Research Department
Federal Reserve Bank of San Francisco

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FRBSF Weekly Letter

Mediocre Year

The Western economy stumbled through a mediocre year in 1980, suffering first a sharp (but brief) recession and then a faltering recovery toward year-end. Some industries missed all the suffering, but others—especially housing-related industries—felt the full impact of all the negative forces operating on the national economy. And at year-end, inflation-bloated interest rates promised further problems for at least the early part of the new year.

Still, business activity in these Sunbelt states remained somewhat stronger than in the Snowbelt states of the Northeast. Much of this relative strength stemmed from continued heavy in-migration from other parts of the country and other parts of the world. Recent Census figures, while still preliminary, indicate a 21-percent gain in Western population over the past decade—more than twice the gain recorded elsewhere. The region's 37 million people—whether they arrived by car, plane or stork—represent a strong underpinning of demand in the 1980's as in the 1970's.

Modest job and income gains

Civilian employment in this nine-state area rose almost 1½ percent—an increase of roughly 200,000 new jobs—to reach about 16.2 million in 1980 (annual average basis). That job expansion, however, represented only a fraction of the gains recorded during the 1976-79 boom. But 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. (In this recession-and-recovery year, civilian employment elsewhere in the nation barely matched the 1979 average.) Employment gains were spotty throughout regional industries; even in stronger industries, such as aerospace, the job expansion was considerably weaker than in earlier years.

Reflecting this spotty job performance, regional unemployment rates increased considerably during 1980, although falling below the national figure for the first time in years. California's jobless rate, for example, rose from 6.2 to 6.9 percent between 1979 and 1980, whereas the national rate jumped from 5.8 to 7.2 percent (on average) during the year. For more than a decade, California's jobless rate had hovered one or two percentage points above the national rate, because of heavy in-migration (which bolstered the civilian labor force) and problems with key regional industries. That situation changed by the end of the 1970's because of the state's recent boom—and even though the California jobless rate reached 7.4 percent in late 1980, it lagged far below the 10-percent figure reached in the 1975 recession.

Personal income in the West increased 11 percent in 1980, to about $385 billion. But households lost ground in real terms, because of a sharp acceleration in consumer prices. The consumer-price index increased about 13½ percent at the national level, but by several percentage points more in California because of the greater upsurge in that region's home-purchase costs. In both cases, the increases were overstated because of the overweighting of housing costs in the price index—but they remained in double digits even after adjustment for that factor. Retail sales consequently remained flat (or worse) throughout the region, especially in autos and housing-related goods. Consumer credit-card buying, which had been held in check by the credit-restraint program during the second quarter, rebounded after midyear but then softened again during the fall months. And in December, many retailers resorted to pre-Christmas sales to attract scarce customers and to avoid paying high interest rates on unwanted inventory.

Spotty industrial performance

Some Western industries, especially aerospace-equipment manufacturing, showed gains in sales and employment in 1980, but

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most of the strength was concentrated in the early part of the year. Orders for commercial aerospace products slowed during the second half of the year because of the impact of the national recession. Orders for commercial jet transports fell off sharply, reflecting the decline in passenger traffic and the soaring fuel costs which affected the world's airlines. Civilian orders for electronic equipment also slowed as business firms and private households spent less on computers, communication equipment and electronic games. But defense and space business remained strong throughout the year as Western firms received a growing share of the Federal government's expanding military and space outlays.

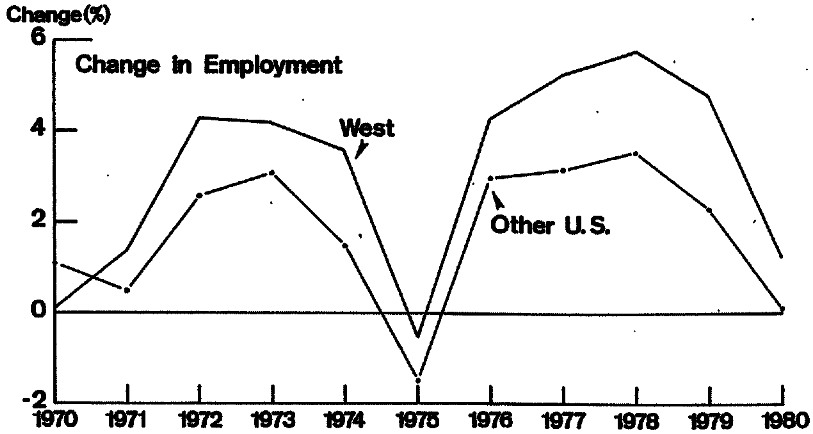
The regional steel industry suffered a year of decline. Two major regional producers began to close down high-cost production and fabricating facilities, leading to a 20-percent decline in raw production for the year. Foreign producers, benefitting from this shutdown, thus increased their share of the Western market from 34 to 43 percent. But the size of the market still declined, because of a slowdown in nonresidential building and highway construction. In contrast, the Northwest aluminum industry suffered from supply problems which made it difficult to keep pace with heavy demand. Aeorspace-related demand for aluminum remained relatively strong, but production suffered from the Northwest's prolonged dry spell, which forced recurring cutbacks in power supplies from Federal hydroelectric facilities. The regional copper industry meanwhile experienced early-year price speculation, a lengthy summer-long strike, and year-round weakness in demand from its key auto and housing customers.

Regional petroleum consumption declined during 1980, partly because of the recession, but also because of the price upsurge that followed in the wake of the Iranian revolution. Western utilities and industrial plants reduced their demand for fuel oil, taking advantage of the increased availability of clean-burning natural gas. But gasoline and diesel-fuel consumption fell even more sharply as higher pump prices persuaded drivers to reduce their consumption per vehicle. Still, Western crude-oil production increased sharply for the fourth straight year, reflecting the late-1979 boost in Alaskan pipeline capacity (and flowthrough) from 1.2 to 1.5 million barrels per day. The import share of the regional market continued dropping to 20 percent—from 48 percent at the 1976 peak—as Western refineries substituted more and more Alaskan oil for imports. Meanwhile, the continuing program to decontrol wellhead prices encouraged the highest levels of drilling activity since the mid-1950's.

Recession in housing—and lumber

The Western housing market, which had already weakened in 1979, almost collapsed in 1980. Housing starts in the Western census region dropped to about 280,000 units in 1980, as against 460,000 units in 1979, because of severe financing problems in the spring and again in the late-fall months. On the other hand, powerful economic and demographic factors stimulated housing demand—and these factors suggest the probability of a strong recovery whenever financing problems can be overcome. Many households found housing investment attractive because of rising inflation expectations coupled with the favorable tax treatment of housing. Moreover, the West's strong economic-growth prospects stimulated in-migration and family formation, further amplifying demand. These pressures became reflected in rapid increases in housing prices, with (for example) Southern California's 15-percent price increase in 1980 contrasting with a 10-percent nationwide increase. Western mortgage-financing institutions tried to meet the demand with a number of "creative financing" schemes, but their efforts failed in the face of soaring mortgage rates and sharply reduced savings flows.

The nationwide housing slump took a severe toll on the Western lumber industry, forcing a 17-percent cut in production and heavy lay-



offs on the heels of more moderate declines in the 1978-79 period. The cutback was aggravated by declines in other important lumber markets, including nonresidential construction. Softwood-lumber prices thus fell 23 percent below the fall-1979 peak at the spring-1980 housing trough, and recovered only partway before weakening again in late 1980. The industry also suffered from the Mount St. Helens eruption, which downed about one billion board-feet of timber, of which about half may not be salvageable. The pulp-and-paper segment of the industry, in contrast, recorded modest gains in sales and employment until markets began to weaken late in the year.

Spotty agricultural record

Western farmers and ranchers, like their urban cousins, were hard-pressed to keep up with inflation in 1980. According to preliminary reports, net farm income weakened substantially during the year, as soaring production costs outpaced an 11-percent increase in farm-marketing receipts. Prices for farm products generally lagged, because of large harvests and recession-weakened consumer demand, although the Western industry benefited from drought-caused shortages elsewhere in the country.

Harvests throughout the region generally were on the high side. The grape harvest approached record levels, despite a harvest-time strike, and citrus growers recorded bumper crops which sharply depressed orange prices. Sugarbeet growers benefited from strong worldwide sugar demand which sharply increased prices thus offsetting the poor profits recorded in the several preceding years. Potato prices doubled over year-before levels at the height of the drought-caused summer shortage. Northwest crops (except for cherries) generally benefited from favorable growing conditions, and this helped offset losses from the Mount St. Helens eruption—which in any case were far less than originally reported.

Cattlemen began to move onto the upside of the cattle cycle. Early in the year, many ranchers continued to reduce their herds, thus putting downward pressure on beef prices. But as the year advanced, they began to expand their herds, and beef prices rose correspondingly. Dairymen meanwhile reported a fairly profitable year, because of growing demand for dairy products.

Somber outlook

On balance, 1980 turned out to be a mediocre year for the Western economy, and 1981 could be more of the same. Western households, like their national counterparts, have tightened their belts under the spur of inflation and a tight policy response, and this means weakness in consumer markets for at least the early part of the year. Western resource industries also are likely to suffer from the growing sluggishness of demand in both national and international markets. And increasingly expensive energy could continue to spell trouble for the West's key tourist industry and other industries as well.

Still, the West seems certain to outpace the rest of the U.S. economy in 1981, as it has in other recent years. This region, because of its resource base, will continue to play the dominant role in the nation's search for a solution to its energy problems. Similarly, because of the presence here of a major aerospace industry, it will continue to play the dominant role in the nation's search for a stronger defense posture. Overseas demand for the region's farm products and high-technology products, especially in the expanding Pacific Basin countries, should provide further underpinning for the regional economy. Despite some snow flurries in this segment of the Sunbelt, the likely prospect is for sunnier skies as the year proceeds.

Regional staff

BANKING DATA—TWELFTH FEDERAL RESERVE DISTRICT

(Dollar amounts in millions)

Selected Assets and Liabilities Large Commercial Banks	Amount Outstanding 12/10/80	Change from 12/3/80	Change from year ago Dollar	Change from year ago Percent
Loans (gross, adjusted) and investments*	145,516	1,122	9,508	7.0
Loans (gross, adjusted) — total#	123,329	1,103	10,333	9.1
Commercial and industrial	36,344	50	4,186	13.0
Real estate	49,818	170	6,673	15.5
Loans to individuals	23,855	74	– 316	– 1.3
Securities loans	1,354	103	– 172	– 11.3
U.S. Treasury securities*	6,727	32	– 593	– 8.1
Other securities*	15,460	– 13	– 232	– 1.5
Demand deposits — total#	46,365	–1,182	272	0.6
Demand deposits — adjusted	34,078	98	1,335	4.1
Savings deposits — total	28,875	– 274	313	1.1
Time deposits — total#	69,939	810	11,096	18.9
Individuals, part. & corp.	60,766	739	10,611	21.2
(Large negotiable CD's)	27,722	501	5,821	26.6

Weekly Averages of Daily Figures	Week ended 12/10/80	Week ended 12/3/80	Comparable year-ago period
Member Bank Reserve Position			
Excess Reserves (+)/Deficiency (–)	n.a.	n.a.	37
Borrowings	196	65	82
Net free reserves (+)/Net borrowed(–)	n.a.	n.a.	– 45

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

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