Research Department
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October 17, 1980

FRBSF Weekly Letter

California—Cycles and Trends

One widely held 1980 forecast appears to be correct—California has weathered the downturn much better than the rest of the country. That was a fairly safe prediction to make, however, since California generally outpaces the nation during recessions because of its strong underlying growth trend. There have been exceptions—sometimes major exceptions, such as the severe recession caused by the downturn in the state's key aerospace-manufacturing industry in the early 1970's. But at most other times, the recessions have been milder and the expansions stronger in California than elsewhere.

The point is that national and regional business cycles do not always coincide. California of course is affected by the ups and downs of the national and world economies. But California is itself a nation-sized state, accounting for almost one-eighth of the national economy, and its size and differentiated industrial structure—along with its underlying growth trend—provides the state with a noticeably more moderate cyclical pattern than the rest of the nation.

Unemployment vs. employment

Unemployment rates provide one indicator, although not always a clear indicator, of the relative cyclical strengths of regional economies. By that standard, California has encountered shifting fortunes, for its unemployment rate in recession years has varied considerably in relation to the nation. In 1980, as in 1954 and 1958, California's jobless rate has run about one-half percentage point below the national rate, reflecting strength in the aerospace sector in the face of recessionary pressures elsewhere. Conversely, in 1971 as in 1949, California's jobless rate ran at least three percentage points higher than the national average, reflecting the combined pressures of recession and aerospace collapse.

The California picture is systematically stronger, however, on the basis of employment data. California suffered a greater-than-national decline in nonfarm employment in only one downturn of the past quarter-century (see chart). From peak to trough, California employment dropped 2.3 percent in the 1969-70 recession, compared with a national decline of 1.0 percent, whereas the national decline was considerably greater in 1957-58, 1960-61, and 1973-75. In the present recession, of course, the peak-to-trough dating hasn't yet been determined, but over the past year (September-September), California has recorded a 0.7-percent increase in employment, compared with the nation's 0.3-percent decline.

The fact that California has a higher-than-average growth in employment and a higher than average rate of unemployment can be traced to the underlying structure of supply and demand for labor in the state. The higher average growth in employment reflects the strong demand for labor to meet the needs of California industry which is growing faster than the average of industry in the nation. The higher-than-average rate of unemployment in California reflects labor supply conditions—the inflow of people from the rest of the United States plus immigration from south of the border.

Demand for jobs

With respect to the demand side of the labor market California has a smaller proportion of employment in those sectors most vulnerable to economic downturns, such as mining, construction and manufacturing. (For example, factory jobs account for about one-fourth of California's total employment, but the proportion rises to two-fifths in a heavily industrialized state such as Indiana.) Conversely, more of its employment is concentrated in service, trade, finance and government—the sectors generally less susceptible to cyclical fluctuations. These sectors account for 75 percent of California's nonfarm jobs, compared with a 70-percent share for the nation.

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The contrast in cyclical behavior is especially evident in manufacturing, which is highly vulnerable to economic contractions. Over the course of the four pre-1980 recessions, the nation suffered an average manufacturing-employment decline, peak to trough, of 9 percent, compared with a 2½-percent average decline in non-factory jobs. California suffered a smaller average decline in manufacturing—roughly 8 percent, and even less with aerospace left out of consideration.

The manufacturing-industry mix itself is another important source of difference. California maintains a smaller-than-national proportion of basic manufacturing activities, such as primary and fabricated metals, autos and heavy equipment, and textiles and apparel—all of which are vulnerable to economic downturns. Instead, California tends to emphasize high-technology sectors. "The worldwide demand for higher-technology goods, and the competitiveness of California producers, has helped to create a growth industry in the state which is usually relatively immune from fluctuations in the overall economy," says the Governor's Economic Report.

Soaring aerospace

The fortunes of the highly technical aerospace sector, with its reliance on the continued development of advanced and sophisticated products, for decades have been closely tied to the breakthroughs achieved in university laboratories and research centers. The industry has found a very fertile field in California, which boasts four of the top dozen or so graduate schools in the nation. These schools attract large numbers of top-flight students, and thus a disproportionately large share of the nation's new scientists and engineers.

California's dominance in aerospace has come about because of the continued excellence of these educational and research facilities. These facilities have originated a circular development process whereby research projects generate production contracts, which generate new research contracts, and so on. The key resource, skilled scientific manpower, also has been attracted by the state's highly touted sun, sea and sky, despite all the deterioration in this respect in recent decades.

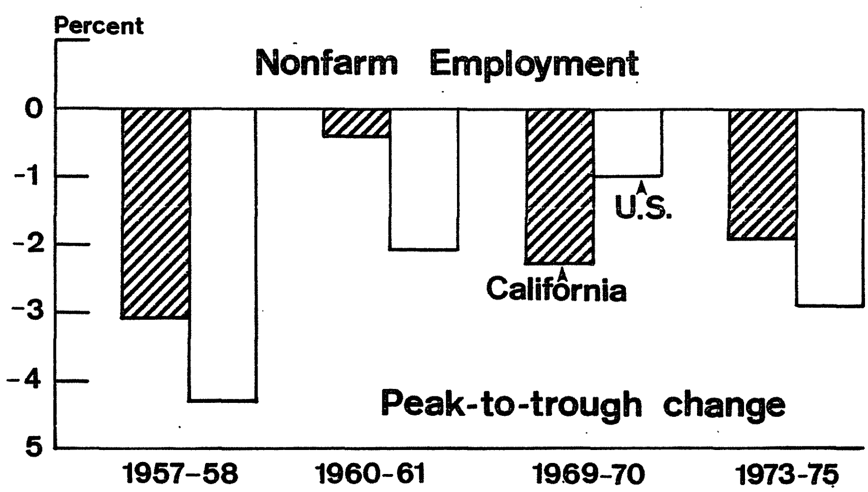
Aerospace and the companion knowledge industry generally have contributed strongly to California's underlying growth trend, except of course during the severe industry cutbacks of the late 1940's and the early 1970's. But migration has been associated with more than just this single industry—indeed, for more than a century, migration has stood out as one of the basic factors behind California's growth. The newcomers have included more than the skilled workers attracted by new industrial opportunities. They also include refugees of one type or another—for example, those fleeing from war in Saigon or revolution in Tehran, along with those fleeing from the poverty and turmoil of Mexico and Central America—or simply those fleeing from the declining industries and the energy-poor communities of the American snowbelt.

"With population growth have come new worker skills, job competition, and rising consumer demand for the goods and services provided by California businesses," in the words of the Governor's report. This is true even though the process of job creation sometimes lags behind the migrant flow, leading to periods of higher-than-national unemployment, as in the early 1970's. But the process is largely self-correcting, because high joblessness discourages migrants from coming, while a rising economy attracts new workers. Thus, net migration dropped almost to zero in 1972, but then approached or exceeded 200,000 a year in the 1978-79 boom.

The combined impact of cyclical fluctuations and strong underlying growth trends can be measured from personal-income statistics. After several decades of rapid growth, California's share of the nation's total income reached a peak of 11.4 percent in 1964. Then a relative decline set in, until the state's share of the national total fell to 10.8 percent in 1973—as a reflection of the national boom as well as the region's aerospace recession. With the strong expansion of the late 1970's, however, California's personal-income share reached a new peak of 11.8 percent last year.

Until recently, relative per capita income figures have shown a declining trend for California residents in recent decades, partly because of the state's migration-based population boom. Prior to World War II, Californians boasted about a 40-percent edge in per capita income over the national average, but that margin declined to 23 percent in 1960 and to less than 10 percent in 1973. A reversal then occurred, however, with California's margin exceeding 14 percent in 1979. But generally speaking, individual Californians have come to resemble other Americans in income terms, even while the state as a whole gains a greater share of the national total.

William Burke



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BANKING DATA—TWELFTH FEDERAL RESERVE DISTRICT

(Dollar amounts in millions)

Selected Assets and Liabilities Large Commercial Banks	Amount Outstanding 10/1/80	Change from 9/24/80	Change from year ago Dollar	Change from year ago Percent
Loans (gross, adjusted) and investments*	141,396	1,302	5,875	4.3
Loans (gross, adjusted) — total#	119,462	1,242	7,152	6.4
Commercial and industrial	35,174	828	3,426	10.8
Real estate	48,131	192	6,997	17.0
Loans to individuals	23,833	46	461	2.0
Securities loans	941	− 96	− 1,278	− 57.6
U.S. Treasury securities*	6,526	49	− 1,018	− 13.5
Other securities*	15,408	11	− 259	− 1.7
Demand deposits — total#	46,928	4,052	813	1.8
Demand deposits — adjusted	33,756	1,479	2,641	8.5
Savings deposits — total	29,934	581	− 540	− 1.8
Time deposits — total#	64,148	− 983	9,521	17.4
Individuals, part. & corp.	55,617	− 945	9,300	20.1
(Large negotiable CD's)	24,859	− 244	4,590	22.6

Weekly Averages of Daily Figures	Week ended 10/1/80	Week ended 9/24/80	Comparable year-ago period
Member Bank Reserve Position			
Excess Reserves (+)/Deficiency (−)	− 3	− 57	26
Borrowings	188	136	96
Net free reserves (+)/Net borrowed(−)	− 192	− 194	− 71

* Excludes trading account securities.
\# Includes items not shown separately.

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