

Federal Reserve Bank of San Francisco

December 28, 1979

Still Strong

The widely heralded recession failed to appear in the West during 1979, as most industries confounded the experts and posted substantial gains in sales and payrolls. There were some weak spots, of course, aggravated by a severe inflation which sapped the strength of an otherwise healthy four-year-old expansion. Most analysts expect those weaknesses to lead to a slowdown in 1980, but the dip (if any) should be quite modest in comparison with the downturn anticipated elsewhere in the nation.

In 1979 as in other recent years, population growth provided a strong underpinning for economic growth. Since the 1970 census, in fact, the West's population has increased by about 5 million, bringing the regional total to about 35½ million. This means additional political as well as economic power, because the reapportionment following the 1980 census will probably mean one or more new House seats for California, Washington, Arizona, Oregon and Utah.

Expanding jobs and income

Civilian employment in this nine-state area jumped almost 5 percent—an increase of almost 800,000 new jobs—to reach a new peak of 16.0 million during 1979. The job expansion lagged behind only the unsustainable pace set during the 1977-78 boom. Also, in terms of jobs as well as population, the West continued to outpace the rest of the nation, as it has done since the early 1970's—indeed, in 1979, jobs increased twice as fast in the West as elsewhere. Employment gains were substantial almost across the board, especially in aerospace manufacturing and a wide range of service industries. The only exception was the government sector, where employment remained almost flat because of tight fiscal controls in practically every jurisdiction.

Reflecting the active job market, regional unemployment dropped from about

6.8 percent of the labor force in 1978 to roughly 6.2 percent in 1979. The improvement was evident in almost all Western states. California in particular brought its jobless rate into line with the national rate in late fall. For more than a decade, that state's jobless rate had hovered one or two percentage points above the national rate, because of heavy in-migration and problems with key regional industries. Indeed, at the beginning of the recovery in 1975, its jobless rate exceeded 10 percent, but after a four-year-long expansion less than 6 percent of the state's labor force were counted as unemployed.

Personal income in the West increased about 14½ percent in 1979, to about \$345 billion—the largest annual gain of this expansion period. But most of the gain was eaten up by inflation, as consumer prices rose about 11½ percent between 1978 and 1979. Retail sales remained strong through much of the year—considerably stronger than elsewhere—reflecting the gains in real as well as nominal income. Moreover, new-car registrations ran substantially higher than a year ago, at least prior to the opening of the weak 1980 model year.

Industry shifts

Income growth benefited from a stronger-than-national expansion of manufacturing production, and also from a widening wage differential between the West and the rest of the nation. The key aerospace-equipment industry experienced boom conditions, which spurred an 8-percent increase in industry employment over the course of the year. The main demand stimulus came from the world airline industry. In response to rapid passenger-traffic growth and to the imperative to improve fuel efficiency, the airlines continued to place large orders for both the present and next generation of jet transports. Defense and space business also increased as Western firms received more

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funding for production contracts, not to mention development programs for new programs such as the MX mobile missile and the air-launch cruise missile. The electronic-equipment segment of the industry also benefited from increased consumer purchases of its products, such as the electronic games which were so popular at Christmas time.

The regional steel industry recorded only a 3-percent rise in production for the year, as buyers dipped into inventories to meet increased demand for heavy-construction steel and other products. The "trigger price" mechanism helped reduce imports sharply, by raising the minimum permissible price for foreign steel. Even this provided little support for the regional industry, however, and two major producers late in the year announced plans to close some of their higher-cost basic-steel and fabricating facilities. In contrast, the aluminum industry operated at virtually full capacity during 1979, as it strained to meet the increase in demand from aerospace and other industries. Its operations were somewhat hampered, however, by dry weather in the Northwest, which forced a late-year cutback in power supplies from Federal hydro-electric facilities. The copper industry meanwhile benefited from increased worldwide consumption—plus heavy speculative demand, which reflected the use of copper as well as gold and silver for an anti-inflation hedge.

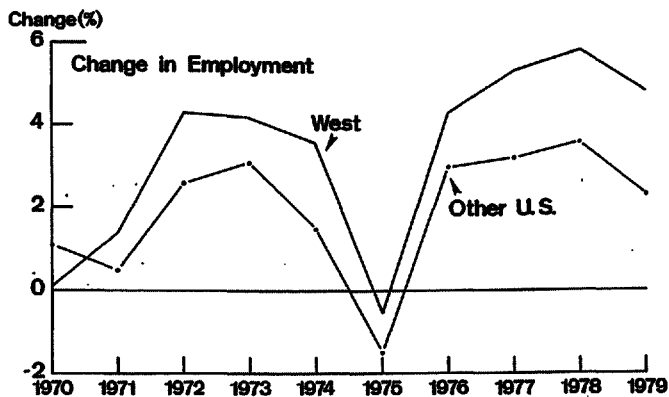
The supply problems and consequent upsurge in world oil prices that resulted from the Iranian revolution helped to limit the growth of the regional petroleum market. Western utilities and industrial plants boosted their demand for fuel oil, but gasoline consumption rose only slightly, reflecting last spring's sudden shortages and gas lines. Still, regional crude-oil production increased sharply for the third straight year, as the Alaskan pipeline's capacity (and flowthrough) rose from 1.2 to 1.5 million barrels per day. The import share of the regional market continued dropping to 23 percent—it was 48 percent at the 1976

peak—as Western refineries substituted more and more Alaskan oil for imports. And looking toward the future, the oil industry paid a spectacular \$2 billion for oil-and-gas development rights in the ice-choked Beaufort Sea off Alaska's northern coast, plus another \$574 million for leases on federal acreage off the Southern California coast.

Weakening housing—and lumber

The housing market represented the major weak spot in the regional picture during 1979, as housing starts dropped roughly 15 percent below the peak 1978 figure, to about 460,000 units. (That decline was roughly in line with the national decline.) Even so, inflationary cost pressures pushed the median price of new Western homes to \$73,000 at midyear—18 percent above the mid-1978 level, and double the price of five years ago. Demand pressures remained high, reflecting the strong evidence that buying a home is one of the best hedges against inflation. But financing problems afflicted the industry during the year, because of the high costs and decreasing availability of mortgage money. With mortgage rates reaching or exceeding 13 percent in late 1979, many prospective lenders were priced out of the market, especially those living in communities subject to usury-law rate limits. But financial institutions continued to have some funds available—in contrast to their plight during earlier housing crunches—because of their ability to attract funds through savings certificates whose rates were tied to Treasury-bill rates.

The national housing decline reduced the flow of incoming orders at Western lumber mills, resulting in a 4-percent drop in production for the year. But a heavy backlog of unfilled 1978 orders, plus the rising cost of timber from public lands, pushed softwood-lumber prices to historic highs. In September, producer prices stood 14 percent above the year-earlier figure and more than double the average level reached during the 1974 recession. But with the acceleration of the housing slide, prices declined to about the year-earlier level



by year-end. The pulp-and-paper segment of the industry meanwhile experienced sharp price increases throughout the year, because of strong demand, rising costs and a prolonged early-1979 strike at Pacific Northwest mills.

Stronger farm picture

Despite substantial increases in production costs, the Western farm economy recorded a gain in net income on the basis of continued strength in domestic and foreign demand. Moderate overall temperatures and adequate water supplies generally provided excellent growing conditions, and farmers and ranchers produced bumper crops of many commodities. The decline of cattle herds meanwhile slowed after nearly four years of liquidation, in response to high prices and improved grazing conditions. Export markets for Western products remained very strong as a result of the continued weakness of the dollar and the continued upsurge of world food demands.

Farm cash receipts increased almost 25 percent for the year, with healthy gains in both the crop and livestock sectors. Crop receipts generally benefited from strong production gains, which offset weakening prices in some sectors. The citrus crop, for example, was 19 percent larger than the frost-affected 1978 crop, and the California cotton crop was 16 percent larger than the 1977 record. Crops of rice, nuts, feed-grains and most fresh vegetables also posted significant gains. One notable exception, however, was potatoes, as Idaho produced its smallest crop of the past four years. Wheat production failed to match the bumper 1978 crop, but prices ran about 20 percent higher than a year ago.

Cattlemen appeared to be moving out of the trough of the cattle cycle, as California and Oregon ranchers began to rebuild their herds, offsetting most of the decline recorded elsewhere in the West. But along with herd rebuilding went a cutback in beef production, which boosted beef prices by nearly 22 percent and stimulated

production of hogs and poultry. Record broiler production, for example, occurred both in regional and national markets, leading to some softening in the price of this product. Ranchers benefited from improved range and grazing conditions, which helped them offset a sharp 16-percent increase in feed costs.

Recession in 1980?

On balance, 1979 turned out to be a fairly solid year for the Western economy, but 1980 could be somewhat more somber. The housing industry seems likely to decline even further, given the high price of housing and the increasing unavailability of mortgage money. (This means problems too for the Northwest's lumber industry.) Debt-ridden and inflation-ridden consumers seem likely to reduce their purchases of postponable big-ticket items, primarily autos, given their need to budget first for increasingly expensive necessities. Most importantly, a worsening energy situation could spell real trouble for the West's key tourist industry and many other industries besides.

Yet withal, the West seems certain to get through 1980 with less damage than the national economy, perhaps with only a modest dip in its growth rate. The structure of the regional economy is in its favor, with a smaller concentration of cyclical industries such as autos, and a greater concentration of relatively recession-proof industries such as trade and services. Another plus is the likelihood of a continued boom in the key aerospace-manufacturing industry—an industry with a bulging orderbook full of new business from the world's airlines and also from the Pentagon, which is boosting its spending in real terms for the first time in a decade. The strength of overseas demand for the region's farm products and high-technology products, especially in the fast-growing Pacific Basin countries, also should provide underpinning for the Western economy. The overall outlook, then, is for a slowdown but not a major recession.

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BANKING DATA—TWELFTH FEDERAL RESERVE DISTRICT

(Dollar amounts in millions)

Selected Assets and Liabilities Large Commercial Banks	Amount Outstanding 12/12/79	Change from 12/5/79	Change from year ago @	
			Dollar	Percent
Loans (gross, adjusted) and investments*	135,692	- 80	+ 15,872	+ 13.25
Loans (gross, adjusted) — total#	112,759	- 39	+ 15,604	+ 16.06
Commercial and industrial	31,301	- 222	+ 3,129	+ 11.11
Real estate	43,031	+ 284	+ 8,940	+ 26.22
Loans to individuals	24,111	+ 80	NA	NA
Securities loans	1,526	+ 35	NA	NA
U.S. Treasury securities*	7,293	- 64	- 838	- 10.31
Other securities*	15,640	+ 23	+ 1,106	+ 7.61
Demand deposits — total#	45,965	- 237	+ 3,492	+ 8.22
Demand deposits — adjusted	32,285	- 214	+ 1,117	+ 3.58
Savings deposits — total	28,467	- 118	- 1,586	- 5.28
Time deposits — total#	58,735	+ 38	+ 7,959	+ 15.67
Individuals, part. & corp.	50,073	- 57	+ 8,738	+ 21.14
(Large negotiable CD's)	21,901	- 145	+ 1,619	+ 7.98
Weekly Averages of Daily Figures	Week ended 12/12/79	Week ended 12/5/79	Comparable year-ago period	
Member Bank Reserve Position				
Excess Reserves (+)/Deficiency (-)	41	- 25		47
Borrowings	82	+ 281		6
Net free reserves (+)/Net borrowed(-)	- 41	- 307		41
Federal Funds — Seven Large Banks				
Net interbank transactions	+1,282	+ 287		+ 843
[Purchases (+)/Sales (-)]				
Net, U.S. Securities dealer transactions	- 159	- 881		+ 960
[Loans (+)/Borrowings (-)]				

* Excludes trading account securities.

Includes items not shown separately.

@ Historical data are not strictly comparable due to changes in the reporting panel; however, adjustments have been applied to 1978 data to remove as much as possible the effects of the changes in coverage. In addition, for some items, historical data are not available due to definitional changes.

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