Research Department
Federal Reserve
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Western Upturn

The economy of the Western United States appears to be recovering this year from the recession, although the results are uneven among the various states because of their diverse industrial bases. One indicator of the recovery is employment growth which, while slow, has exceeded the rate recorded nationally. It has narrowed the differentials between state and U.S. unemployment rates for Nevada, Oregon, and Washington, all of which started the recovery with unemployment rates higher than the nation's. Other states in the Twelfth Federal Reserve District, including California, Arizona, Idaho and Hawaii, have made slower progress in reducing unemployment, while in Alaska and Utah, unemployment rates have reached new highs.

Improved industrial outlook

The gains in employment are coming largely from industries that serve interest-rate sensitive markets, such as housing and automobile manufacturing. As declining mortgage rates have made homes increasingly affordable, the pace of homebuilding has picked up both in the West and throughout the nation. All nine states in the western region experienced a large increase in the number of residential construction permits issued in the first quarter of this year compared to the same period a year ago. California and Washington, for example, posted 83 percent and 86 percent increases, respectively.

The pick-up in homebuilding activity increased the demand for construction workers and construction materials, particularly for lumber and wood products produced in California and the Pacific Northwest. If interest rates remain near their current levels, the growth in homebuilding and lumber employment should continue this year.

Other key western industries remain depressed, especially those producing capital goods for use in expanding or modernizing capacity in the manufacturing and transportation sectors. Capital goods production tends to lag behind general upturns in the economy because the manufacturing sector draws from slack capacity in upturns before it adds to its capital stock.

The West has a high concentration of high-technology, capital goods producing industries, such as the electronic equipment and airframe manufacturing industries. The consumer and defense markets for these goods have grown this year and have helped to offset employment losses resulting from weak demand for business capital goods such as business computers and commercial jet transport planes. Still, layoffs have outweighed employment gains, and it will be some time before these industries experience significant overall improvement in demand and production.

The West mines and fabricates a high proportion of the metals that are used in "final" national markets such as transportation equipment, construction, machinery and equipment, and containers. It also accounts for a large share of the nation's total output of precious metals. The non-ferrous metals industries—aluminum, copper, lead, and zinc—were seriously affected when housing activity, automobile, aircraft and appliance production plunged during the recession and sharply reduced the demand and prices for these materials. Capacity utilization sank to exceptionally low levels and these industries have been slow to recover.

Similarly, the demand for gold and silver for both consumption and speculative purposes fell during the recession due to the weak worldwide economy and lower U.S. inflation. As a result, prices for these precious metals also fell sharply and have begun to rise again only recently. Furthermore, the drop in the world price of oil has reduced

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activity in western energy-producing industries and caused cutbacks in oil drilling, coal production, and synthetic fuel development. None of these industries is expected to contribute to the West's recovery in the near future.

The West's key agriculture sector also is suffering from depressed prices as a result of excessive worldwide production and weak foreign and domestic demand. The weak global economy combined with the strong foreign exchange value of the dollar have reduced agricultural exports. Prices for California fruits and vegetables have risen recently because of damage inflicted by heavy rains, but this effect may be short-lived. The federal payment-in-kind (PIK) program (under which farmers receive ownership of government inventoried crops in return for planting lower acreage) is intended to bolster prices for cotton and grains. Farmers will benefit also from lower operating costs this year because of the fewer acres planted under the PIK program and lower interest and energy costs. Still, net farm income throughout the West in 1983 may be only moderately above the depressed level of a year ago.

Diverse state performances

California, by virtue of its high concentration of capital goods producing and agricultural industries, did not begin to recover until after the national economy. The state's unemployment rate reached a peak of 11.2 percent in February. Employment growth then combined with a decline in the civilian labor force to reduce the state's unemployment rate to 9.8 percent by April. For the first time in a year and a half, California's unemployment rate was below the national average. But in May, as formerly discouraged workers re-entered the labor force in a renewed search for employment, its unemployment rate jumped above the national average once again to 10.5 percent.

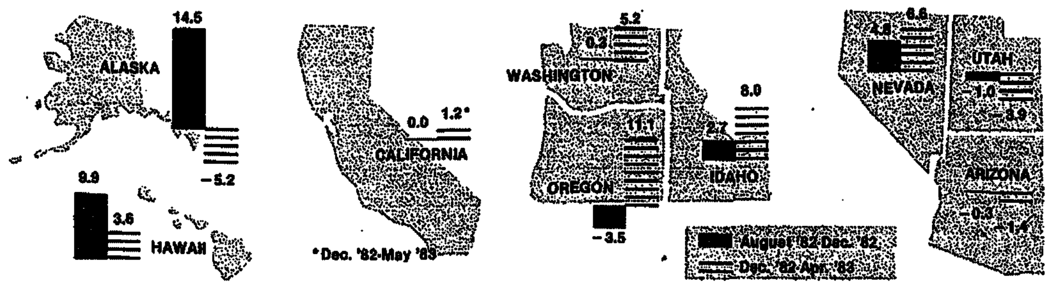
Overall employment growth in the state since the end of last year has been modest (See map). The trade, finance, insurance, real estate, and service sectors have posted sizeable gains recently. But the most impressive growth has occurred in California's construction sector. Meanwhile, there has been some recent improvement in manufacturing employment because of widespread job increases in the food processing, lumber, furniture, non-electrical machinery, and chemical industries. These increases are in sharp contrast to the layoffs that have continued in the huge aerospace equipment manufacturing industry.

The *Pacific Northwest* states have made even better progress this year in expanding employment. In both Oregon and Washington, unemployment rates have dropped at least one percentage point from the cyclical highs reached late last year. Part of this improvement can be attributed to the beneficial effects of the upswing in national homebuilding activity on the Northwest's important lumber and wood products industry. During the first four months of 1983, softwood lumber production was up 39 percent from the same period last year, while lumber prices were up on average by 12 percent. As mills gradually recalled workers, lumber industry employment in Oregon—the nation's largest lumber-producing state—jumped upward at an annual rate of 20 percent between December and April. Lumber industry employment in Washington also rose, although by a smaller percentage.

Equally important, the growth of Northwest employment has not been confined to the lumber industry and related activities such as trucking and warehousing. Employment also has been rising in such previously depressed sectors as retail trade and construction. In fact, much of Washington's employment growth has been confined to non-manufacturing sectors.

Washington—like California—has a high concentration of industries that produce durable capital goods for which business

BEHAVIOR OF EMPLOYMENT (Percent change at annual rate)



investment demand remains low. Such industries include aerospace equipment, truck building, machinery and equipment, and ship manufacturing. Therefore, apart from the growth in lumber industry employment, Washington's manufacturing sector has continued to cut back employment this year. The greatest employment cutbacks have occurred in the commercial areas of the aerospace equipment industry. The Boeing Company laid off nearly 10,000 workers during 1982 and is undergoing a similar retrenchment this year. Still other manufacturing industries, such as aluminum and paper, have not experienced a significant turnaround in demand yet, although aluminum companies have re-opened some idle capacity this year in response to the increased availability of low-cost hydroelectric power.

Most *Intermountain states*, with the exception of Nevada, show only scattered signs of recovery. In Arizona and Utah, employment actually decreased during the first four months, pushing unemployment rates up. Idaho's growth in employment could not support the renewed growth in its labor force. Nevada, however, experienced employment growth sufficient to reduce its unemployment rate despite substantial growth in its labor force.

A common problem area in these states is the mining industry. Although a few mines have re-opened, including a large silver mine in Idaho and a few copper mines in Arizona, the industry's rate of operation remains depressed. Moreover, the drop in oil prices and energy consumption has curtailed coal mining in Utah and stifled synthetic fuel development. Idaho's farms also have been suffering from the depressed prices and rising production costs that have afflicted agriculture elsewhere in the West.

Nevertheless, employment in some sectors of the Intermountain economies has increased. For example, in Arizona and Utah, the electronics industry has been benefiting from increased defense spending. Utah firms received $1.4 billion in military contracts during the first four months of this year. Throughout this region non-manufacturing employment also has increased. For example in Nevada, service sector employment has increased because of the improvement in the gaming business in Las Vegas, which more than offset losses due to winter storms in the same business in Lake Tahoe.

Alaska was immune from recession last year and appears to remain healthy. The total number of people employed there remains above the level of a year ago even though the figure has dropped thus far in 1983. The decline in the price of oil over the past year is hurting Alaska's oil industry and reducing state government tax revenues from that source. Construction, fueled by a State mortgage rate subsidy program, continues to be one bright spot, however.

Hawaii began its recovery from the recession in the last quarter of 1982 with the revival of tourism. Jobs continue to be created despite difficulties in the State's agricultural sector where key crops (pineapples and sugar) continue to suffer from low prices caused by worldwide excess supply. Hawaii's unemployment rate (at 6.3 percent in April) is far below the national average and is the lowest in the West.

Conclusion

The nine western states have vastly diverse economies. An overall appraisal of the strength of their recovery therefore is not easy to make. Most evidence, however, suggests that the West is beginning to pull out of recession. As long as interest rates remain stable, the recovery in its key lumber and construction industries should continue to boost employment. Increased defense spending should remain a positive influence. Also, as business capital investment begins to pick up later in the year, the civilian demand for capital goods should rise and boost employment. Overall, economic growth should at least match the national performance.

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BANKING DATA—TWELFTH FEDERAL RESERVE DISTRICT
(Dollar amounts in millions)

Selected Assets and Liabilities Large Commercial Banks	Amount Outstanding 6/1/83	Change from 5/25/83	Change from year ago Dollar	Change from year ago Percent
Loans (gross, adjusted) and investments*	163,088	1,091	3,280	2.1
Loans (gross, adjusted) — total#	141,533	1,128	2,411	1.7
Commercial and industrial	44,345	81	484	1.1
Real estate	56,208	32	– 998	– 1.7
Loans to individuals	23,660	110	343	1.5
Securities loans	2,641	– 56	615	30.4
U.S. Treasury securities*	8,080	162	1,835	29.4
Other securities*	13,474	– 199	– 966	– 6.7
Demand deposits — total#	44,889	5,649	2,786	6.6
Demand deposits — adjusted	27,938	126	1,548	5.9
Savings deposits — total†	67,216	740	36,069	115.8
Time deposits — total#	64,140	– 714	– 31,079	– 32.6
Individuals, part. & corp.	57,916	– 524	– 27,587	– 32.3
(Large negotiable CD's)	18,263	– 547	– 17,392	– 48.8

Weekly Averages of Daily Figures	Week ended 6/1/83	Week ended 5/25/83	Comparable year-ago period
Member Bank Reserve Position			
Excess Reserves (+)/Deficiency (–)	104	106	63
Borrowings	110	59	98
Net free reserves (+)/Net borrowed(–)	– 6	47	– 35

* Excludes trading account securities.
# Includes items not shown separately.
† Includes Money Market Deposit Accounts, Super-NOW accounts, and NOW accounts.

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