FEDERAL RESERVE BANK
BUSINESS REVIEW
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THE SECURITIES BUSINESS AND CONSCIOUSNESS III

RECOVERY FROM AN INFLATIONARY RECESSION

REGIONAL ECONOMY SLIPS IN '70

ANNUAL OPERATIONS AND EXECUTIVE CHANGES

JANUARY 1971

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The Securities Business and Consciousness III*

by David P. Eastburn, President
Federal Reserve Bank
of Philadelphia

A person reading the financial pages these days might get the impression that the securities business—or some parts of it, at least—is in trouble. Failures have raised doubts about how adequately brokerage houses are capitalized and how well the industry is regulated. There is criticism of the commission structure. The "third market" is a continuing threat to the establishment. And the industry is arguing among itself.

I am not competent to analyze these problems and do not intend to talk about them. Instead, I should like to look into a development which could have even greater impact than these problems on your industry. This is criticism of the business by those—mainly young people—who are expressing an active concern about social justice and the quality of life. In fact, I am surprised that your industry has so largely escaped such criticism. After all, for those who profess to believe in pursuit of the good life rather than the buck, the securities industry would seem to be a logical target. Considering the problems of our times, buying and selling securities, analyzing market trends, determining resistance levels and breakthroughs might seem to them rather frivolous and unproductive ways to spend one's time.

There is, of course, a rationale for securities markets and for those who work in them that makes good economic sense and is socially acceptable. What I want to do this evening is: (1) to spell out this rationale as I understand it; (2) to view this rationale (as nearly as I can) through the eyes of socially concerned youth; (3) to suggest some implications of this view. At all times I am speaking as an outsider to the industry. As such, I bring to the subject no special expertise but, hopefully, some objectivity. And I am not so much interested in preaching conclusions of my own as in raising questions to think about.

RATIONALE FOR SECURITIES MARKETS

Let me now spell out in very simplistic

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terms the traditional economic role of the securities markets. The most important one is to help allocate scarce resources. Conglomerated Computers Corporation needs money to build a new safety pin factory and, through an underwriter, enters the new-issue market where it competes with others in need of funds. Investors—intermediaries like insurance companies as well as individuals—make decisions about whether to buy and at what price. Behind all of the financial trappings of this operation is a transfer in the command over real resources. Conglomerated Computers gets the wherewithal to buy materials and hire labor. And in all of this, the security analyst plays a key role.

Only a small proportion of securities transactions, of course, involves shifts in the command over real resources; most of them involve trading in outstanding issues. There is a close relationship between trading in secondary markets and raising new capital; if investors like Conglomerated Computers and are willing to pay a high price for its stock, the corporation finds it easier to raise new money. But the main function of secondary markets is to provide liquidity. A good market for Conglomerated enables an investor to get out easily if he needs cash or wants to switch to IBM.

In the process of performing their economic role, securities markets respond to needs of society. When Conglomerated Computers raises funds to build its factory, it is responding to (or anticipating) a need for its product. If analysts and investors think the outlook for Conglomerated is good, they facilitate the shifting of real resources necessary to help meet society's needs.

Again, this is a greatly oversimplified description of the traditional role of securities markets and security analysts. But I think it is sufficient for us to take the next step and examine how the young person concerned with social matters might look at the same process.

CONSCIOUSNESS III

Perhaps the most up-to-date description of the state of mind of today's young people is that by Charles Reich in *The Greening of America*. Reich calls this state of mind Consciousness III.

Consciousness I, he says, is the traditional outlook begun in the 19th Century and held by the farmer, small businessman, and worker. It was a simple, human view of the role of the individual. Consciousness II describes the values of organizational society in which the "corporate state" dominates everything. These are the values of a non-human, technological, self-seeking, consumeristic society.

Consciousness III began in the mid-1960's. It is a new view of the promise of life but, at the same time, a disillusionment with existing conditions. It emphasizes the "discrepancy between what could be and what is." Those who hold this view stress human rather than material values, quality rather than quantity, emotion rather than reason, technology as servant rather than master. They feel "full personal responsibility" to take action in matters that need reform. However, according to Reich, reform will not take place through violence or politics, but "revolution by consciousness." In other words, the kids either will convert the rest of us or, in any case, will soon take over anyway.

How might a young person taken with Consciousness III react to traditional rationale for the securities industry? He could do no better than to go back three and a half decades for another view of the way the markets work. This he could find in that landmark of economics which you are all familiar with—Keynes' *General Theory*. Keynes, who as you know was no babe in the woods when it came to making a killing in the markets, had this to say:

> It might have been supposed that competition between expert professionals, possessing judgment and knowledge beyond that of the average private investor, would correct the vagaries of the ignorant indi-

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vidual left to himself. It happens, however, that the energies and skill of the professional investor and speculator are mainly occupied otherwise. For most of these persons are, in fact, largely concerned, not with making superior long-term forecasts of the probable yield of an investment over its whole life, but with foreseeing changes in the conventional basis of valuation a short time ahead of the general public. They are concerned, not with what an investment is really worth to a man who buys it "for keeps", but with what the market will value it at, under the influence of mass psychology, three months or a year hence. . . .

Thus the professional investor is forced to concern himself with the anticipation of impending changes, in the news or in the atmosphere, of the kind by which experience shows that the mass psychology of the market is most influenced. . . . The social object of skilled investment should be to defeat the dark forces of time and ignorance which envelop our future. The actual, private object of the most skilled investment to-day is "to beat the gun", as the Americans so well express it, to outwit the crowd, and to pass the bad or depreciating, half-crown to the other fellow.
. . . it is, so to speak, a game of Snap, of Old Maid, of Musical Chairs—a pastime in which he is victor who says *Snap* neither too soon nor too late, who passes the Old Maid to his neighbour before the game is over, who secures a chair for himself when the music stops. These games can be played with zest and enjoyment, though all the players know that it is the Old Maid which is circulating, or that when the music stops some of the players will find themselves unseated.

. . . .

If the reader interjects that there must surely be large profits to be gained from the other players in the long run by a skilled individual who, unperturbed by the prevailing pastime, continues to purchase investments on the best genuine long-term expectations he can frame, he must be answered, first of all, that there are, indeed, such serious-minded individuals and that it makes a vast difference to an investment market whether or not they predominate in their influence over the game-players. But we must also add that there are several factors which jeopardise the predominance of such individuals in modern investment markets. Investment based on genuine long-term expectation is so difficult to-day as to be scarcely practicable. He who attempts it must surely lead much more laborious days and run greater risks than he who tries to guess better than the crowd how the crowd will behave; and, given equal intelligence, he may make more disastrous mistakes. There is no clear evidence from experience that the investment policy which is socially advantageous coincides with that which is most profitable.

. . . .

. . . The measure of success attained by Wall Street, regarded as an institution of which the proper social purpose is to direct new investment into the most profitable channels in terms of future yield, cannot be clamied as one of the outstanding triumphs of *laissez-faire* capitalism—which is not surprising, if I am right in thinking that the best brains of Wall Street have been in fact directed towards a different object.

In effect, Keynes in the thirties argued that the way in which the market was supposed to work in performing its two main functions—providing liquidity and allocating resources—was quite different from what really happens. It might provide liquidity for the individual investor but not for all investors combined, and preoccupation with short-run gains gets in the way of allocating resources according to long-run needs. Today, a casual glance around might suggest to our committed youth that "the best brains of Wall Street" are still pointed in the direction they were when Keynes observed them. Performance may not be quite the standard of success it was before recent chastening experiences, but it is still very much there. And, in contrast to the situation in Keynes' day, with the growth of mutual funds and other such investors, it has become deeply ingrained institutionally.

The young person imbued with Consciousness III might well question not only the ethics of spending one's adult life trying to beat the other guy but whether there is something an industry might do that is socially more productive. Is it all worth the millions of manhours poured into analysis?

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Do the sharp fluctuations in stock prices serve a worthwhile social purpose? And, behind it all, are real resources being directed to socially worthwhile uses?

IMPLICATIONS

I don't really know what all the implications (if any) of such an attitude might be, but let me suggest some possibilities.

Possibility #1. A belief that your industry is failing to perform a worthwhile social function could lead to the kinds of criticism which some other industries have felt recently and which is forcing reforms. The automobile industry has been criticized for disregarding auto safety; it has been responding. Utilities and others have been criticized for polluting the environment; they have been responding. If the securities industry is criticized, say, for favoring large institutional investors over small investors, or for undue secrecy in its operations, it too might have to respond. These and other kinds of criticism, of course, are coming from several quarters. But they might well be extended by another kind, directed toward the preoccupation of the industry with short-run gains and toward the impact on allocation of resources. The result of both kinds of criticism might be that the industry's freedom of action could be considerably more constrained in the future than it has been.

Possibility #2. An indifferent public could slow the growth of the securities industry. This might happen if, as today's youth take over the economy, they were to decide that analyzing, trading, and even investing in securities is really not worth all the time and effort it takes. At the same time, the industry might have difficulty recruiting enough interested people.

Possibility #3. Ways might be sought to guide the securities industry into what are considered more socially desirable directions. In recent years, young people have used their influence on universities to vote proxies with certain social ends in view. It is now fashionable to talk of the social responsibility of business; corporations are being urged to look beyond short-run profits to the longer run impact of their actions. Similarly, security analysts might be urged to pay more attention to social costs which certain industries may impose or social benefits which certain industries may confer. These costs and benefits would require analysts to develop unconventional accounting and analytical techniques.

Possibility #4. Government action (either by incentives or restraints) to deal with social problems might influence the profitability—in the *conventional* sense—of certain industries. The hope would be that if Government could take steps to induce corporations to undertake socially desirable action because it is *profitable* for them to do so, the traditional market process might be made to work better.

Possibility #5. Consciousness III may turn out to be limited to relatively few people or just a passing phase. In either case, there might be little or no impact on the securities industry at all.

CONCLUSIONS

Which of these possibilities do you prefer and what might the securities industry do to influence the outcome? First, you might be tempted to hope the problem will not amount to anything (Possibility #5). If you want to take this tack, I suggest the first thing to do would be to burn all copies of Adam Smith's *The Money Game*. I can imagine the dismay and indignation of a sincere Ralph Nader-type as he stumbles onto the book for the first time. Chapter 17 on "Losers and Winners" might hit him

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particularly hard. You may remember the part about Poor Grenville, the fund manager whose "nails are bitten down to the nubs" because he is in the awkward position of holding $25 million in cash with the market going up. It finally was decided that he should get

> . . . back in the market, $25 million in one big gulp. He bought a mixture of high flyers like Xerox, Polaroid, and garbage. And that was part of the reason for the roily-boily market we had a while ago. The cyclical stocks reflecting business were sold down all they would go. Then along came Poor Grenville and his gunslinger competitors selling stocks because stocks were going down, riding with the trend instead of against it. . . . When the gunslingers hit the volatile stocks, Fairchild and Xerox and Polaroid and what have you, they knocked them down so hard that the x's on the chart made downtrend lines and then the downtrend said sell, and then you just didn't want to show a bombed-out stock in your portfolio; it made you look dumb. So out went all the bombed-out stocks. Somebody has to be last at this sort of game.

Since I doubt if you can cover up all aspects of the game, you might be better advised to prepare yourself for some criticism (Possibility #1). Chances are already good that you will be reading headlines like: "Congressional Report Recommends Drastic Change in Commissions." But in addition, there could be others: "Students Stage Sit-in; Demand Voice in Running Stock Exchange." You may be harder pressed than ever before to justify your existence, to explain just how the pursuit of short-run capital gains helps solve problems of the poor, the city, and the environment.

As you prepare your case, I suspect you may find it difficult to show a clear and direct relationship between the search for profit and social welfare. (Possibility #3). One can argue, as many do these days, that, say, corporation investment in the ghetto is perfectly consistent with the profit motive if one takes the long view; corporations may not have any profits if they do not do something about the core city. But this solution requires such radical changes in orientation, in calculating profits, that it may be expecting too much.

Perhaps a more feasible approach is that in Possibility #4; that is, for the securities industry to work with Government in providing whatever inducements are necessary to make social action by business profitable even in the short run. If this can be accomplished, the securities industry might, with some modifications, still act in its traditional ways and come closer to meeting social needs. For example, suppose the Government were to devise means—say, by tax incentives—to make investment in anti-pollution devices profitable. Analysts would recognize this, the market would reflect the analysts' judgment, and shifts of resources to this kind of effort would be facilitated. There would be no need for business and analysts to make elaborate calculations of social costs and benefits, trying to factor them into their evaluation of securities, and then trying to convince everybody that a security is really worth something other than the market thinks it is.

Finally, to the extent you succeed in reexamining and justifying your reason for existence in today's world of social concerns, I suspect you can minimize Possibility #2—that is, a diminishing role in society. You may find gunslinger types like Poor Grenville becoming a rarer breed, and you may find fewer people on commuter trains preoccupied with the day's closings; but this is pure speculation. In any case, the industry should be on a sounder basis for growth if it can feel comfortable with itself that it is fulfilling a worthwhile social purpose and if it can make that purpose understood and acceptable to the people who, before very long, will be running things. ■

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Recovery From an Inflationary Recession

by Edward G. Boehne

Moving from the superheated, inflationary economy of the late 1960's to a more evenly paced and balanced economy of the 1970's has proved to be no easy task. Inflation is turning out to be less sensitive and unemployment more sensitive to a slack economy than previously hoped. With rising unemployment, therefore, the focus of policymakers has shifted over the past year from slowing down the economy to combat inflation to speeding up economic growth without sidetracking whatever disinflationary momentum there is.

This shift in emphasis raises two important questions: first, how rapidly can the economy recover without setting off additional rounds of inflation; and second, how long will it take to regain high levels of employment?

WHERE IS THE ECONOMY NOW?

After over a year of no growth, a sizable gap has opened up between what the economy actually produces and what it is capable of producing. In the upper part of Chart 1, potential GNP is represented by the straight, upward-sloping line. It slopes upward because the capacity of the economy to produce goods and services expands over time with the addition of more and better skilled workers as well as enlarged and more efficient plant and equipment. The jagged line represents actual output. It represents what consumers, business, government, and foreigners actually demanded from the economy. Over the past year, real output has remained essentially unchanged, largely because of restrictive monetary and fiscal policies of 1969. The result is a gap between actual and potential GNP of about $45 billion. As shown in the bottom panel of Chart 1, this growing gap has also meant swelling unemployment.

What kinds of growth rates in GNP, *real growth* rates that abstract from inflation, would it take to close the gap and bring the rate of unemployment down to 3.8 per cent? The chart shows three possibilities: closing the gap by the end of 1971, 1972, or 1973. For full employment to be restored by the end of '71, assuming average productivity gains and increases in the labor force, the economy would have to expand in real terms

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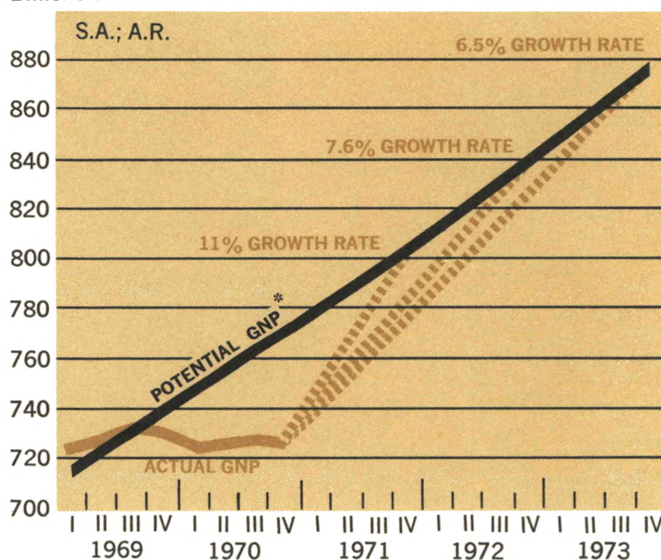
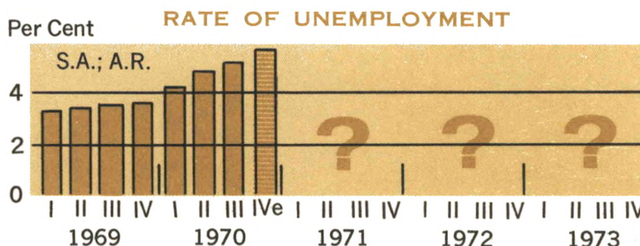
CHART 1

ACTUAL AND POTENTIAL GROSS NATIONAL PRODUCT (1958 DOLLARS)

A sizeable gap has opened up between what the economy actually produces and what it is capable of producing. As a result, the rate of unemployment has been rising. To close the gap and reduce the unemployment rate to 3.8 per cent in 1971 would require a whopping growth rate of 11 per cent. A more reasonable growth rate of 6.5 per cent would close the gap by the end of 1973.

Billions of Dollars





*Trend line of 4 per cent from 1st quarter 1969 to 4th quarter 1969, 4.3 per cent from 4th quarter 1969 to 4th quarter 1970, 4.4 per cent from 4th quarter 1971 and 4.3 per cent from 4th quarter 1971 to 4th quarter 1975.

e = estimated

Sources: Department of Commerce, The Council of Economic Advisors and the Department of Labor

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at a rate of 11 per cent; full employment by the end of '72 means a growth of 7.6 per cent; and closing the gap by the end of '73 implies a growth rate of 6.5 per cent. The answer appears simple enough: let's get on with getting the economy growing again, the sooner the better.

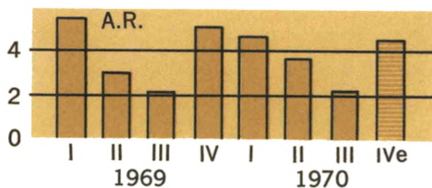
What About Inflation? The only reason for creating slack in the economy has been to unwind inflation. And the results so far of curtailing inflation have been mixed, modest, and certainly disappointing.

CHART 2

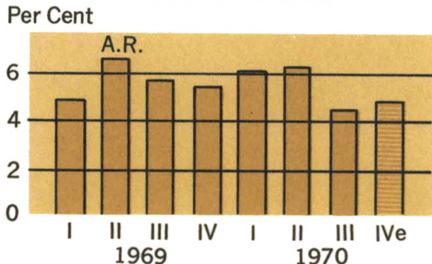
QUARTERLY CHANGES IN PRICES

Progress against inflation has been mixed, modest, and disappointing.

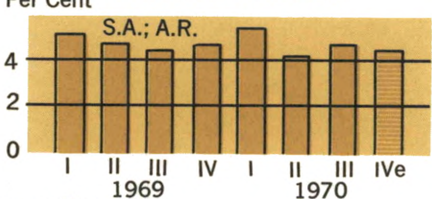
INDUSTRIAL WHOLESALE PRICES



CONSUMER PRICES



GNP PRICE DEFLATOR—PRIVATE SECTOR



e=estimated
Sources: Department of Labor and Department of Commerce

At the wholesale level, a basic indicator of inflation is the price index for manufactured goods. For the first three quarters of 1970, the rate of increase for industrial commodity prices trended downward, as shown in Chart 2. As in 1969, however, this trend was not sustainable through the fourth quarter. In part, this may reflect a normal seasonal pattern. Even on a year-to-year comparison, however, the price behavior of manufactured goods at wholesale is not encouraging.

Consumer prices have shown modest improvement in recent months. From a first half rate of over 6 per cent, the pace slackened to 5 per cent during the last two quarters of 1970. However, much of the improvement in the consumer price index stemmed from reductions in food prices. Further improvement, therefore, is threatened by adverse effects on food prices that may flow, for example, from the "corn blight."

A more comprehensive measure of inflation is the private GNP price deflator. This index measures the rate of inflation for the entire private economy and, in addition, reflects the changing composition of GNP. As can be seen in the bottom panel of Chart 2, little, if any, progress has been made during the last two years.

Why has inflation proved so stubborn to bring under control? One reason is that it is the worst inflation in two decades. It has been going on for over five years and has reached levels unsurpassed since the Korean War. The result is that inflationary expectations permeate the economy. Labor seeks wage increases which far outstrip productivity gains in an attempt to catch up with past inflation and to stay ahead of anticipated inflation. Most businessmen continue to bet that rising costs can still be passed along to consumers through higher prices. Lenders insist on an inflation premium from borrowers. So, once built into the fabric of the system,

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inflation is very difficult to purge.

Another reason inflation is not responding quickly to a slack economy is that the present slowdown is mild compared to previous recessions. In essence, the weakest remedy in over a quarter of a century is being used to combat the most severe inflation in 20 years. In hindsight, then, as we look back at 1970, we should not be surprised that inflation persisted as it did.

So, speeding up the economy in 1971 to reduce unemployment is complicated by inflation. Too rapid a recovery will accelerate inflation; too slow a recovery in '71 will mean even more unemployment. Is there a reasonable compromise?

A REASONABLE COMPROMISE

History provides some useful guidelines that suggest a reasonable compromise. First, when the economy operates above about 98 per cent of capacity, roughly a 4.5 per cent rate of unemployment, inflation begins to escalate. Second, as the economy approaches 98 per cent of capacity, high rates of growth, say, greater than 6 per cent, tend to be inflationary.

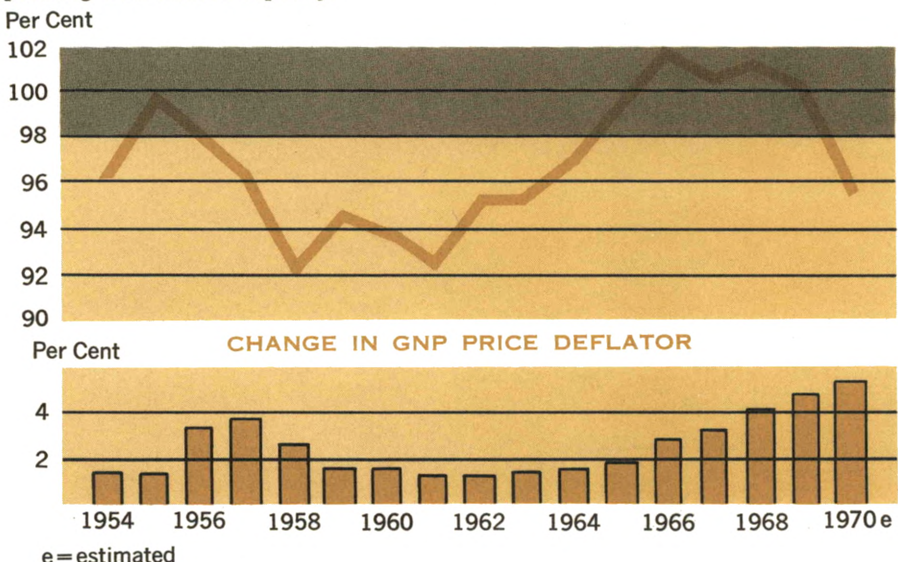
Chart 3 shows the relationship between capacity utilization and the rate of inflation. In the top part of the chart, the rate of capacity utilization, that is, actual GNP as a percentage of potential GNP, is shown. Low rates of utilization, such as occurred in the recession years of 1958 and 1961, are associated—usually with a lag—with periods of declining rates of inflation or periods of relative price stability. (See the lower part of Chart 3.) Conversely, periods of high capacity utilization, as in 1955-56 and 1965-69, are

CHART 3

CAPACITY UTILIZATION

(ACTUAL GNP AS A PERCENTAGE OF POTENTIAL GNP)

High rates of capacity utilization typically precede periods of escalating inflation. Also, declining rates of inflation follow—often with a lengthy lag—periods when the economy is operating with unused capacity.



Source: Department of Commerce and The Council of Economic Advisors

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associated—again, typically with a lag—with periods of escalating rates of inflation. So, experience seems to indicate that whenever excess capacity in the economy is less than 2 per cent, the pace of inflation is likely to speed up.

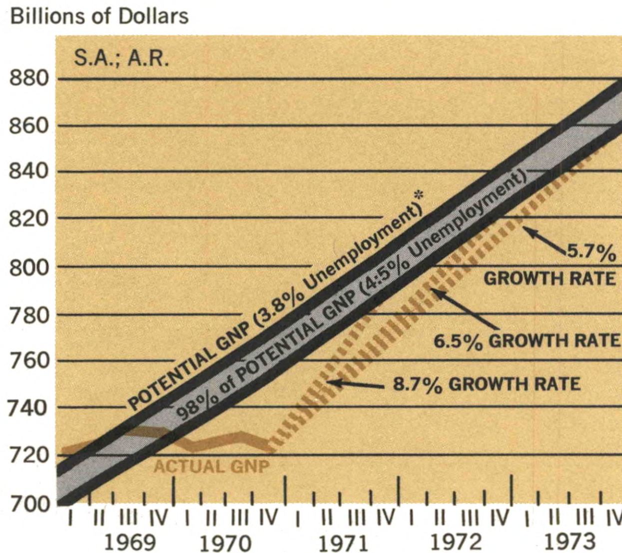
The second guideline—concerning growth rates—is not so clear-cut. But in only five of the last 15 years has the real growth rate exceeded 6 per cent—1955, 1959, 1962, 1965, and 1966. In 1959 and 1962, the economy was operating way below its potential, and prices remained stable. In the other years, however, when there was much less unused capacity, a 6 per cent growth rate did bring more inflation. So, it is difficult to distinguish between a rapid growth rate and the amount of excess capacity as the main cause of inflation. What does seem clear, though, is that unless excess capacity in the economy is considerable, growth rates in excess of 6 per cent do make the economy vulnerable to inflation.

What does this mean for 1971 and perhaps '72 and '73 as well? As can be seen in Chart 3, the economy is still operating at about 96 per cent of capacity, considerably higher than the last time inflation was brought under control in the late fifties and early sixties. Because of the mildness of the cur-

CHART 4

ACTUAL AND POTENTIAL GROSS NATIONAL PRODUCT (1958 DOLLARS)

The goal of 4½ per cent unemployment can be reached by the end of 1973 if the economy grows in real terms at an annual rate of 5.7 per cent. Higher and probably more inflationary growth rates would be needed to close the gap between actual and potential GNP in 1971 or 1972.



*Trend line of 4 per cent from 1st quarter 1969 to 4th quarter 1969, 4.3 per cent from 4th quarter 1969 to 4th quarter 1970, 4.4 per cent from 4th quarter 1971 and 4.3 per cent from 4th quarter 1971 to 4th quarter 1975.

Source: Department of Commerce and The Council of Economic Advisors

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rent slowdown and the severity of the current inflation, policymakers will have to move cautiously toward increasing the amount of capacity utilized.

TIMETABLE FOR RECOVERY

How do these guidelines translate into a timetable for recovery? Chart 4 is similar to Chart 1; however, the target for recovery has been changed, in light of these guidelines, to 98 per cent of capacity, or roughly 4.5 per cent unemployment, instead of 100 per cent, or 3.8 per cent unemployment. The difference, 2 per cent, is represented by the shaded area. To close the remaining gap by the end of 1971 would require a growth rate of 8.7 per cent. If the gap is to be closed by the end of '72, the economy would have to grow at 6.5 per cent for the next two years. Or, if the timetable is pushed out to the end of '73, the necessary rate is 5.7 per cent.

If a reasonable tradeoff between subduing inflation and reducing unemployment is to be made in the 1970's, policymakers may have to think in terms of this latter kind of timetable—a timetable which stretches out to 1973 the period for getting unemployment back down to the 4.5 per cent rate. A policy of gradualism was popular when the economy was slowing down; if gradualism is to have *any* hope of success in unwinding inflation, the nation likely will have to adhere to it on the way up as well.

But what about getting the rate of unemployment below 4.5 per cent? It may be that aggregate tools, like monetary and fiscal policies, cannot reduce unemployment below 4.5 per cent without reigniting inflation. To reduce unemployment further, monetary and fiscal policies likely will have to be supplemented in the 1970's with greatly expanded programs designed to improve job training and worker mobility. Indeed, if we are to achieve high levels of employment and low levels of inflation in the decade ahead, they can only come if manpower policies aimed at reducing structural bottlenecks in the economy are coordinated with policies aimed at securing a balance between overall demand and supply. ■

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Regional Economy Slips in '70

by Kathryn L. Kindl

Third District residents can find some comfort in knowing that the slowdown in the region in 1970 was milder than the downswing in the national economy. Both production and sales held up better in the region than in the rest of the nation. And, although consumer prices rose a little more here than elsewhere, the unemployment rate in the District remained well below the national level.

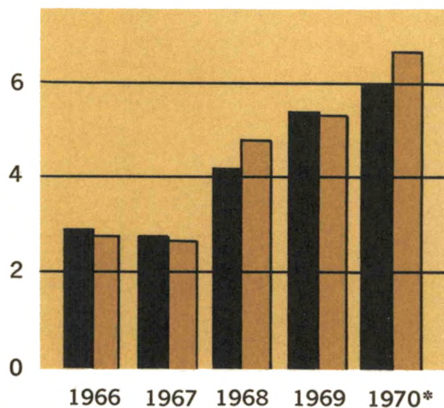
PRICES AND UNEMPLOYMENT MOVE UP

Rising costs of housing, clothing, medical care, and countless other goods and services held the attention of many Third District consumers as 1970 pushed to a close. Indeed, with prices mounting more rapidly in the region than nationally, shoppers here were forced to discover even more and better ways to stretch their buying dollars.

All sectors fell victim to the inflationary spiral as consumer prices in the Philadelphia area soared 6.7 per cent in 1970, surpassing the increases of '68 and '69. Moreover, unlike 1969, when weekly wage gains outdistanced price rises, price increases in 1970 outstripped wage advances.

Real purchasing power of District workers actually fell in '70 as price rises of nearly 7 per cent eroded wage gains, which were less

CHART 1
PRICES RISE RAPIDLY IN '70



*Based on first 11 months
Source: Department of Labor

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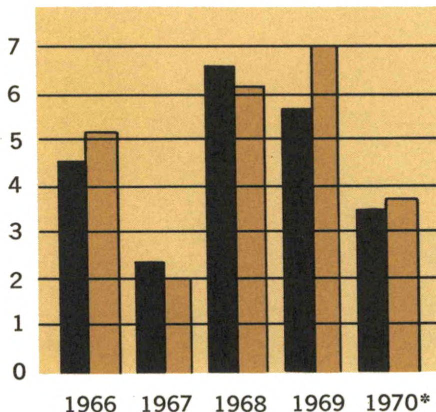
CHART 2
WEEKLY EARNINGS ADVANCE MORE SLOWLY

UNITED STATES **THIRD DISTRICT**

Percentage Change in Average Weekly Earnings in Manufacturing in the Third District

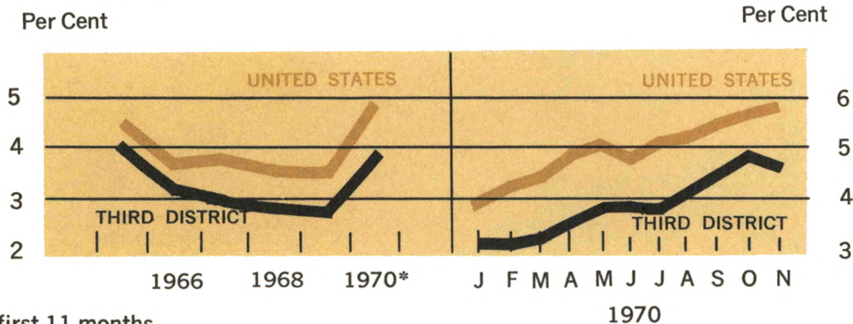


*Based on first 11 months.
Source: U.S. Data, Department of Labor

than 4 per cent. Although contract settlements in some industries resulted in large gains in hourly wages, both shorter and fewer workdays put a damper on earnings growth.

Job-holders in the Third District did fare better in one respect than those across the nation, however, particularly during the first seven months of last year. Had unemployment in the region climbed to the national

CHART 3
UNEMPLOYMENT IN THE DISTRICT TRENDS UPWARD



*Based on first 11 months

Source: U.S. Data, Department of Labor

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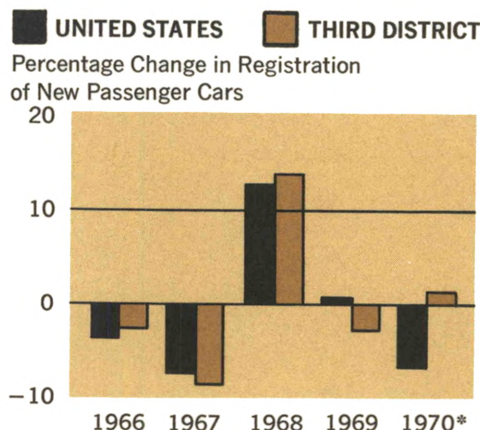
average, more than 35,000 more members of the labor force would have been forced into the already swollen ranks of unemployed. As shown in Chart 3, the unemployment rate in the District rose from 2.9 per cent in 1969 to 3.9 per cent in '70. In the same one-year period, the unemployment level nationally jumped from 3.5 per cent to 4.9 per cent, 1 per cent higher than the rate registered in the District.

SALES AND PRODUCTION SLOW

Growing unemployment fostering fears of job insecurity, coupled with rising prices and more slowly rising incomes, made last year's worker reluctant to spend his earnings. Accordingly, retail customers did little to brunt the economic slowdown in '70. Registrations of new passenger cars (a rough proxy for new car sales) inched only 1 per cent above its 1969 level (Chart 4) in the District. Yet even this minimal advance pushed regional registrations far over the national rate.

Department store sales, which remained sluggish throughout 1970, also reflected consumer caution. Although sales in some metropolitan areas within the District outran those nationally, no gains were registered in Philadelphia or Trenton. Retail activity in Scranton and Wilkes-Barre roughly kept pace with the nation (Chart 5).

CHART 4
NEW PASSENGER CAR REGISTRATIONS LAG, AND . . .

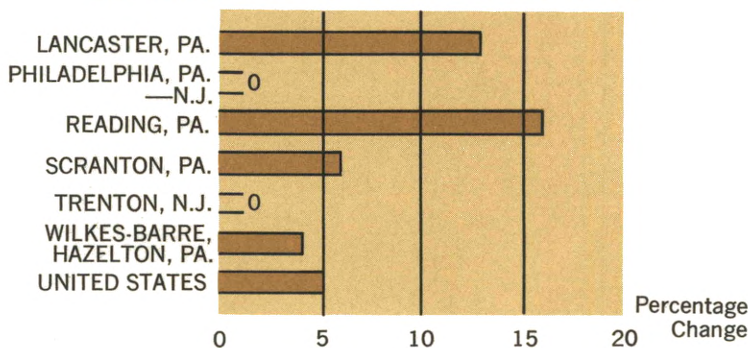


*Based on first 10 months
Source: U.S. data, Automotive News

This lack-luster performance by consumers and consequent cutbacks in investment plans by business halted growth in manufacturing activity. Last year, output in the Third District, measured by manhours of labor used in production,* fell more than 4

*Manhours used in production is a proxy measure of output which, because of changes in productivity over the business cycle, tends to understate movements in that series.

CHART 5
DEPARTMENT STORE SALES WANE*



*Based on First 8 months
Source: Department of Commerce, Data, SMSA Basis

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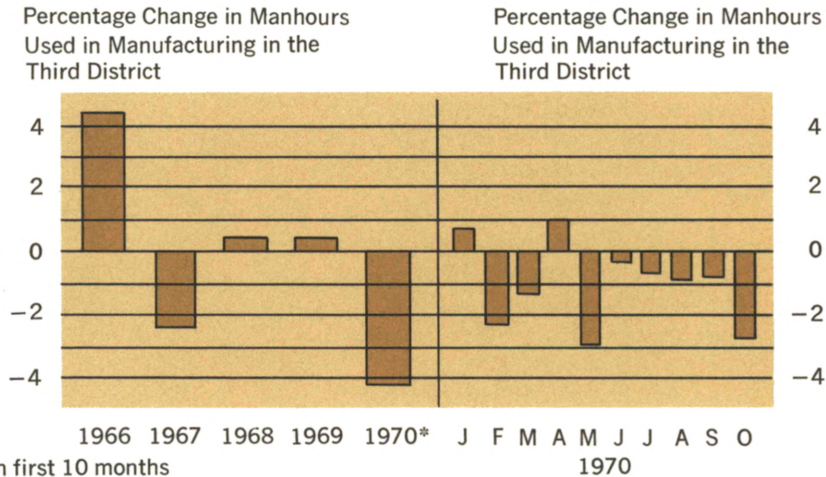
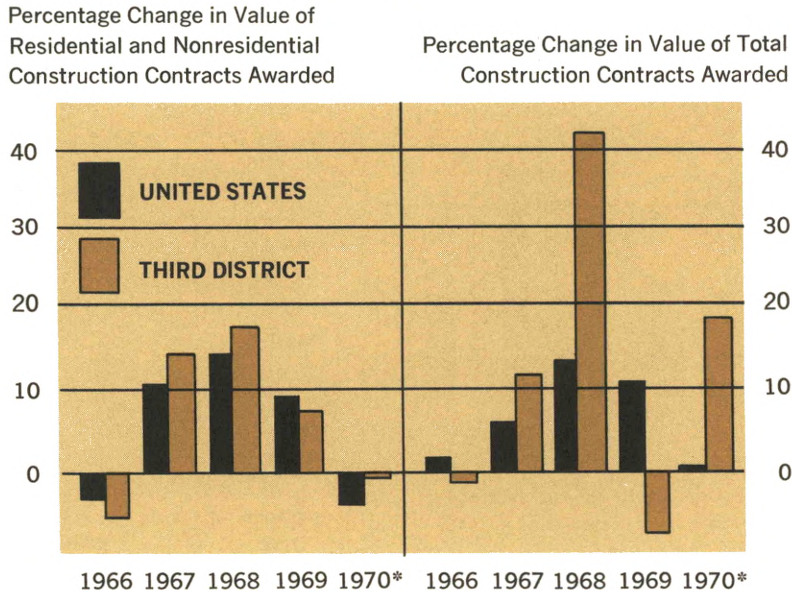
CHART 6
MANHOURS OF LABOR USED IN PRODUCTION FALL IN THE DISTRICT



*Based on first 10 months

CHART 7
RESIDENTIAL AND NONRESIDENTIAL BUILDING SLOWS . . . WHILE TOTAL PRIVATE AND PUBLIC CONSTRUCTION INCREASES



*Based on first 11 months
Source: F. W. Dodge Corporation

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per cent, down sharply from 1968 and 1969.

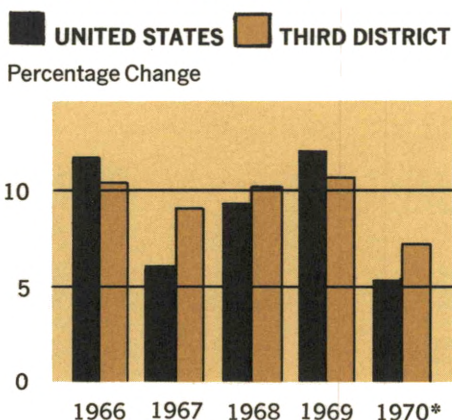
Building construction, too, was squeezed in 1970. Although nonresidential and residential construction contracts awarded declined less in the District than across the nation, both national and regional building fell for the first time since 1966. (See Chart 7.) One bright spot did appear in the regional picture in '70, however. Buoyed by a 75 per cent rise in public works and utilities, total construction contracts awarded jumped almost 20 per cent.

BANKING REACTS

The weakened business climate, accompanied by attempts by corporate borrowers to improve their liquidity positions, was reflected in banking activity. Although loans by member banks in the Third District rose 7.2 per cent in 1970, a notch ahead of the national rate (Chart 8), their advance trailed last year's increase by several percentage

CHART 8

LOANS ADVANCE WEEKLY*†



*Loans include both loans and discounts

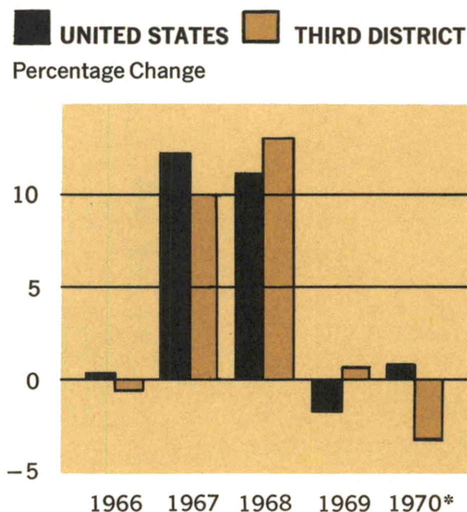
†Member banks only—data for last Wednesday of each month

*Based on first 11 months

Source: U.S. Data, Board of Governors of the Federal Reserve System

CHART 9

BANK INVESTMENTS ARE CURTAILED*†



*Investments include U.S. Government obligations and other securities

†Member banks only—data for last Wednesday of each month

*Based on first 11 months

Source: U.S. Data, Board of Governors of the Federal Reserve System

points. Investments by member banks also turned down in '70, as shown in Chart 9. In recent months, however, bankers, faced with deteriorating corporate demand for credit as would-be borrowers shifted from bank loans to long-term borrowings in the bond market, have made extensive efforts to expand their securities holdings. Member institutions also have lowered the prime interest rate in successive attempts to attract borrowers and increase loans.

PROSPECTS FOR THE FUTURE?

In short, 1970 moved sluggishly into '71. High unemployment rates and increases in consumer prices persisted, while production

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remained weak. But, with economic policy on a course of moderate ease for almost a year now, at least a mild recovery appears to be shaping up for the District and the nation. Although consumers remain cautious, retail spending is likely to accelerate somewhat this year. This pickup in the economy is consistent with expectations of area executives, who foresee a modest upturn in business activity in the coming months as well as some improvement in labor market conditions. (See below.) The path of inflation, however, remains a major uncertainty in the outlook for '71. ■

WHAT THIRD DISTRICT BUSINESSMEN SEE FOR 1971

The Federal Reserve Bank of Philadelphia conducts a monthly Business Outlook Survey. The purpose of the survey is to obtain a reading of business conditions within the Third Federal Reserve District—an area comprising the eastern two-thirds of Pennsylvania, the southern half of New Jersey, and Delaware. The survey sample polls manufacturing firms with 500 or more employees.

Since its inception at the request of the regional business community nearly three years ago, the Business Outlook Survey has become a useful source of economic intelligence both for business and public policymakers. You may request that names be placed on the mailing list for the Business Outlook Survey by writing to Public Services, Federal Reserve Bank of Philadelphia, Philadelphia, Pennsylvania 19101.

OUTLOOK FOR 1971

Area executives expect the general level of business activity to pick up steam in 1971 after a weak performance last year. Most manufacturers in the Third District anticipate rising sales and new orders in the coming months. In part, this newly emerging optimism reflects stepped-up production at General Motors in the aftermath of its strike, as well as some steel stockpiling in anticipation of a possible strike by the United Steel Workers this summer. But this budding optimism also reflects some feeling in the business community that the basic trend of the economy will be upward—if only modestly so—in '71.

Caution rather than optimism, however, still dominates the thinking of area businessmen. Because of excess capacity, area management plans to hold the line on capital spending—at least through the first half of the year. Also, regional manufacturers appear reluctant to add new employees to their work forces until the firmness of the recovery is more apparent. Although this "no hire" policy will keep layoffs to a minimum, it does not preclude some further increases in unemployment. The reason is that with an expanding pool of manpower because of increasing population, new jobs need to be created—not just old ones maintained —if unemployment is to be checked or reduced.

The outlook for prices remains inflationary. Although the rate of inflation may slow, the majority of respondents to the Business Outlook Survey still expects to be paying higher prices during 1971.

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ANNUAL OPERATIONS AND EXECUTIVE CHANGES

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DIRECTORS AND OFFICERS

At the election held in the fall of 1970, Richard A. Herbster, President, Lewistown Trust Company, Lewistown, Pennsylvania, was elected by member banks in Electoral Group 3 as a Class A Director for a three-year term beginning January 1, 1971. He succeeded H. Lyle Duffey. Philip H. Glatfelter, III, Chairman and President, P. H. Glatfelter Co., Spring Grove, Pennsylvania, was reelected by member banks in Electoral Group 1 as a Class B Director for a like term.

The Board of Governors designated Bayard L. England, Chairman of the Board, Atlantic City Electric Company, Atlantic City, New Jersey, as Chairman of the Board of Directors and Federal Reserve Agent at the Federal Reserve Bank of Philadelphia for 1971. Mr. England succeeded Willis J. Winn, Dean of the Wharton School of Finance and Commerce, University of Pennsylvania. Dr. Winn served as Chairman since 1966. To serve as Deputy Chairman of the Board of Directors for 1971, the Board of Governors named D. Robert Yarnall, Jr., President of Yarway Corporation, Blue Bell, Pennsylvania, who has been a director of the Reserve Bank since 1965. To fill the vacancy created by Willis J. Winn, whose term expired December 31, 1970, the Board of Governors appointed John R. Coleman, President of Haverford College, Haverford, Pennsylvania, to a three-year term as a Class C Director, commencing January 1, 1971.

The Board of Directors selected G. Morris Dorrance, Jr., President and Chief Executive Officer, The Philadelphia National Bank, Philadelphia, Pennsylvania, to serve during 1971 as the member of the Federal Advisory Council from the Third Federal Reserve District.

The Directors of this Bank elected David P. Eastburn as President and David C. Melnicoff as First Vice President effective March 1, 1970, to complete the unexpired portion of the present term of these offices ending February 28, 1971.

Also effective March 1, 1970, a number of changes and additions occurred in the official staff. Joseph M. Case was promoted to Vice President from Assistant Vice President in the Department of Supervision and Regulation. Max Klass was designated Regulations Officer to assist Mr. Case. In the same department, James P. Giacobello was advanced from Chief

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Examining Officer to Assistant Vice President. Thomas K. Desch was made Chief Examining Officer and Stephen M. Ondeck became an Examining Officer. In the Personnel Department, Joseph R. Joyce, formerly Department Head, was appointed Assistant Vice President. William F. Staats, Secretary, assumed expanded responsibilities in the newly created Executive Office. Lawrence C. Murdoch, Jr., returned to the Bank as Vice President-Staff within the Executive Office. George C. Haag, formerly Public Information Officer, became Public Services Officer in the Department of Bank and Public Services. In the Department of Research and Statistics, Mark H. Willes was promoted from Senior Economist to Director of Research. Edward G. Boehne, Richard W. Epps, and Hugh Chairnoff were appointed Research Officers and Economists. Warren J. Gustus became Economic Adviser to the President.

Effective September 1, 1970, Hugh Chairnoff was appointed Assistant Vice President in the Credit-Discount Department, and Donald J. McAnemy was named Examining Officer in the Department of Supervision and Regulation.

Effective January 1, 1971, William A. James was promoted from Vice President to Senior Vice President, assuming responsibility for internal services as well as personnel. Alexander A. Kudelich, formerly Assistant Vice President, became Vice President with responsibility for the entire collection and check processing function. Continuing in their present areas of responsibility, Mark H. Willes was promoted to Vice President and Director of Research, William F. Staats to Vice President and Secretary, and Eugene W. Lowe to Assistant Vice President. In an important shift of duties, James A. Agnew, Assistant Vice President, moved to the Cash Department and Warren R. Moll, Assistant Vice President, moved to the Department of Collections and Check Processing.

During the year 1970, the Bank lost four members of its official staff. On February 27, William L. Ensor, Examining Officer, died as a result of a heart attack. Karl R. Bopp, President, and Robert N. Hilkert, First Vice President, retired on February 28 under provisions of the Retirement System of the Federal Reserve Banks. Albert Spencer, Jr., Assistant Vice President in the Credit-Discount Department, retired on August 31.

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DIRECTORS AS OF JANUARY 1, 1971

GROUP		Term expires December 31,
	CLASS A	
1	HAROLD F. STILL, JR. President, Central Penn National Bank Bala-Cynwyd, Pennsylvania	1971
2	WILLIAM R. COSBY Chairman of the Board, Princeton Bank & Trust Company Princeton, New Jersey	1972
3	RICHARD A. HERBSTER President, Lewistown Trust Company Lewistown, Pennsylvania	1973
	CLASS B	
1	PHILIP H. GLATFELTER, III Chairman and President, P. H. Glatfelter Co. Spring Grove, Pennsylvania	1973
2	HENRY A. THOURON Chairman of the Board, Hercules Incorporated Wilmington, Delaware	1971
3	EDWARD J. DWYER President, ESB Incorporated Philadelphia, Pennsylvania	1972
	CLASS C	
	BAYARD L. ENGLAND, Chairman and Federal Reserve Agent Chairman of the Board Atlantic City Electric Company Atlantic City, New Jersey	1972
	D. ROBERT YARNALL, JR., Deputy Chairman President, Yarway Corporation Blue Bell, Pennsylvania	1971
	JOHN R. COLEMAN President, Haverford College Haverford, Pennsylvania	1973

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OFFICERS AS OF JANUARY 1, 1971

DAVID P. EASTBURN, President

DAVID C. MELNICOFF, First Vice President

JOSEPH R. CAMPBELL, Senior Vice President
WILLIAM A. JAMES, Senior Vice President
JAMES V. VERGARI, Senior Vice President and General Counsel
EDWARD A. AFF, Vice President
HUGH BARRIE, Vice President
JOSEPH M. CASE, Vice President
NORMAN G. DASH, Vice President
RALPH E. HAAS, Vice President
ALEXANDER A. KUDELICH, Vice President
G. WILLIAM METZ, Vice President and General Auditor
LAWRENCE C. MURDOCH, JR., Vice President-Staff
WILLIAM F. STAATS, Vice President and Secretary
MARK H. WILLES, Vice President and Director of Research
WARREN J. GUSTUS, Economic Adviser to the President
JAMES A. AGNEW, Assistant Vice President
JACK P. BESSE, Assistant Vice President
HUGH CHAIRNOFF, Assistant Vice President
D. RUSSELL CONNOR, Assistant Vice President and Assistant Secretary
JAMES P. GIACOBELLO, Assistant Vice President
JOSEPH R. JOYCE, Assistant Vice President
EUGENE W. LOWE, Assistant Vice President
WARREN R. MOLL, Assistant Vice President
HENRY J. NELSON, Assistant Vice President
KENNETH M. SNADER, Assistant Vice President
RUSSELL P. SUDDERS, Assistant Vice President
THOMAS K. DESCH, Chief Examining Officer
JACK H. JAMES, Examining Officer
LEONARD E. MARKFORD, Examining Officer
DONALD J. McANENY, Examining Officer
STEPHEN M. ONDECK, Examining Officer
HILIARY H. HOLLOWAY, Assistant Counsel and Assistant Secretary
A. LAMONT MAGEE, Assistant General Auditor
SAMUEL J. CULBERT, JR., Bank Services Officer
EDWARD G. BOEHNE, Research Officer and Economist
RICHARD W. EPPS, Research Officer and Economist
GEORGE C. HAAG, Public Services Officer
MAX KLASS, Regulations Officer
DAVID P. NOONAN, Personnel Officer

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STATEMENT OF CONDITION
FEDERAL RESERVE BANK of PHILADELPHIA

(000's omitted in dollar figures)	End of year	
	1970	1969
ASSETS		
Gold certificate account	$ 721,185	$ 525,671
Special Drawing Rights Certificate	23,000	—
Federal Reserve notes of other Federal Reserve Banks	60,448	34,614
Other cash	9,761	5,034
Loans and securities:		
Discounts and advances	150	650
United States Government securities	3,261,250	3,071,751
Total loans and securities	$3,261,400	$3,072,401
Uncollected cash items	693,676	729,778
Bank premises	2,533	2,475
All other assets	42,670	125,279
Total assets	$4,814,673	$4,495,252
LIABILITIES		
Federal Reserve notes	$2,933,550	$2,756,766
Deposits:		
Member bank reserve accounts	1,163,059	986,466
United States Government	64,016	70,870
Foreign	6,375	6,760
Other deposits	16,474	17,965
Total deposits	$1,249,924	$1,082,061
Deferred availability cash items	529,336	557,760
All other liabilities	29,919	30,631
Total liabilities	$4,742,729	$4,427,218
CAPITAL ACCOUNTS		
Capital paid in	$ 35,972	$ 34,017
Surplus	35,972	34,017
Total liabilities and capital accounts	$4,814,673	$4,495,252
Ratio of gold certificate reserve to Federal Reserve note liability	24.6%	19.1%

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EARNINGS AND EXPENSES
FEDERAL RESERVE BANK of PHILADELPHIA

(000's omitted)	1970	1969
Earnings from:		
United States Government securities	$194,106	$164,711
Other sources	4,064	8,371
Total current earnings	$198,170	$173,082
Net expenses:		
Operating expenses*	12,631	10,701
Cost of Federal Reserve currency	1,196	1,262
Assessment for expenses of Board of Governors	1,078	779
Total net expenses	$ 14,905	$ 12,742
Current net earnings	$183,265	$160,340
Additions to current net earnings:		
Profit on sales of U.S. Government securities (net)	424	—
All other	189	319
Total additions	$ 613	$ 319
Deductions from current net earnings:		
Loss on sales of U.S. Government securities (net)	—	317
Miscellaneous nonoperating expenses	14	25
Total deductions	$ 14	$ 342
Net additions	599	(22)
Net earnings before payments to U.S. Treasury	$183,864	$160,317
Dividends paid	$ 2,082	$ 2,000
Paid to U.S. Treasury (interest on Federal Reserve notes)	179,827	157,082
Transferred to or deducted from (−) Surplus	1,955	1,235

* After deducting reimbursable or recoverable expenses

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VOLUME OF OPERATIONS
FEDERAL RESERVE BANK of PHILADELPHIA

Number of pieces (000's omitted)	1970	1969	1968
Collections:			
Ordinary checks*	386,878	363,658	324,466
Government checks (paper and card)	38,050	33,933	32,821
Postal money orders (card)	13,022	13,708	14,649
Non-cash items	876	899	832
Food stamps redeemed	51,492	29,581	22,633
Clearing operations in connection with direct sendings & wire & group clearing plans**	606	607	655
Transfers of funds	325	308	271
Currency counted	349,173	334,891	319,723
Coins counted	752,489	803,868	492,377
Discounts and advances to member banks	1	1	(a)
Depositary receipts for withheld taxes	1,296	1,293	1,056
Postal receipts (remittances)	276	281	272
Fiscal agency activities:			
Marketable securities delivered or redeemed	557	569	482
Computerized marketable securities (Book entry transactions)	7	18	13
Savings bonds and notes (F.R. Bank and agents)			
Issues (including reissues)	10,932	10,187	10,506
Redemptions	9,098	9,229	7,941
Coupons redeemed (Government and agencies)	867	996	959

Dollar amounts (000,000's omitted)	1970	1969	1968
Collections:			
Ordinary checks	$120,156	$116,717	$100,774
Government checks (paper and card)	9,553	9,421	8,952
Postal money orders (card)	240	241	253
Non-cash items	1,775	1,464	1,258
Food stamps redeemed	76	42	31
Clearing operations in connection with direct sendings & wire & group clearing plans**	69,340	66,946	61,742
Transfers of funds	404,927	351,524	250,695
Currency counted	2,650	2,494	2,351
Coins counted	102	103	58
Discounts and advances to member banks	4,607	6,289	1,193
Depositary receipts for withheld taxes	6,344	7,012	5,695
Postal receipts (remittances)	1,051	1,031	1,008
Fiscal agency activities:			
Marketable securities delivered or redeemed	11,155	11,603	14,091
Computerized marketable securities (Book entry transactions)	7,286	5,966	7,877
Savings bonds and notes (F.R. Bank and agents)			
Issues (including reissues)	491	428	468
Redemptions	497	530	403
Coupons redeemed (Government and agencies)	146	380	394

* Checks handled in sealed packages counted as units
** Debit and credit items
(a) Less than 1,000 rounded

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