centers had been classified in this group. In the Seventh Federal Reserve District, only two labor markets (Des Moines and Madison) were in the low unemployment group in December 1970, compared to 11 a year earlier. In the United States, 37 labor markets were classed as having substantial unemployment—more than 6 percent of the labor force—in December 1970. A year earlier only five centers had substantial unemployment. In the Seventh District, seven labor markets were in the substantial labor surplus class in December—five of them in Michigan—compared to only one in this class a year earlier.

Employment was held down in 1970 by a series of strikes. These strikes were particularly important in the Midwest. In early February, employees returned to work at plants, some in this region, of the nation's largest electrical equipment producer after a work stoppage of more than three months. In mid-April, a nationwide truck drivers' strike began that lasted a month in most areas and two and one-half months in the Chicago area. The auto strike, most important of all, lasted almost two months. In addition, there were numerous other disputes of varying importance in construction, equipment manufacturing, and government. All told, about 65 million man-days were lost in the United States in 1970 because of strikes, half again as many as in 1969, and far more than in any year since 1959 when a long steel strike occurred.

Labor organizations were able to obtain substantial increases in compensation for their members in 1970 in the face of softening demand for labor. Typically, increases in wages and other benefits negotiated in 1970 were even larger than in 1969. Increases in compensation averaged about 8 percent per hour, often in three-year contracts, with especially large wage increases for the first year. In some sectors, notably transportation and construction, increases in compensation of 12 to 20 percent annually were obtained.

Unemployment rate rose sharply during 1970



Sales and income

Despite declining employment through most of 1970, personal income continued to rise. The uptrend was interrupted temporarily in October when a slight dip was associated with the auto strike. Larger social security payments, increased unemployment compensation, and most important, increases in wage rates and salaries kept income rising, although at a slower pace.

For 1970 as a whole, personal income rose 7 percent, only slightly less than the rise of almost 9 percent in the previous year. Income after taxes (disposable income) rose 8.5 percent in 1970, about as much as in 1969. The larger gain in after-tax income reflected the

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end of the 10 percent income tax surcharge.

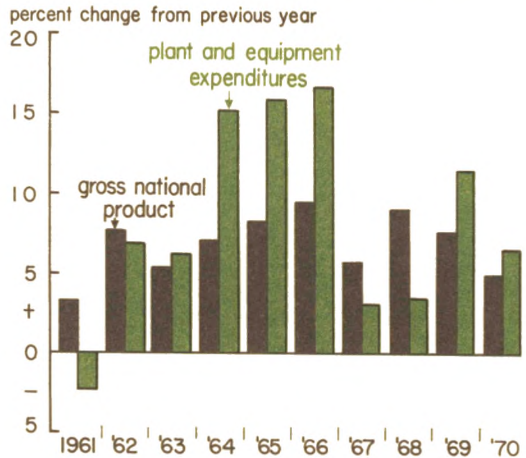
Personal consumption expenditures rose as much as personal income in 1970, but did not keep pace with disposable income. Outlays on nondurable goods and services increased about as much as after-tax income, but outlays on durable goods—chiefly autos and household furnishings—increased only 1 percent. After adjustment for price changes, spending on durables declined. Consumer instalment credit, used mainly to purchase durables, rose only $2 billion in 1970, compared with $8 billion in 1969.

Because consumer expenditures rose less than after-tax income in 1970, the rate of savings increased. The 6 percent savings rate for 1969 was near the average of the past decade. For 1970, the rate was more than 7 percent. The dollar volume of savings jumped almost one-third to about $50 billion. For some consumers, savings took the form of increases in holdings of liquid assets or real estate. For others, savings were reflected in debt repayments.

Continued sluggish consumer spending in the fourth quarter of 1970 was related, in part, to the auto strike and the limited supply of new cars. Spending on durables was almost certain to rise in early 1971, not only because of the prospective ample supply of new autos, but also because of rising housing starts, which are usually associated with increased purchases of home furnishings.

With current disposable income at a rate of $700 billion, and still rising, a 1 percentage point reduction in the savings rate to a more normal level would increase consumer purchases by about $7 billion. Meanwhile, consumers have been improving their financial positions, including their ability to incur debt. A rapid expansion in consumer purchases throughout 1971 could lead the economy on a new surge of prosperity. Such a development will depend heavily on an improvement in consumer confidence in future jobs and income, still shaky in late 1970.

Plant and equipment spending rose less in 1970 than in 1969



Price inflation continues

From 1961 through 1964, average prices in the private economy rose only about 1 percent annually. Each year since then has brought a more rapid rate of increase. The rise was 4.5 percent in 1969, the largest increase since 1951. A slower rate of inflation was generally expected in 1970 as a result of widening margins of unused manpower and facilities. Instead, prices averaged about 5 percent higher than in 1969. Toward year-end, however, there were growing signs that the rate of price increase was slowing.

Some wholesale prices declined sharply in 1970. Included were prices of most nonferrous metals, lumber and other building materials, and meat animals. Indirect price cuts in the form of quantity discounts, freight absorption, upgrading, and provision of special services were increasingly common. Some types of machinery were available at lower

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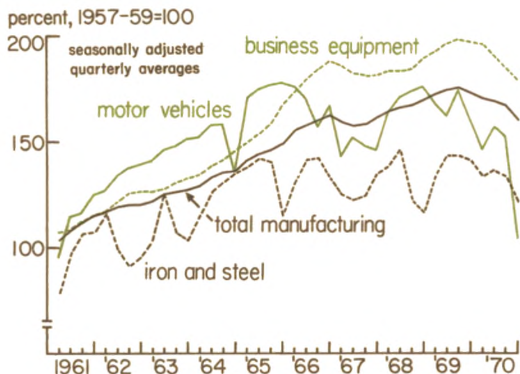
prices as producers bid for a smaller volume of business. Starting in the late summer, prices of meats declined at the retail level.

But the inflation generated in the Vietnam period retained substantial momentum in late 1970. Prices of many goods and services incorporating substantial labor inputs were under even stronger upward pressure than a year earlier.

The acceleration in the rise in prices in the past five years has been associated with a rise in unit labor costs. The question of cause and effect between rising prices and rising wages may never be resolved. Obviously, there is an interaction. But labor costs per unit of output should not be equated with compensation per hour. Compensation can rise in the private economy without upward price pressures if higher pay is accompanied by a proportionate increase in output per man-hour, i.e., productivity.

In the past decade, increases in output per man-hour have averaged about 3.5 percent annually. Throughout 1969 and in early 1970, there was little or no increase. As employment declined in the spring and summer of 1970, and marginal facilities were retired, productivity rose at a significant rate. If the more optimistic forecasts for total activity in 1971 are realized, the increase in output per man-hour may equal, or exceed, the long-term average because facilities will operate closer to the optimum level. Improved productivity provides the main hope for success in the struggle to contain price inflation while maintaining a high level of employment.

Durable goods industries led output decline from 1969 peak



Equipment output declines

With 16 percent of the nation's population, the five states of the Seventh Federal Reserve District produce more than one-third of the output of producer equipment. For some products the share accounted for by these states is much larger—60 percent for trucks, 70 percent for farm equipment, and 50 percent for construction equipment. The region also accounts for a substantial part of the nation's output of electrical apparatus and industrial machinery.

Total expenditures on new producer equipment by U. S. firms reached a record $68 billion in 1970. About $35 billion was spent on nonresidential construction, also a record. Total nonresidential private fixed investment, therefore, totaled about $103 billion, up about 4 percent from the 1969 level. Average prices of new plant and equipment rose more than expenditures, however, so the physical volume of investment declined.

Expenditures on new equipment and buildings have been relatively strong since 1964. In the six-year period, 1965-70, the proportion of gross national product accounted for by private fixed investment ranged from 10.3 to 10.9 percent. In the previous six-year period, 1959-64, this proportion had ranged from 9.0 to 9.7 percent.

Although total spending for equipment and buildings increased in 1970, many firms, especially durable goods manufacturers and

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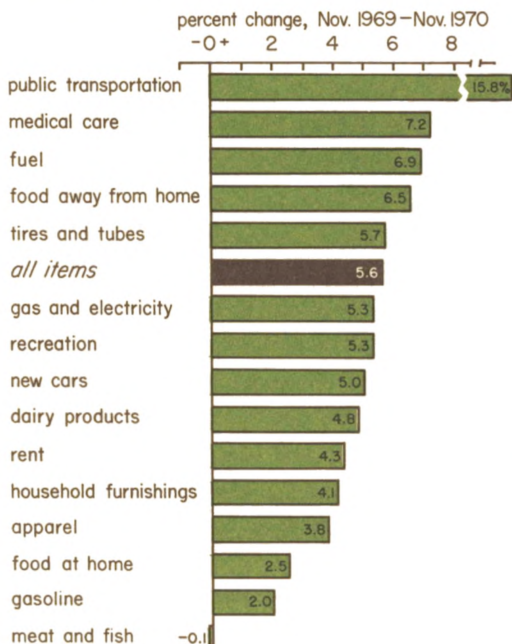
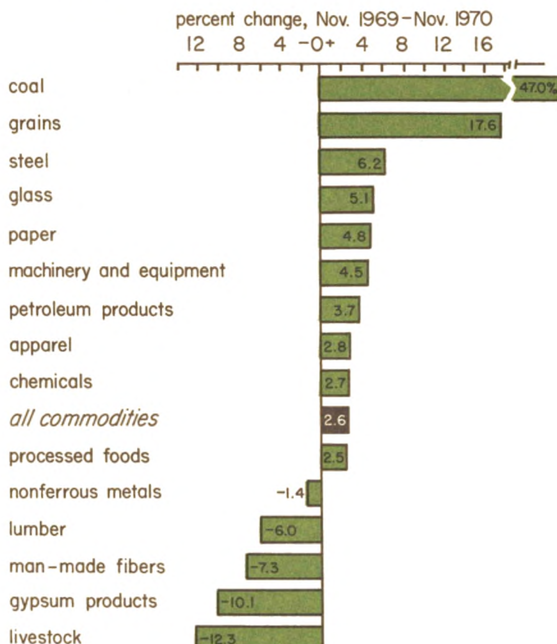
Large increases in consumer prices occurred in most items



Some wholesale prices declined sharply



transportation companies, canceled or postponed spending plans during the year. These actions were taken as it became apparent that sales, orders, and profits were falling short of budgeted levels.

In February, manufacturing firms expected to increase expenditures on new plant and equipment by almost 10 percent in 1970. By November, the expected rise was less than 2 percent, with durable goods manufacturers estimating a slight decline. Railroads and trucking firms also reduced plans to purchase equipment substantially.

While manufacturers lowered their investment goals in 1970, electric, gas, and communications utilities expanded their plans somewhat. In February, utilities expected to spend 15 percent more than in 1969 on new plant and equipment. By November, an 18 percent increase was expected. While capacity of many manufacturing firms was rising in the face of declining sales in 1970, public utilities were hard pressed to satisfy customer demands for their services.

Output of all types of business equipment, measured in physical units, reached a peak in the third quarter of 1969. By the fourth quarter of 1970 this output had declined 10 percent. Machine tools and railroad equipment were among the industries suffering the largest declines in orders.

As 1970 drew to a close, surveys of business firms suggested that dollar spending on new plant and equipment will rise slightly in 1971, but much less than the expected rise in prices. Apparently the decline in equip-

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ment output will continue. Many producers of equipment, however, believe that the advantages of new facilities that reduce costs and improve quality will cause a reversal in the order downtrend when general business conditions become more favorable and credit more available. It was generally expected, however, that the revival would not occur until the second half of 1971.

Poor year for autos

Michigan contributes 40 percent of the output of the nation's motor vehicle industry. Indiana accounts for 7 percent, Illinois for 5 percent, and Wisconsin for 4 percent. The welfare of the entire Michigan economy is tied closely to the fortunes of the motor vehicle industry. In the other Midwest states the industry is the dominant employer in certain communities.

Output and sales of passenger cars were slow throughout 1970 in comparison to the rates of earlier years. For the January-August period, unaffected by the strike, output of passenger cars was down 12 percent from the same months of 1969. Deliveries of "domestic" models, including imports from Canada, were off 8 percent in this period. Sales of trucks were about equal in both eight-month periods, at a near record level.

Inability of the United Auto Workers Union and the General Motors Corporation to agree on terms for a new three-year contract resulted in a work stoppage that began September 14 and ended November 11. Vehicle assemblies were resumed on a limited basis on November 24. Plants producing railroad locomotives and household appliances also were idle during the strike. About 400,000 GM workers were directly involved. In addition, many thousands of workers in plants producing materials and components were laid off. The strike meant the temporary loss of about 1.5 million new cars and trucks in the United States and Canada. It was by far the most serious work stoppage in the motor vehicle industry since shortly after World War II.

Weaker demand and the strike were not the only factors depressing output of cars in the United States in 1970. Imports increased again, both small cars from Europe and Japan and domestic-type cars from Canada.

About 8.4 million new cars were delivered to U. S. customers in 1970. Of these, 6.5 million were from current U. S. production; 300,000 represented a reduction in dealer inventories; 400,000 were net imports from Canada; and 1.2 million were imports from Europe and Japan.

Net imports from Canada, under the automotive trade agreement, have increased each year since 1965 when the trade was negligible. A further rise is expected in 1971.

Imports from nations other than Canada —principally Germany and Japan—have increased each year from 1963 through 1970. Moreover, the proportion of the entire market accounted for these cars also rose in each of these years—from 5 percent to 15 percent. Major U. S. auto producers now offer new small cars (containing important foreign-made components) that compete directly with the subcompacts. As a result, industry experts believe that imports of subcompacts will not rise much next year, and may decline.

Car output in 1970 in the U. S. was the lowest since 1961. Truck output, only 1.7 million because of strike losses, was the lowest since 1967. A substantial increase in 1971 is virtually assured for both cars and trucks.

Motor industry executives suggested in late 1970 that auto deliveries to U. S. customers in 1971 could reach a record 10 million, and truck deliveries could match the 1969 level of almost 2 million. In view of the large

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carryover resulting from the strike, the 10 million figure for car sales is not as spectacular as it appears at first glance. Moreover, because of the expected continued high level of imports, U. S. production of cars probably will trail the 1965 record. In any case, a catch-up period is underway that will continue for some months to come. With overtime and Saturday work scheduled, auto production in the first quarter of 1971 is projected at a record 2.6 million.

Recovery in steel

More than 20 percent of the nation's steel is produced in the Chicago-Northern Indiana area. The Detroit area accounts for an additional 7 percent. Most of the steel from these plants is consumed by manufacturers, and construction contractors, in the industrial centers of the Midwest.

In 1970, U. S. steel producers shipped a total of 91 million tons of steel products, down only 3 million tons from the 1969 record. Steel shipments would have declined more if imports had not dropped the second successive year. Imports totaled 13 million tons, off 5 million tons from the 1968 peak. Strong markets abroad, and voluntary quotas agreed to by foreign producers, were responsible. Exports of steel, which increased sharply in 1969, continued at a fast pace in the first half of 1970. Later in the year, however, exports declined.

Capacity to produce important types of steel—including hot and cold rolled sheet and strip—increased in 1970. The supply of labor available to the mills was adequate for the first time in several years. As a result, steel markets were highly competitive in the second half of 1970. Order lead times were very short, and prices of some types of steel were under downward pressure.

Orders for steel increased in late 1970. Output rose in December, after declining in earlier months. The improvement in orders was broadly based, coming from producers of both consumer goods and business equipment. Some customers delayed taking deliveries in late 1970 to reduce inventory taxes.

Steel mills expect record output in the first seven months of 1971. Demand, especially from the automotive industry, is likely to rise because most purchasers of steel will be building inventories to protect against a possible strike when the current labor contract expires on July 31, 1971.

A contraction in steel output is almost certain after the July 31 deadline, whether or not a work stoppage occurs. Ups and downs in steel output associated with strikes or threats of strikes have been a triennial feature of the economy for more than a decade.

Construction activity

Outlays on new construction totaled $91 billion in 1970, about the same as in 1969. Because of rising costs, however, the real value of construction put in place declined about 6 percent. In physical terms, activity was at the lowest level since 1964.

There are three major sectors of construction activity—private residential, private nonresidential, and public—each of which accounts for roughly one-third of the total. Residential construction was somewhat more depressed than the other sectors. Nevertheless, for all three the picture was basically the same: spending in 1970 about equaled 1969,

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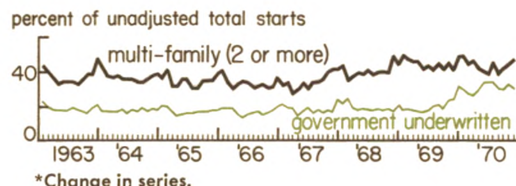
while physical activity declined.

During the year, however, the three sectors of construction showed varied patterns. Residential construction activity was about level through the first half and improved at an accelerated pace in the third and fourth quarters. Nonresidential private construction declined quarter by quarter through the year, mainly because of a slowing in commercial and industrial building. Public construction, although not stable through 1970, showed no clear trend, up or down.

The major construction sectors were all affected by restricted availability of credit and high interest rates in 1970. Single-family home building was hard hit in the first half, but rebounded later in the year as credit became more available. Lack of credit also caused the postponement or cancellation of some apartment buildings and commercial structures.

Housing activity rebounded sharply in 1970 . . .

. . . and FHA financing expanded significantly



*Change in series.

For 1970 as a whole, housing starts totaled 1.4 million units, down about 70,000 from the previous year. But 1969 starts were below the 1.5 million total for 1968. In terms of completed housing units, the 1970 drop was even sharper. The reduction in the number of new housing units provided in 1970 occurred in the face of a rise in demand, mainly because of increased family formations, but also because of demolitions and abandonments. The picture appears much more favorable if mobile homes shipments, about 400,000 in both 1969 and 1970, are added to the new housing units constructed on permanent sites.

Credit and construction

The tightening in credit markets that began in late 1968 continued through 1969 and into 1970. Rising yields on a variety of money market instruments considerably reduced the investment appeal of home mortgages, and slowed the inflow of funds to institutions, savings associations, and savings banks, which invest heavily in home loans. Mortgage yields failed to rise as fast as yields on alternative investments, in part because of state usury ceilings covering home mortgage loans. Several states, including Illinois and Michigan, raised, or suspended, these ceilings through legislation in 1969.

Mortgages on apartment buildings, commercial structures, and other income properties are usually exempt from usury ceilings. As a result, borrowers were better able to pay competitive rates. In addition, mortgages on income properties now commonly carry variable loan rates, or "equity kickers," that give lenders a share of the rents or profits. For these reasons, the flow of mortgage money to income properties was fairly well maintained in 1969-70.

Augmenting the reduced flow of savings from thrift institutions to home mortgages,

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was the housing credit supplied by the Federal National Mortgage Association (FNMA) and the Federal Home Loan Banks. Sums injected into the home mortgage market in the form of secondary market purchases of mortgages by FNMA, and through the extension of credit to savings and loan associations by the Home Loan Banks, amounted to almost $10 billion from mid-1969 to mid-1970. These funds accounted for more than half of the addition to outstanding home mortgage credit during the period.

Savings inflows picked up sharply in the second quarter of 1970 and continued at high levels through the remainder of the year. This helped reverse the decline in housing starts. Larger savings deposited in thrift institutions were related to consumer caution on current expenditures, and to the decline in market interest rates.

The downturn in housing activity in the first half of 1970 was more severe in the Seventh District than in the nation and the subsequent improvement was less emphatic here. For the first nine months of 1970, permits issued for new housing units in the large metropolitan areas of the district were down 25 percent from the year-earlier period. A 7 percent decline was reported for the United States. Chicago area permits were off 33 percent. For Indianapolis the decline was 36 percent; for Detroit, 23 percent; and for Milwaukee, 19 percent. Decreases in permits for smaller areas in the Midwest were generally smaller than for the large centers.

Mortgage interest rates remained on a record high plateau through most of 1970, despite substantial softening of rates in some other sectors of the credit market. The average effective rate on conventional mortgages was 8.4 percent in November 1970, down only slightly from the August peak and above the 8.1 percent rate of a year earlier. But further easing of rates, and of other mortgage terms, appeared to be developing.

Some mortgage lenders reduced "prime" rates. Others cut mortgage loan fees. In addition, lenders once again were granting 80-percent loans for terms as long as 25 and even 30 years.

Easier conditions in the home mortgage market were underscored by the December 1 rollback of the maximum contract rate on FHA and VA home loans from 8.5 percent to 8 percent. Some lenders were making FHA and VA loans at the lower rate ceiling without the deduction of "points," which had been charged earlier in the year.

Credit stringency has not been the only factor discouraging home purchases. Increases in construction costs, land prices, taxes, and insurance in recent years may have been as significant as higher interest rates in raising the monthly payments required to service mortgage loans. Nevertheless, analysts of the housing market predict total starts in 1971 of 1.6 to 1.8 million. Probably, a further reduction will occur in the average home size. A long-term trend toward larger units was reversed in 1970, partly because of the smaller units built under newly available government subsidies.

Public construction is expected to be substantially higher in 1971. Utilities also probably will spend more. Recent trends in construction contracts for manufacturing and commercial structures, however, suggest a decline for those categories.

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Agricultural developments

Net farm income edged lower in 1970. Sharp gains posted earlier in the year were offset in the second half because of a rapid decline in commodity prices and a steady rise in production costs.

In December, the index of prices received by farmers for all commodities was nearly 7 percent below a year earlier, and 8 percent less than at the beginning of the year. Livestock prices, especially hog prices, dropped sharply during the year. Poultry and egg prices averaged well below the levels of the previous year. Dairy products, bolstered by high support prices, averaged slightly above the 1969 level. Crop prices were generally below 1969 levels in the early part of the year, but demand strengthened and prices rose sharply as the harvest was reduced by corn blight and drought.

Government payments to farmers slipped around 3 percent in 1970 from the $3.8 billion paid out in 1969. This was due mainly to reduced participation in the feed grain program.

Total gross farm income rose about 3 percent in 1970 from $54.6 billion in the previous year. Higher prices for most production items and larger quantities purchased, however, boosted total farm costs about 5 percent from the record $38.4 billion outlay in 1969. As a result, net farm income declined slightly to $16 billion compared with $16.2 billion in 1969.

Annual income per farm, on the other hand, rose to a record $5,740, reflecting the continued decline in the number of farms. Earnings of farmers from off-farm jobs also were up from 1969, although opportunities for such employment were more limited.

Crop production cut

Mainly in response to modifications in government programs, farmers increased the acreage planted to crops by about 1 million acres in 1970. The biggest increases were for acreage planted to feed grains—up about 3 million acres over 1969. Farmers in each of the district states boosted acreage planted to crops.

Early summer crop prospects pointed to a record harvest. But prospects deteriorated rapidly during the summer months. Dry weather in the Plains states and the spread of blight through the Corn Belt resulted, overall, in about a 3 percent cut in crop production from the 1969 record. Most of the reduction was accounted for by smaller feed grain output, principally corn.

Corn production dropped more than 10 percent in 1970. Illinois, Indiana, and Iowa —which normally produce over half the corn crop—accounted for about three-fifths of the total reduction in the U. S. corn crop.

Prices of corn rose sharply in the fall as the extent of the blight damage became apparent. By mid-December, average farm prices for corn were a fourth more than a year earlier. While higher prices more than offset the reduced production overall, the effect was uneven. Returns to farmers in many areas of the district were severely curtailed by reduced output, even though prices were higher.

With less corn available, demand for wheat for animal feeding strengthened. Export demand also was relatively favorable. Coupled with slightly smaller wheat supplies, increased

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demand caused wheat prices to advance during the year.

Soybean producers harvested a 1.1 billion bushel crop in 1970—up about 1 percent from 1969. The increase resulted mainly from larger planted acreage rather than greater yields. In Illinois, the leading soybean producing state, yields dipped about 3 bushels per acre—more than offsetting slightly expanded acreage. In Iowa and Indiana, yields were about the same as the year before, but larger acreage resulted in 2 percent larger production.

Soybean usage expanded during 1970 and prices rose. In mid-December, soybean prices at farm level were about $2.77 per bushel—around 50 cents per bushel higher than in 1969, and the highest for that time of year since 1966.

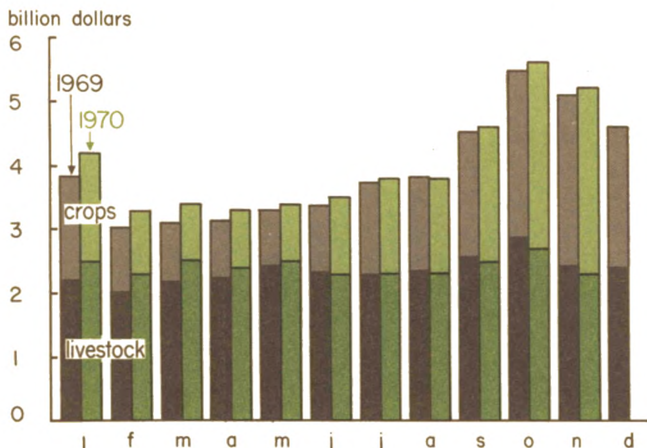
Meat production expanded

Livestock producers closed the year with returns falling and losses mounting. This situation had a widespread impact on the Seventh District, especially in the Corn Belt states where a relatively large portion of the income is derived from cattle and hog sales.

Pork producers suffered the greatest setbacks, especially in the second half. Total 1970 pork production was only slightly larger than in 1969, but all of the increase was in the second half, and most of that in the closing months. Monthly slaughter, July through December, averaged about 10 percent larger than in 1969. By contrast, the first half had shown a 6 percent reduction from a year earlier. Weekly slaughter reached 20-year highs during the late fall, and average hog prices dropped to the lowest level since 1965—more than $9 per hundredweight below the midyear level. Rising feed costs brought net returns even lower. Prices of hogs during the first half averaged around $25 per hundredweight—more than $2 above 1969.

Cattle feeders experienced a similar pattern of price movements, although to a considerably smaller degree. The margin of beef supplies over the previous year was relatively stable throughout 1970—averaging about 2 percent higher than in 1969. Prices for beef held close to year-earlier levels, but continued to drift lower throughout the entire year.

Cash receipts held above year earlier



Dairy farmers benefited from higher milk prices resulting from an increase in the government price support rate. Prices for milk for manufacturing averaged about 5 percent higher than in 1969, but consumer demand for dairy products continued to decline due to higher retail prices and increased use of substitute products. Milk production was slightly larger than in 1969, and the government had to remove about 5 percent of the total from normal market channels to maintain prices.

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Investments and credit

Total farm expenditures for buildings and equipment fell about 3 percent in 1970 from $6 billion in 1969. This was somewhat less than the estimated capital depreciation. Apparently, 1970 marked the third consecutive annual decline in net capital investment in agriculture.

Expenditures for most capital items were off sharply during the first half of 1970, but rose somewhat in the second half. Tractor purchases through October were about 5 percent under 1969. Increases in the third quarter of the year failed to offset sharp declines in the first half. Baler purchases were down 8 percent, while purchases of combines were about 3 percent lower than in 1969.

Prices of farmland weakened further in 1970, mainly because of continued tight credit conditions. Although pressures to enlarge farms remained strong, the volume of land transactions was reduced.

Bankers surveyed at the end of the third quarter reported lower land values in each of the district states, except Iowa. Land values in Iowa were reported to be about 1 percent higher than in the previous year.

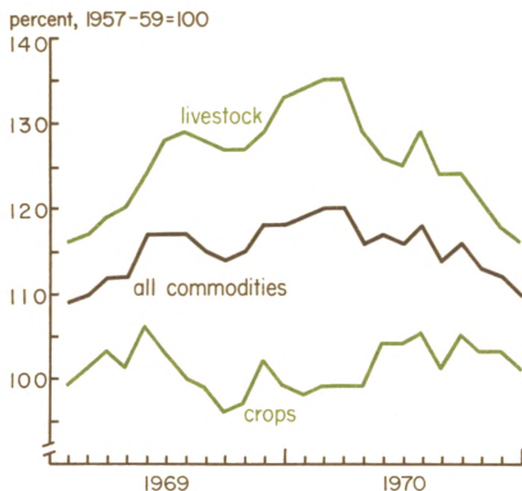
Total farm debt rose to around $60 billion at year-end—up about 8 percent during the year. Non-real estate debt outstanding accounted for most of the increase, although farm real estate debt also rose.

Individual sellers financed about three-fifths of the farmland transfers in 1970, compared with less than half in 1969. This reflects a higher proportion of sales on land contracts. Merchant-dealer credit extended to farmers also increased relative to the total, also reflecting reduced availability of credit from private institutions.

By midyear, production credit associations accounted for 30 percent of non-real estate credit extended by institutional lenders, compared with 26 percent in 1969. The share accounted for by commercial banks was 64 percent, down from 67 percent a year earlier. Federal land banks held about 40 percent of debt secured by farm mortgages at midyear, up from 38 percent a year earlier.

Shifts in farm credit sources during 1970 reflect general credit conditions. High interest rates, state usury ceilings, and economic uncertainties caused some private institutional lenders, especially insurance companies, to de-emphasize loans to agriculture.

Farm prices moved lower



Livestock and crop prospects

Most of the recent trends in production and prices of agricultural commodities probably will be extended well into 1971. More uncertainty than usual, however, prevails for the new year as a whole.

Consumer demand will be influenced largely by the degree of rebound in the general economy. Export prospects are clouded by moves toward more restrictive trade policies. Production and price prospects depend

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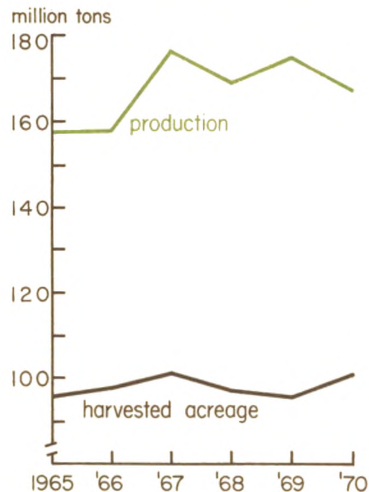
heavily on the effect of the 1970 corn blight on planting decisions and on the extent of the blight in 1971.

Livestock production is likely to be curtailed by the less favorable relationships between livestock and feed costs. Total meat supplies are apt to remain above the 1970 record level because of the time required for farmers to cut back their operations.

Although hog production will continue large through the first half of 1971, the second half may see a substantial cutback. Sow slaughter was well above year-earlier levels during the last months of 1970, indicating that curtailment of production was already underway. Reduced slaughter and higher prices may occur in 1971, especially late in the year.

Feed grain production curtailed by reduced yields



Beef production probably will be maintained near the 1970 level. Marketings of fed cattle probably will be larger in the first half of 1971 than in 1970, reflecting larger numbers now on feed. Second half beef output will depend largely on the number of cattle placed on feed in the first half of 1971. But a larger feeder cattle supply and ample feedlot capacity suggest a further rise in marketings throughout 1971. High feed costs, which could reduce feeding activity, may be reflected in reduced slaughter weights.

Cow slaughter is likely to continue to decline as beef cow herds are expanded and dairy herds are culled less rigorously. Coupled with reduced calf slaughter, this could hold beef production close to the 1970 level. Prices probably will recover from current levels, but are likely to average under highs of 1970.

Milk production should hold close to the 1970 level as increases in output per cow about offset the trend to fewer cows. Prices farmers receive for milk will average close to 1970 levels, assuming no change in federal support of dairy prices.

Many observers of the grain markets expect the strong demand and price situation that prevailed this past year to continue through 1971. Perhaps there are reasons for a more cautious outlook. Demand may weaken while supplies expand.

In the past year, demand for feed grains and soybean protein meal was stimulated by favorable livestock-feed price ratios, and by substantial increases in livestock numbers both in the United States and abroad. The current situation is markedly different; livestock prices have declined sharply while feed prices are higher, making such ratios con-

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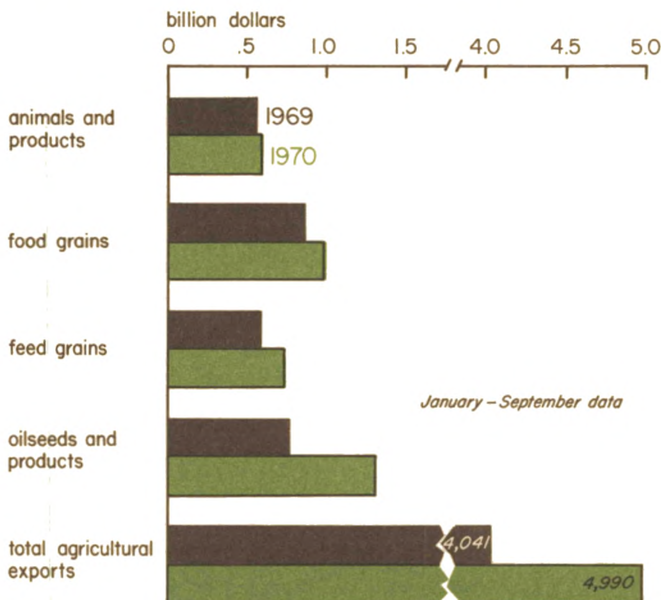
siderably less favorable. In the past, unfavorable ratios have resulted in less demand for feed than livestock numbers alone would indicate. At higher prices, less feed is used per animal.

Grain producers rely heavily on foreign markets. Exports expanded sharply in 1970, but current higher price levels may dampen foreign demand in the months ahead.

Production of grains in 1971 is likely to have a greater impact on prices than usual because surplus stocks of most major grains have been reduced. For the first time in years, an across-the-board decline in carryover stocks is anticipated for feed grains, wheat, and soybeans. Both high prices and the 1971 government programs will encourage sizable expansion in crop acreage.

Agricultural exports up sharply



The "set-aside" provision of the government's new farm program will increase farmers' ability to expand corn and other feed grain acreage in 1971. Recently announced guidelines for program participation could markedly curtail the number of idle acres. Around 16.5 million acres are tentatively expected to be diverted ("set-aside") from corn and sorghum production in 1971, compared with the 37.5 million feed grain acres diverted under the 1970 program.

Farmers have demonstrated their ability to expand crop acreage rapidly. In 1967, high grain prices and government encouragement resulted in an 18 million acre expansion in planted acreage. Yields that year approached record levels—boosting total production to a new high. Current—and very tentative—estimates indicate that corn acreage will be increased by about 4 million acres in 1971.

Expansion in crop acreage in 1971 will lead to further advances in farm production expenses. More planting and harvesting equipment, more fertilizer, insecticides, pesticides, and seed probably will be purchased. As a result, credit needs and associated interest expenses are likely to increase.

A large increase in production outlays will again work to offset any gains in cash receipts from the sale of crops and livestock. Some current estimates indicate that government payments to crop farmers will be curtailed by as much as $500 million—the degree depending upon final program arrangements and level of participation. Thus, the outlook for net income that will be realized by farmers in 1971 is less favorable than it has been in several years.

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Trade and the payments balance

Foreign trade of the United States increased sharply in 1970. Both exports and imports rose to record levels. In the first nine months of the year, exports were up 17 percent, and imports were up 11 percent from the same period of 1969. Because of the volume of trade lost and never regained due to the dock strike in 1969, the gains posted for 1970 are somewhat inflated. Nonetheless, the 1970 increases were far in excess of the 5 percent rise in the gross national product. It should be noted, however, that export volume which increased rapidly during the first half of the year leveled off in the second half; import volume continued to increase during the second half.

Strong foreign demand, especially from western Europe and Japan, resulted in gains in shipments of foods and feeds, industrial supplies, and capital goods in 1970. These three categories in recent years have accounted for about 80 percent of U. S. exports. Automobile exports in the January-September period about equaled the total for the same period a year earlier. Consumer goods exports showed a gain of 6 percent, entirely attributable to a rise in nondurable consumer exports.

Soybean exports in the first three quarters of 1970, mainly grown in the Midwest, were up 80 percent from the same period of 1969. Exports of iron and steel products increased 60 percent, continuing a marked advance that began in 1969. During the earlier 1960s, iron exports were stable. Shipments of steel scrap, coal, and pulp and paper were all strong. Foreign demand for steel, however, weakened appreciably in the final months of the year as world supplies eased.

A 20 percent rise in capital goods exports was paced by civilian aircraft, up almost 30 percent; and computer and office equipment, up 50 percent. This rise in aircraft shipments reflected deliveries of large, new transports.

Substantial gains in imports in 1970, as much as 20 percent, were recorded for foods and feeds, capital goods, and consumer goods. These categories comprise about three-fifths of U. S. imports. Among individual commodities, the largest increases in imports were for coffee, iron ore, motorcycles, electrical machinery, textiles, and apparel.

Although the U. S. trade balance improved in 1970 to an estimated $2.8 billion from about $1 billion in both 1968 and 1969, it nevertheless remained far below the 1964 total of $7 billion, the peak for the decade. The trade surplus did not improve throughout the year. The excess of exports over imports was smaller in the second half of 1970

Foreign trade surplus increased in 1970

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than in the first half. Moreover, the trade surplus was not of sufficient size to comfortably support the nation's overall balance-of-payments position which includes international financial flows, direct investments abroad, and military outlays abroad.

Declining prices on the U. S. stock market in the early part of 1970, coupled with high interest rates abroad, resulted in a slowdown of foreign investments in the United States. In the second half of the year, the U. S. stock market decline was reversed, and foreign purchases of stock picked up. It is unlikely, however, that the total inflow of foreign capital funds in 1970 will equal the record levels of 1968 and 1969. Meanwhile, flows of U. S. funds into long-term investment abroad continued at high rates, particularly in the form of direct investments.

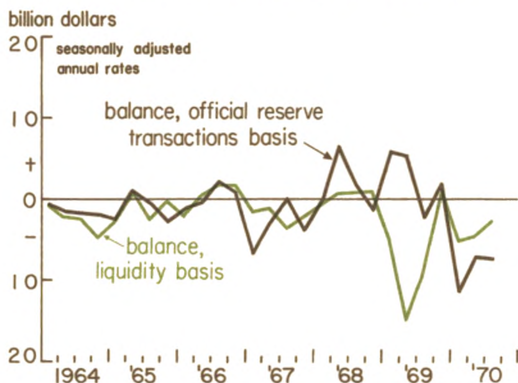
The balance of payments

The two alternative measures of the U. S. balance of payments gave conflicting answers in 1970. On the "liquidity" basis, a deficit of $3.3 billion was estimated for the first three quarters, much improved from the $7.4 billion deficit recorded for the year-earlier period. But the "official transactions" basis for calculating the balance of payments showed a deficit of $6.5 billion for the first three quarters, compared to a surplus of $2.2 billion for the 1969 period. Unfortunately, both measures of the balance-of-payments position were distorted in 1970 by special transactions.

The liquidity balance is intended to measure potential pressures on the dollar that result from changes in short-term liabilities to all foreigners, private and official. The deficit so calculated was inflated substantially in 1969 by U. S. funds flowing into the Eurodollar market. In large part, these funds were simultaneously "returned" as U. S. banks borrowed Eurodollars. Also, certain transactions with foreign governments resulted in a shift of officially held funds from the nonliquid to the liquid category, which worsened this balance. As a result, the liquidity deficit in 1969 greatly overstated the deterioration in the nation's international liquidity position. In 1970, on the other hand, the liquidity deficit was understated to some extent because foreign governments shifted funds from liquid assets to "near-liquid" assets that are not counted as short-term liabilities.

The other calculation of the balance-of-payments position, based solely on official transactions, is intended to measure more immediate pressures on the dollar in the foreign exchange markets. This measure was greatly affected in 1969 and 1970 by movements of funds between official holders and private Eurodollar market participants, and also by shifts of officially held dollars between the United States and the Eurodollar market. In 1969, shifts from official to private owners, under the impetus of heavy demand for Eurodollars by U. S. banks, caused

U. S. balance of international payments remained in deficit



Note: Data for first three quarters of 1970 include allocation of special drawing rights.

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this measure to show a surplus. In 1970, as Eurodollar borrowings were repaid by U. S. banks, dollars returned to official holders. This development resulted in a very large deficit in the official transactions measure.

Stripped of unusual developments, the nation's balance of payments in 1970 showed only a modest improvement, compared with previous years. Looking ahead to 1971, it appears that problems of management of the balance of payments will continue to require the close attention of responsible authorities.

Government finance

Demands for public services outpaced lagging revenues in 1970. Despite economy moves, total purchases of goods and services at all levels of government exceeded $220 billion —up 4 percent from 1969.

Federal purchases of goods and services declined about 2 percent to $100 billion in 1970, the first year-to-year drop since 1960. A reduction in defense spending more than offset increases in other sectors. Total federal expenditures—including transfer payments, grants-in-aid to state and local governments, and interest—increased in 1970 by some 7 percent, but at a slower rate than in other recent years.

Purchases of goods and services by state and local governments exceeded $120 billion, a rise of 9 percent from 1969. This was the smallest rise since 1964, and included relatively larger increases in pay scales for employees than in earlier years.

Financial problems of state and local governments in 1970 partly reflected changes in the status of the population. The number of people in schools and colleges, the number of retired people, and the number of welfare recipients all increased more than the population as a whole. These groups consume a large share of public services, while providing a relatively small share of public revenues.

Of the dependent groups, those receiving public assistance were most responsible for upward pressures on government expenditures. At midyear, 12.4 million people were beneficiaries of welfare payments, almost 20 percent more than a year earlier. Most of the rise was accounted for by people covered by the Aid to Families with Dependent Children program (known as AFDC). More than half of the funds for this program are provided by the federal government. At least two-thirds of the people receiving public assistance are under AFDC.

Federal grants-in-aid to state and local governments of all types were up 22 percent from a year earlier in the third quarter of 1970. These grants, which include outlays for highways, urban renewal, education, and welfare, account for about one-fifth of all state and local government receipts.

Rising revenues

Tax collections of state and local governments reached a record annual rate of $101 billion in the third quarter of 1970, 10 percent more than the rate of a year earlier. Property tax revenues—the mainstay of local governments—increased about as much as total revenues in 1970. Individual income tax receipts rose somewhat more than total rev-

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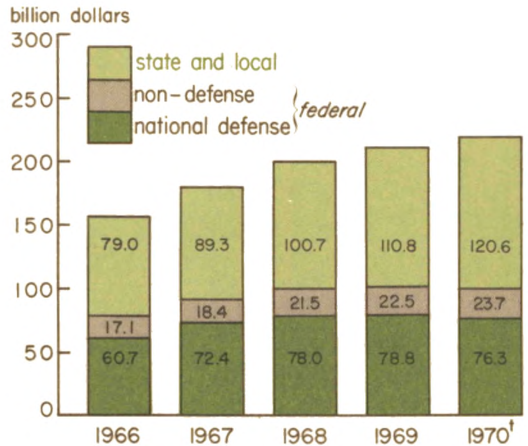
enues, while the rise in receipts from motor fuel taxes and license fees was somewhat less.

Legislation enacted in 1969 helped boost state and local tax collections in 1970. In Illinois, personal and corporate income taxes were in effect for a full calendar year for the first time in 1970. In Wisconsin, the sales tax base had been broadened. Motor fuel tax rates had been raised in Illinois and Indiana.

Although relatively few changes in state tax structures were enacted in 1970, certain significant revisions were made. In Michigan, coverage was broadened for both the personal income tax and the sales tax. In Iowa, a new franchise levy on financial institutions was imposed. Late in the year, Illinois voters approved a new constitution embodying a more flexible revenue article.

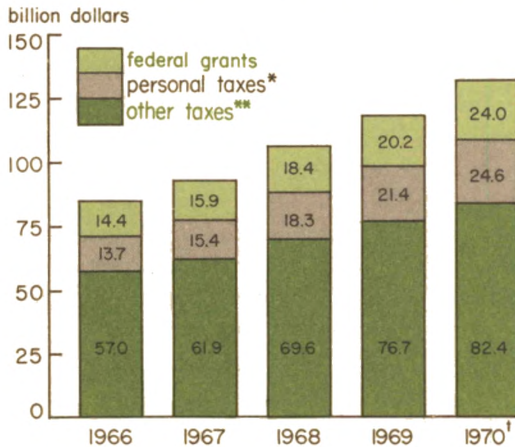
Defense cutbacks slowed the rise in total government outlays



†Estimate.

Note: Figures within bars are in billion dollars.

State and local revenues from all sources increased in 1970



*Payments on income, personal property, and inheritance taxes. Also fines and fees paid by individuals.

**Accrued liabilities of businesses to state and local governments, including sales and excise taxes. Also all real property taxes whether paid by businesses or individuals.

†Estimate.

Note: Figures within bars are in billion dollars.

Sharp rise in debt

Some public programs, especially building projects, were delayed by high interest rates in 1970, but not so frequently as in 1969. Rates on new issues of long-term, tax-exempt municipals exceeded 7 percent in June, a record high. By December, the rate had slipped below 6 percent.

Many state and local bond issues could not be marketed in 1969 because of legal ceilings on rates. As a result, such restrictions were modified, or suspended, in a number of states that year. Included were Illinois, Indiana, Michigan, and Wisconsin. Iowa provided for a higher ceiling rate in April 1970.

State and local governments sold close to $18 billion of long-term securities in 1970, up almost 50 percent from 1969 and a new

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record. Seventh District states sold about $2 billion of long-term securities last year. On a per capita basis, the volume of security issues sold by public bodies in Michigan and Wisconsin was above the national average. In Illinois, Indiana, and Iowa, per capita sales were well below the national average.

While long-term financing by state and local governments increased in 1970, short-term financing declined from the record level of 1969. The increase in outstanding short-term debt was about $3 billion, compared to $4 billion in the previous year.

Commercial banks were the major purchasers of municipal securities in 1970, especially of the shorter maturities. Banks, as a group, had added only a small amount of these securities to their portfolios in 1969 because of heavy demands upon their resources from other borrowers.

Money and banking

Federal Reserve policy in 1970 was designed to achieve two principal goals: to halt and reverse the decline of the economy that began in the second half of 1969, and to moderate the rapid pace of price inflation. By year-end, there was growing evidence of progress toward each of these objectives.

The easier monetary policy adopted early in 1970 encouraged accelerated growth of the money supply and bank credit as banks were supplied with a more ample volume of reserve funds and obstacles to deposit growth were removed. Restrictions on the rates commercial banks could pay on time deposits were modified. As a result of these and other developments, banks reduced their reliance on nondeposit sources of funds.

In the final month of 1970, the money supply (currency and demand deposits in the hands of the public) averaged 5.5 percent above the December 1969 level. Quarterly gains during the year were relatively steady. In the second half of 1969, the money supply had increased at an annual rate of only 1 percent.

Time deposits rose throughout 1970, and were up 18 percent for the year. In 1969, time deposits had declined continuously, mainly because of a reduction in large certificates of deposit. By the end of July 1970, the 1969 loss had been regained.

Interest rates followed a mixed pattern in 1970. Short-term rates trended lower through most of the year and declined sharply in the second half. Long-term rates declined early in the first quarter, but then rebounded, reaching new highs about midyear. In the second half, most long-term rates drifted down. The decline was evident most clearly in the case of the highest-grade bonds.

Regulatory actions

In addition to providing reserves necessary to support moderate monetary growth, Federal Reserve authorities used their regulatory powers to enhance the effectiveness of monetary policy. In part, this entailed steps designed to: (1) permit banks to compete for money market funds more effectively, (2) restore more effective central bank control over bank liabilities, and (3) stimulate domestic economic activity without creating undue problems for the balance of payments position of the United States.

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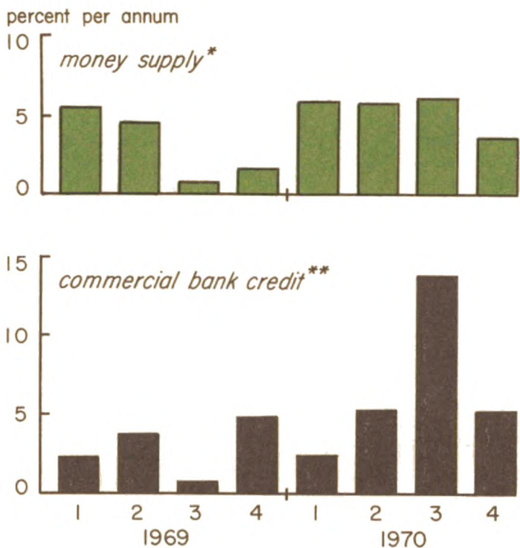
Rates of change in financial aggregates



*Seasonally adjusted currency and demand deposits held by the public.

**Seasonally adjusted loans and investments (including loans sold to affiliates after second quarter 1969).

Ceiling rates commercial banks could pay on time and savings deposits under Regulation Q were raised, effective January 21, 1970. The maximum interest rate payable on deposits of less than $100,000 with no specific maturity (mainly passbook savings) was raised from 4 to 4.5 percent. On large negotiable certificates of deposit, ceilings were raised by .75 to 1.25 percentage points, depending on maturities. These changes were designed to permit banks to compete for money market funds more effectively. Outflows of time deposits had occurred in 1969, when investors bypassed commercial banks to obtain higher yields through direct investments in the money and capital markets—a development termed "disintermediation."

On June 24, the ceiling on 30-89 day certificates of deposit in units of $100,000 or more was suspended indefinitely, giving banks freedom to attract funds in this form through the offer of competitive rates. The timing of this action was related to stringency in the commercial paper markets following the bankruptcy of the Penn Central Railroad. It enabled the banks to supply needed liquidity to some issuers of commercial paper who had difficulty replacing maturing notes because of a general deterioration of investor confidence.

On August 17, the Federal Reserve Board amended Regulation D to require a 5 percent reserve requirement on funds obtained by member banks through the sale of commercial paper by bank affiliates. A similar amendment had been proposed in the fall of 1969 when the sale of loans by large banks to holding company affiliates first became a significant factor. Together with the suspension of CD ceilings and the decline in market interest rates during 1970, this action resulted in a sharp reduction in sales of loans to affiliates and in related issues of commercial paper.

Outstanding bank-related commercial paper reached a peak of about $7.8 billion in July. By mid-December, only $2.6 billion remained outstanding. The effect on total reserves of the application of the 5 percent requirement to commercial paper was largely offset by a concurrent reduction, from 6 to 5 percent, in the reserve requirement for time deposits in excess of $5 million.

The discount rate was lowered from 6 to 5.5 percent in two steps late in 1970. Declines in market rates had gradually closed the wide gap between the discount rate and short-term rates that had existed since early 1969. The second discount rate cut, in mid-December, was paired with an increase from

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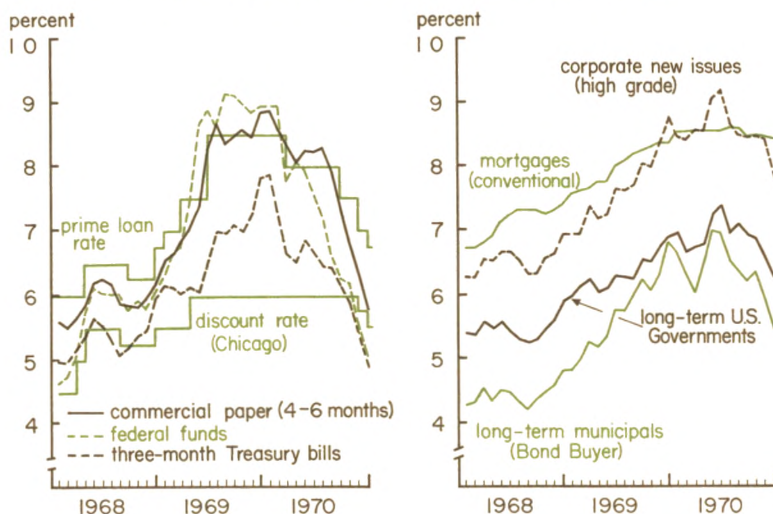
10 to 20 percent in reserve requirements against Eurodollar borrowings above the reserve-free base. The purpose of this action was to induce banks to retain their Eurodollar liabilities, the repayment of which would have a severe payments balance impact.

Interest rates declined from all-time highs



Note: Data are monthly averages, except discount and prime rates.

Interest rate trends

At the start of 1970, rates on federal funds and prime commercial paper were about 9 percent, and yields on three-month Treasury bills were about 8 percent—all at or near record highs. Yields on corporate, municipal, and U. S. Treasury securities also were at record levels.

Short-term rates declined sharply in the first quarter. After a brief uptrend in May and June, short rates declined again. By year-end, rates on all money market instruments except Eurodollars were below 6 percent. Treasury bill yields were below 5 percent.

In most long-term markets, yields also declined in the early months of the year despite a heavy volume of new issues. These rates rebounded, however, reaching new peaks near midyear. Thereafter, declines in interest rates were general. By September, average yields on governments, municipals, and corporates were below January levels. Near year-end, these rates were at the lowest levels since mid-1969.

Interest rate response to easier monetary policy typically occurs first in the short-term area. In 1970, declines in short rates partly reflected increased demand for liquid assets by financial institutions and by non-financial businesses seeking to reinvest funds raised in the capital markets.

Throughout 1970, the volume of corporate bond offerings was well above the record levels of 1969. For the year as a whole, total corporate offerings reached $38.5 billion, up 45 percent from the previous year. Bond issues by states and municipalities also were large, exceeding 1969 volume by 50 percent. Mortgage funds became more abundant in the second half, as inflows of funds to savings associations surged to record levels.

District banking

During 1970, experience of Seventh District banks generally paralleled national trends. In sharp contrast to 1969, banks increased investments, decreased use of non-

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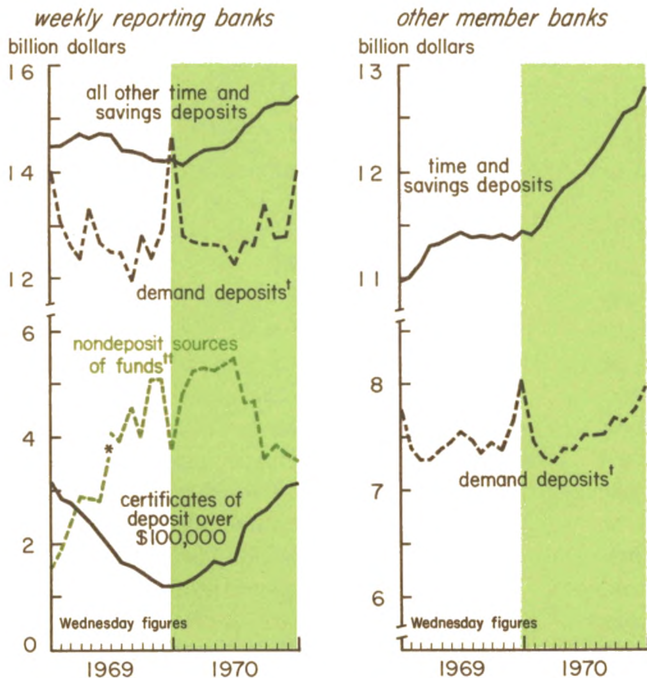
deposit sources of funds, and adopted less restrictive loan policies. These developments reflected both sharply rising deposits and reduced demand for loans. Total deposits of Seventh District member banks rose 11 percent in 1970, compared with a small decline in the previous year. For all member banks in the United States, deposits grew 12 percent in 1970.

Time deposits rose much faster than demand deposits in 1970. For all district member banks, time and savings deposits rose 17 percent, in contrast to a 6 percent decline in 1969. Demand deposits, adjusted to eliminate year-end distortions, rose about 5 percent.

Bank credit grew less rapidly than deposits in 1970. Total loans and investments of all district member banks increased about 7 percent, compared with less than 2 percent in 1969. Loans rose less in 1970 than in the previous year. Holdings of government securities increased in the second half, but remained well below the peak level of two years earlier. A much larger rise was reported for "other securities"—mostly municipals and U. S. agency issues. Altogether, securities accounted for 46 percent of the $4.5 billion gain in earning assets.

Time deposits rose rapidly in the Seventh District



*Series changed to include sources not previously reported.

†Adjusted for uncollected cash items.

††Includes Eurodollars and other borrowings, net federal funds purchased, and bank-related commercial paper.

Trends in assets and liabilities for all district banks often are heavily influenced by developments at the largest institutions. Because of their participation in the money market and because of the importance of their business loans, large banks are sensitive to changes in monetary policy and to changes in business activity. The largest district weekly reporting member banks (55 banks with deposits over $100 million) reported a 7 percent increase in assets in 1970, about the same as the 900 other member banks. Loan growth in the largest banks, however, was smaller and investment growth larger than at the other banks. But the most important development at the large banks was the change in the composition of their liabilities.

Deposits and nondeposits

The shifts in sources of funds of large banks in 1970 represented a return to normal chan-

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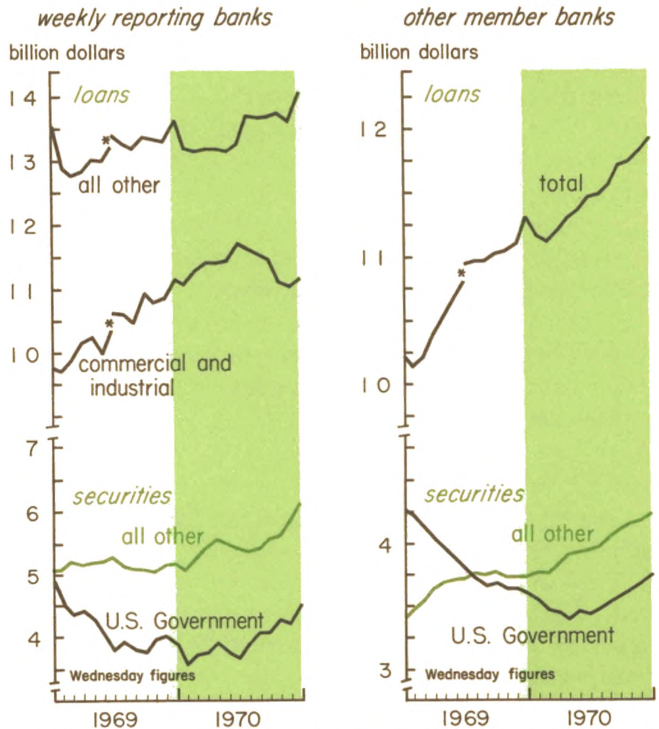
nels from the substitutes developed in the preceding period of restraint. The success of commercial banks in attracting savings and investment funds through rate competition and through the introduction of new time deposit instruments was a significant financial development of the Sixties. At large city banks, the principal instrument was the large denomination negotiable CD, designed to compete with existing money market instruments, such as commercial paper and short-term U. S. Treasury obligations.



*Change in series. Beginning with June 1969, WRB data also adjusted for loans sold to affiliates.

In 1969, Regulation Q ceilings prevented banks from raising offering rates on CDs in line with higher yields on other debt instruments. As a result, banks were unable to maintain the volume of their outstanding CDs. In the district, outstanding CDs declined by $2 billion, or about two-thirds, during that year. For very large banks, the major issuers of CDs, the drain was even more severe. In addition, personal savings balances suffered attrition in the second half of 1969.

To meet strong demands for loans in the face of declines in deposits in 1969, large banks borrowed from their foreign branches, entered into repurchase agreements, and borrowed federal funds (reserve balances) from other banks. Moreover, large banks transferred loans to their holding company affiliates. The holding companies raised the necessary funds by sales of commercial paper not subject to the Regulation Q ceilings. For all banks, funds acquired through these nondeposit sources in 1969 more than offset the decline in deposits.

This pattern was reversed in 1970. Excluding large negotiable CDs, time and savings deposits of the large weekly reporting banks increased from a January low of $14.1 billion to $15.4 billion by year-end. After the January boost in the rate ceilings, growth in these deposits proceeded at a fairly stable pace throughout the year.

Negotiable CDs issued by large banks rose moderately during the first six months of 1970, and increased sharply in the third quarter. In July, following the suspension of rate ceilings on short-term negotiable CDs, outstandings at district banks jumped $600 million—more than the gain in the first half

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of the year. After July, the rate of increase slowed somewhat. As market interest rates declined and needs for funds eased, banks lowered their offering rates on CDs and lengthened the maturities of new issues.

As deposits rose in the second half of 1970, large district banks reduced nondeposit liabilities. Of the $2.4 billion increase in total district deposits, about $2 billion was used to repay nondeposit liabilities.

Most district banks with less than $100 million in deposits did not experience a deposit drain in 1969, and were not under pressure to seek alternative sources of funds. These banks reported a large rise in time and savings deposits, 12 percent, in 1970.

Asset composition

Commercial and industrial loans increased at large Seventh District banks during the first half of 1970. Including transfers to affiliates, loans reached a peak at midyear. As demand slackened in the second half of the year, outstanding loans declined, contrary to the usual seasonal pattern.

Reduced demand for loans, coupled with falling interest rates in the money and capital markets, resulted in a series of reductions in the prime rate charged by large banks to their most credit-worthy customers. From a record high of 8.50 percent, in effect from mid-1969 to February 1970, the prime rate was reduced to 6.75 percent by year-end. Three of the four cuts in the prime rate were made after mid-September.

Real estate loans outstanding at district banks declined in the first half of 1970. The downtrend was reversed in the second half. For the entire year, real estate loans increased less than 1 percent, compared with a 7 percent rise in 1969. Consumer instalment loans increased less than 3 percent in 1970, about the same as in 1969.

Loans to nonbank financial institutions during the early part of 1970 were below the levels for the same period of 1969. These loans rose sharply in July when the market became less receptive to commercial paper offered by finance companies.

Growth in total loans was larger proportionately at banks with deposits of less than $100 million in 1970. These banks hold relatively fewer business loans than the largest banks and relatively more real estate and consumer loans. As a result, loan portfolios of these banks do not show the same volatility as those of the largest banks. Loans of the under $100 million banks rose 5 percent in 1970, compared with about 3 percent for the largest banks. In 1969, loans of these banks increased 12 percent.

Loan statistics exclude sales of federal funds. This is significant because country banks have supplied a large portion of the funds borrowed by city banks in this market the past two years. At the end of 1970, total federal funds supplied by the under $100 million banks amounted to more than $700 million, about 6 percent of their gross loans. During most of the past two years, banks with surplus funds have found the Fed funds outlet highly attractive. Favorable returns are available on these risk-free, overnight loans. City banks stand ready to buy federal funds in relatively small amounts from their smaller correspondents.

After reaching a low near midyear, bank holdings of government securities increased. The uptrend restored part of the decline in liquid assets that occurred in the previous two years. Increases in holdings of municipals accounted for the largest share of the rise in bank investments in 1970. Strong bank demand resulted in rising prices and lower yields for these obligations late in the year, in the face of a heavy volume of new issues.

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Investments in securities comprised 23 percent of total assets of the large weekly reporting banks at year-end, up from 21 percent at the start of the year. At other Seventh District member banks this ratio was the same, 33 percent, as a year earlier.

For Chicago reserve city banks the ratio of loans to collected deposits was about 85 percent at the end of 1970—down from the peak of more than 96 percent reached in the fall of 1969, but higher than at any time prior to 1969. The ratio declined because deposits replaced other liabilities, but also because of purchases of securities. For district country banks, the loan-to-deposit ratio was about 60 percent at year-end, higher than a year earlier but slightly below the peak level reached in the spring of 1970.

Recovery ahead

Business activity, as measured by real gross national product, reached a peak in the third quarter of 1969. Declines in real GNP occurred in the fourth quarter of 1969 and in the first quarter of 1970. In the second and third quarters of 1970, real GNP rose slightly, although industrial production declined further. It was hoped, and generally expected, that the fourth quarter of 1970 would provide convincing evidence that a broadly based recovery was underway. This was not to be.

The General Motors strike idled more than half of the nation's motor vehicle production from mid-September to mid-November. Far-reaching side effects of the strike also were noted. Producers of materials and components for motor vehicles, transportation firms, and auto dealerships were forced to lay off employees. As incomes were reduced, family purchases of goods and services were drastically curtailed.

Although the auto strike dashed hopes for a strong upturn in the fourth quarter, much of the lost production and sales will be recovered in 1971. Abstracting from the auto strike, it appears that most other types of activity remained sluggish in the fourth quarter. Defense cutbacks continued, orders for producer equipment declined further, and consumers remained very cautious on purchases, especially of big-ticket items.

Surveys of consumer and business attitudes taken in late 1970 indicated a sustained, perhaps a growing, apprehension concerning future prospects for income and profits. With more ample funds available in late 1970, interest rates declined, but lenders continued to screen the quality of loan applications closely. Like consumers and business firms, financial institutions were anxiously rebuilding liquidity positions. Longer-term credits typically were avoided by commercial banks.

Seldom before since World War II has economic psychology deteriorated so markedly as in 1970. The shift in attitudes was much more pronounced than declines in measures of activity. The reason was that the inflation euphoria, and confidence in a new era of full employment, rising incomes, and favorable profit margins that developed in the late 1960s was abruptly dissipated. Markets for labor and goods became intensely competitive in many sectors.

Beginning in 1965, and continuing through most of 1969, the nation experienced a prolonged period of rapidly expanding demand.

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Even the modest adjustment of late 1966 and early 1967 contributed to the buildup of confidence because declines in affected sectors quickly halted and reversed. The failure of the federal tax increase, enacted in mid-1968 to slow private expenditures, quickly also contributed to faith in the invulnerability of the economy to recessionary forces.

In 1969, reductions in defense procurement and stringent economies on other federal programs were accompanied by monetary policy actions designed to restrict growth of money and credit. Restrictive monetary and fiscal policies were designed to cool an overheated economy by reducing excess demands on limited resources. Only in this manner could the upward spiral of prices and wages be brought under control.

Everybody was unhappy with the accelerating rise in the price level. Everybody thought something should be done about it. It was inevitable that restrictive measures would bring painful consequences to some sectors. But the length of the period of transition to more stable growth had not been generally foreseen.

Throughout 1970, monetary policy was designed to encourage a moderate growth in the supply of money and credit. The 10 percent income tax surcharge, enacted in 1968, was removed in two steps—half at the start of the year and half at midyear. Some types of federal spending increased, especially social security payments and government wages and salaries, as a result of new legislation.

The uptrend of the economy retained substantial momentum until the fourth quarter of 1969, long after restrictive measures had been applied. Similarly, the sluggish economy of 1970 stubbornly resisted measures intended to stimulate activity. Nevertheless, the economy appeared to be responding grudgingly. Late in 1970, some types of activity were rising again, and the rate of price inflation had moderated. The stage was set for a broadly based recovery in 1971.

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