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The Western Regional Economy

Like the national economy, the western economy enjoyed broad-based, although uneven, expansion in the second year of the recovery. Economic developments in the Twelfth District, as in the nation, were driven mainly by growth in consumer spending and business investment. Highly expansionary fiscal policy, together with its effects on interest rates and the U.S. dollar, shaped the pattern of developments in the District, as did the boom in high-technology capital spending.

Differences in economic performance among the western states could be traced to an important extent to differences in their economic makeup. States with industries that relied heavily on government orders or that were part of the high-technology sector generally fared well, whereas states with industries significantly hurt by high interest rates and the strong dollar often suffered by comparison. Also following the national pattern, rapid economic growth in the beginning of 1984 slowed to a more sustainable pace in the second half of the year.

Overall measures of recovery

In keeping with its size and economic diversity, the West as a whole enjoyed an unemployment rate roughly equal to that of the nation. There was considerable diversity in unemployment rates among western states, but even so, all but one of the nine states in the Twelfth District had unemployment rates at year-end below their 1983 average rates. (See chart 1.) The lowest rate at the end of the year was enjoyed by Arizona with 4.4 percent unemployment, while Alaska registered the highest rate at 9.6 percent.

Employment growth also varied widely across the states in the District. The most rapid employment gains were made in Utah and Arizona with annual growth rates of 9.6 and 8.1 percent respectively. In contrast, employment continued to grow sluggishly in Oregon and Washington. Growth in housing activity, another important barometer of regional conditions, also varied across states although it improved in most instances over 1983. The number of housing permits issued increased most rapidly in Arizona and California and registered the slowest growth in Oregon and Idaho.

Sources of strength

As in 1983, the prominence of the aerospace and electronics industries in the region added vigor to the recovery in the West. (See chart 2.) Both increased consumer spending and increased defense spending have buoyed the demand for these sectors' products. California, which received 23 percent of all prime defense contracts in 1984, benefited most from the continued strength of defense spending. Employment in the aerospace industry in California rose by 7.2 percent in 1984, and employment in the electronics industries also increased sharply. The economies of Oregon, Utah and Washington received boosts from aerospace and electronics manufacturing activity as well. In fact, the strength of these sectors was crucial in offsetting some of the continued weakness in the important forest products industry of the Pacific Northwest region.

As was true for the nation as a whole, the general increase in consumer and business spending early last year also was a source of strength in the western economy. Employment in the services and trade industries rose an average 5.0 percent from mid-1983 to June 1984 and was particularly important to the economies of Arizona, Utah and California. In Hawaii, for example, increases in tourism helped to offset the effects of the depressed pineapple and sugar industries.

Rapid rates of spending on consumer durables and new housing in the first half of 1984 also were sources of strength in the western economy. In Arizona, construction activity was a particularly important contributor to the state's employment growth, which ranked as the most rapid in the nation in 1984. Toward year-end, however, key indicators such as automobile sales and housing starts signalled that the slowdown observed nationally was occurring in the West as well.

The boom in business capital spending nationwide during this recovery also is reflected in the District's economic performance. Districtwide employment gains of 2.5 percent in manufacturing were registered over the first half of the year, a rate only slightly below that of 1983, and nonresidential construction activity continued at high levels throughout 1984, particularly in Hawaii, Idaho and Nevada.

Areas of weakness

Despite the generally good health of the western economy, there were some markedly weak areas. Agriculture, for example, suffered from the combined effects of continued high interest rates, the international strength of the dollar, and domestic and worldwide gluts in the markets for some products. Although interest rates declined toward the end of 1984, many western farmers were having difficulty with debt burdens they had accumulated over the past several years. The Federal Land Bank reported the highest rate of farm loan delinquencies in California in thirty years, and as many as 15 percent of California farmers left the industry in the past year. Weak foreign markets and the continued strength of the dollar overseas sharply reduced the demand for many of the West's key agricultural products. The value of California farm exports in 1984 fell to $3.0 billion from $3.3 billion in 1982 and $4.2 billion in 1981.

Farm problems have been compounded by unusually large harvests for some crops, most notably, raisins, grapes and almonds. The combination of weak demand and abundant supply of some crops depressed net farm income in most of the states in the District. In California, the deterioration in agriculture has caused as much as a 40-percent decline in certain agricultural land prices. In Idaho and Utah, however, net farm income weathered the difficult economic conditions and posted increases in 1984.

The wood products industry in the West also has remained weak. Although home construction and other uses of wood products have grown significantly since the 1981-1982 recession, product prices remain depressed because of weak export markets. Special regional circumstances also limit the recovery of this industry. Pacific Northwest producers face higher stumpage, labor and transportation costs than producers in the southeastern United States. They also suffer stiffer competition from Canadian producers as a result of the increased weakness of the Canadian dollar. As a result of these competitive disadvantages, production of some wood products at the end of 1984 remained below the levels of 1979.

The weakness in the wood products industry significantly detracted from the economic performance of Oregon and Washington in 1984. Despite strength in other industries in these states, the overall performance in both was lackluster. Oregon and Washington had the second and third highest unemployment rates in the Twelfth District and the slowest overall growth in employment during the year.

The mining industry, concentrated mostly in the intermountain states and Nevada, also was affected by low prices and foreign competition. The decline in inflation over the past two years has sharply reduced the demand for the "inflation-hedge" metals, gold and silver. The subsequent fall in their prices has made much gold and silver mining in the West uneconomical. Copper mining continued to be plagued by weak world demand aggravated by a decline in international competitiveness due to the strong dollar.

Despite the weakness in both mining and forest products, the economies of the intermountain states have been among the best performing in the District. In Utah, for example, the dampening effects of these weak sectors were more than offset by broad-based strength in the manufacturing and service industries and the general stimulus provided by defense expenditures. Indeed, Utah enjoyed the third highest rate of employment growth in the nation during the first half of 1984.

The weakening of the OPEC cartel and the decline in world demand for oil are major causes of the continued poor performance of the Alaskan economy. Alaska depends strongly on oil revenues, to the extent that each one dollar decline in the price of a barrel of crude oil results in a decline of about $150 million in state revenues. For the state as a whole, employment growth in 1984 remained above national and District averages, and the unemployment rate, although still very high, remained stable in 1984. However, employment will grow more slowly during 1985 than in recent years because of declining state revenues.

Chart 1
Unemployment

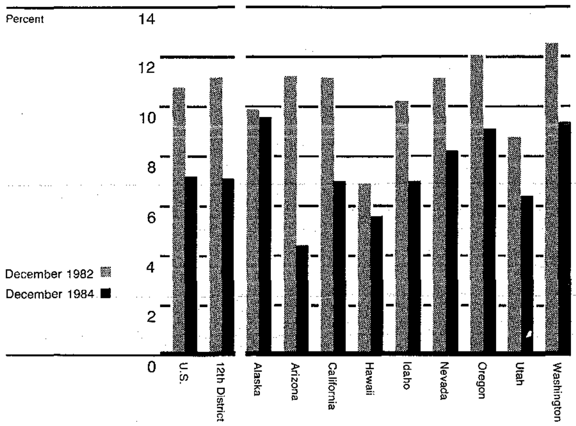
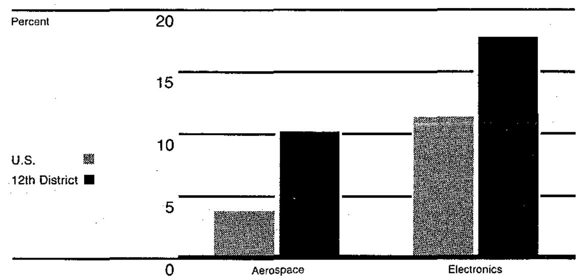


Chart 2
Aerospace



Outlook

Because the western economy is highly diversified, its overall performance next year should reflect that of the nation. Recovery should therefore continue, albeit at a slower pace. Some signs of a slowdown were evident before the end of 1984, but they did not indicate that the District's economy was heading toward a recession. This interpretation is reinforced by healthy Christmas retail sales activity and continuing declines in unemployment rates at year-end.

The decline in short-term and long-term interest rates that occurred in the second half of 1984 will stimulate spending in the interest-rate sensitive sectors of consumer durables and housing. A strong revival in housing demand would be particularly welcome in the Pacific Northwest because it would provide the necessary basis for a broad and sturdy recovery there. Recent passage of federal legislation affecting timber contracts on public lands also should help by reducing the average cost of harvested timber.

Disbursements from existing defense contract commitments should strengthen the aerospace and electronics industries through 1986. Other high technology industries also can be expected to grow through the next two years. But the U.S. dollar's continued high value in foreign exchange markets will threaten to erode even the overseas demand for electronics products, and eventually cause some jobs in these industries to be moved to other countries.

Agriculture also should be healthier in 1985 as the lower level of interest rates stemming from declines in the latter half of 1984 help relieve the current debt burden on farming operations. Export demand for agricultural products would recover if foreign currencies regained some of their strength in relation to the U.S. dollar. Whether this occurs will depend importantly on the outcome of efforts to reduce the federal budget deficit. In any event, 1985 will be a critical year for western farmers generally and California farmers in particular, as many farms already are in poor financial condition.

The economy of the Twelfth District should remain one of the most dynamic in the U.S. economy in 1985. Unlike much of the country, the western region does not depend on older, more vulnerable heavy industry. Rather, it harbors the largest concentration of high technology enterprise in the world and a diversity of other manufacturing, agricultural and raw materials industries. Such diversity gives the West the capacity to continue to grow through 1985.

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Nevada Oregon Utah Washington

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

Selected Assets and Liabilities Large Commercial Banks	Amount Outstanding 01/30/85	Change from 01/23/85	Change from 02/01/85 Dollar	Change from 02/01/85 Percent[7]
Loans, Leases and Investments[1 2]	187,204	5	11,852	6.7
Loans and Leases[1 6]	169,077	– 12	13,891	8.9
Commercial and Industrial	51,998	17	5,843	12.6
Real estate	62,025	28	2,616	4.4
Loans to Individuals	32,479	111	5,719	21.4
Leases	5,276	7	238	4.7
U.S. Treasury and Agency Securities[2]	11,036	22	– 1,205	– 9.8
Other Securities[2]	7,091	– 4	– 832	– 10.5
Total Deposits	192,237	494	6,919	3.7
Demand Deposits	44,037	726	57	.1
Demand Deposits Adjusted[3]	29,077	488	27	.1
Other Transaction Balances[4]	12,464	– 78	404	3.3
Total Non-Transaction Balances[6]	135,736	– 154	6,462	4.9
Money Market Deposit Accounts—Total	43,335	370	3,553	8.9
Time Deposits in Amounts of $100,000 or more	39,373	– 250	1,138	2.9
Other Liabilities for Borrowed Money[5]	21,449	742	1,817	9.2

Two Week Averages of Daily Figures	Period ended 01/28/85	Period ended 01/14/85
Reserve Position, All Reporting Banks		
Excess Reserves (+)/Deficiency (–)	123	21
Borrowings	57	22
Net free reserves (+)/Net borrowed(–)	66	0

1 Includes loss reserves, unearned income, excludes interbank loans
2 Excludes trading account securities
3 Excludes U.S. government and depository institution deposits and cash items
4 ATS, NOW, Super NOW and savings accounts with telephone transfers
5 Includes borrowing via FRB, TT&L notes, Fed Funds, RPs and other sources
6 Includes items not shown separately
7 Annualized percent change