Research Department
Federal Reserve
Bank of
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Business & Financial Letter

Solid Year

The Western economy experienced both a housing boom and a farm recession during 1977, but for most other sectors, it was a year of steady progress. Family incomes outpaced inflation by a substantial margin; employment increased at one of the most rapid rates of recent decades; and these developments helped reduce the ranks of the unemployed. Looking ahead, most regional analysts foresee further growth next year, although perhaps at a slower pace than in 1977.

More jobs, more income
Civilian employment in this nine-state area increased almost 4½ percent—for the second straight year—to a new peak of 14.3 million. The pace of expansion was significantly faster in the West than in the rest of the nation, following a pattern set early in the decade. Manufacturing employment returned to pre-recession levels, and construction employment increased more than 10 percent as building activity soared throughout the West. Jobs also continued to open up in trade, in services and (to a lesser extent) in government.

Reflecting this active job market, the average jobless rate dropped from 9.0 percent in 1976 to 7.6 percent in 1977. The improvement was especially noticeable in the large Pacific Coast states, and the job market worsened significantly only in Alaska, because of the completion of the oil pipeline.

Personal income increased more than 11½ percent to about $259 billion in 1977. Much of the gain was eaten away by inflation as consumer prices rose almost 7 percent during the year—but the result was still a solid gain of more than 4½ percent in real income. (However, this was the third straight year of faster-than-national price increases, probably reflecting the faster pace of business activity in the West.) Consumers purchased almost 13 percent more goods at retail during the first three quarters of the year, largely because of booming sales of autos and other durable goods. During that period, new-car registration in California rose almost 35 percent above the 1976 pace, approaching the 1973 peak level of sales.

Farm recession
Western farmers and ranchers were beset by falling prices, falling exports, and falling water tables during 1977. With crop receipts declining, total agricultural sales dropped about 1½ percent to roughly $15 billion—and the decline in net income was even steeper because of rising production costs. The drop in farm sales reflected widespread price weakness, brought about partly by bumper crops in this country, and partly by a slowdown in demand from overseas customers and an increase in sales by overseas competitors. Agricultural exports from West Coast ports dropped 22 percent between the first three quarters of 1976 and the comparable 1977 period.

Cattle producers' gross incomes rose slightly above a year ago, but their net incomes fell as they had to contend

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with the effects of a second straight year of drought—such as the cost of hay to supplement parched pastures and the cost of water to replenish dried-up ponds. Crop farmers suffered a 3-percent drop in gross income, and they too experienced sharp rises in costs. Federal and state agencies cut water deliveries 60 to 75 percent in California's Central Valley, forcing the farmers to spend large sums for digging wells and pumping water.

The grain farmers of the Northwest were probably affected most by the farm sector's multiple ills, for wheat prices reached a five-year low during the summer, while the drought reduced yields and thus the size of crops. California rice growers reduced output of that very water-intensive crop by 17 percent, but they benefited from prices that were higher by half than a year ago. In contrast, Arizona and California cotton growers increased acreage 31 percent in response to the tight supplies and high prices of 1976, only to see prices plummet under the pressure of worldwide overproduction.

Housing boom

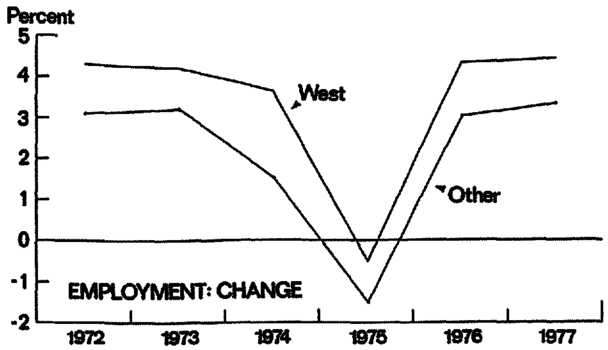
A massive boom in homebuilding, although nationwide in scope, was concentrated in the West, which followed up its 49-percent increase in 1976 housing starts with a further 31-percent increase in 1977. Speculative activity in the single-family end of the market accentuated the boom during the first half of the year, but these speculative excesses were gradually wrung out of the market, with little damage to the industry. Even so, heavy demand and cost pressures pushed the median price of new homes to $53,400 at midyear—13 percent above the year-ago figure and also 13 percent above the current price of homes elsewhere in the U.S.

While single-family housing boomed, the long-depressed multi-family sector of the market began to recover, and industrial and commercial construction also expanded. Moreover, future homebuilding plans looked solid, based upon a 35-percent increase in new permit activity between the first three quarters of 1976 and the comparable period of 1977. On the other hand, savings flows into mortgage-lending institutions began tapering off in the latter part of the year, reflecting the ability of savers to earn higher rates on Treasury bills and other market instruments, but industry sources remained confident that funds would be available to meet their record level of loan commitments.

The nationwide upsurge in residential construction put heavy pressure on the Western lumber industry, which because of strikes and timber shortages increased production only about 3 percent during the year. Despite some easing of prices during the fall months, softwood lumber prices in November remained 75 percent above their late-1974 low. The pulp and paper segment of the industry showed considerable strength during the early part of the year, but market conditions later weakened as slow overseas demand led to stiff competition from imports in the U.S. market.

Manufacturing, metals mixed

Manufacturing production overall expanded at a faster-than-national pace,



sparked by considerable strength in durable-goods (especially aerospace equipment) manufacturing. (Still, aerospace employment lagged behind its pre-recession level and remained 29 percent below the Vietnam-war peak.) Military prime-contract awards rose nearly 7 percent during the year ending in June, on the heels of sharp gains in the two preceding years, and increased funding for such projects as the cruise missile and the F-14 fighter plane helped keep spending high even after the cancellation of the B-1 bomber program. Space-agency awards also strengthened during this period, primarily for the space-shuttle program. Meanwhile, foreign and domestic orders for Boeing jet transports expanded in line with the improved financial position of the world airline industry. Expanded military and consumer purchases of electronic products also contributed to the industry's order flow.

Regional steel production continued in the doldrums, reflecting the gradual weakening in demand from consumer-goods producers and the continued sluggishness in demand from capital-good manufacturers. The domestic industry's problems were aggravated by the aggressive marketing of foreign producers, who increased their penetration (from 31 to 34 percent) of the Western market in an expanded effort to sell here what they could not sell in sluggish markets overseas. The Northwest aluminum industry experienced strong demand but was forced to operate well below capacity because of a drought-related shortage of hydropower—and in these circumstances, the industry was able to raise prices by about 10 percent over the course of the year.

Western consumption of petroleum products increased sharply during the year, partly because of the industrial needs generated by the continued business expansion, but also because of regional utilities' increased reliance on fuel oil as a result of natural-gas and hydro-power shortages. Refinery output rose nearly 16 percent to meet this demand. However, the import share of the Western market declined slightly from the 1976 peak of 48 percent, as regional production of crude oil increased for the first time since 1970, because of the opening of the Alaskan pipeline and expanded output at California's Elk Hills Reserve.

Altogether, 1977 marked the second straight year of strong recovery from the steep 1974-75 recession, which suggests that further gains may be hard to come by as the expansion enters a more mature phase in 1978. From recent indications, auto buying and single-family home construction—the strongest supports of the recent expansion—may decline from their earlier headlong pace. But other sectors could take up the slack, such as apartment, commercial or industrial construction—or defense spending, which is already half again as large as it was five years ago. And with the recent evidence of falling rain and rising prices, the farm picture may show some improvement. On balance, slower but more substainable growth may be the most likely outlook—and the best prescription—for the regional economy in 1978.

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BANKING DATA—TWELFTH FEDERAL RESERVE DISTRICT

(Dollar amounts in millions)

Selected Assets and Liabilities Large Commercial Banks	Amount Outstanding 12/14/77	Change from 12/7/77	Change from year ago Dollar	Percent
Loans (gross, adjusted) and investments*	106,398	+ 1,017	+ 12,900	+ 13.80
Loans (gross, adjusted)—total	82,035	+ 1,283	+ 11,867	+ 16.91
Security loans	2,564	+ 654	+ 892	+ 53.35
Commercial and industrial	24,773	− 110	+ 1,971	+ 8.64
Real estate	27,037	+ 179	+ 5,587	+ 26.05
Consumer instalment	14,365	+ 239	+ 2,344	+ 19.50
U.S. Treasury securities	9,381	− 60	− 622	− 6.22
Other securities	14,982	− 206	+ 1,655	+ 12.42
Deposits (less cash items)—total*	103,144	+ 330	+ 9,058	+ 9.63
Demand deposits (adjusted)	29,738	− 552	+ 2,246	+ 8.17
U.S. Government deposits	293	− 7	− 473	− 61.75
Time deposits—total*	71,275	+ 1,019	+ 6,989	+ 10.87
States and political subdivisions	6,097	+ 578	+ 684	+ 12.64
Savings deposits	31,172	− 128	+ 810	+ 2.67
Other time deposits‡	31,111	+ 415	+ 4,910	+ 18.74
Large negotiable CD's	13,870	+ 576	+ 3,493	+ 33.66

Weekly Averages of Daily Figures	Week ended 12/14/77	Week ended 12/7/77	Comparable year-ago period
Member Bank Reserve Position			
Excess Reserves(+)/Deficiency (−)	+ 64	+ 49	+ 146
Borrowings	+ 24	+ 13	+ 7
Net free(+)/Net borrowed (−)	+ 40	+ 36	+ 139
Federal Funds—Seven Large Banks			
Interbank Federal fund transactions			
Net purchases (+)/Net sales(−)	+ 351	+ 609	+ 939
Transactions with U.S. security dealers			
Net loans (+)/Net borrowings (−)	+ 655	+ 505	+ 448

*Includes items not shown separately. ‡Individuals, partnerships and corporations.

Editorial comments may be addressed to the editor (William Burke) or to the author. . . .
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