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# Western Region

The diverse economy of the western region experienced a slowdown in overall growth in 1985. The unevenness in economic performance across sectors that slowed growth nationally also hurt the Twelfth District (Alaska, Arizona, California, Hawaii, Idaho, Nevada, Oregon, Utah and Washington). In addition, a number of industries in the West struggled to adjust to an environment of lower inflation and declining real asset prices.

Because of differences in industrial composition, this slowdown has affected the economies of some states in the District more than others. In particular, those states with economies that depend more heavily on agriculture, energy production, forest products, or mining posted poorer results in 1985. In contrast, buoyant consumer confidence, lower interest rates, and strong defense spending gave a boost to the economies of other states in the District.

One way to gauge the performance of this District's economy is to compare unemployment rates. For the District as a whole, December unemployment stood close to 7 percent, down from 7.3 percent a year earlier and similar to the national rate of 6.9 percent.

The economic well-being of the nine states that make up the Twelfth District differed widely. For example, in November, Alaska registered the highest unemployment rate at 10.4 percent, while Hawaii had the lowest rate at 5.4 percent. Another indication of diverse economic performance is that unemployment rates were higher than their levels twelve months earlier in three states, lower in four states, and unchanged in two states.

Unemployment rates are not always the best measure of the health of labor markets. Because people tend to leave an area with few employment possibilities, the unemployment rate in a region can *fall* even if that area's economy is troubled. Perhaps a better measure of economic well-being is the employment growth rate. For the District as a whole, employment grew 1.6 percent between November 1984 and November 1985. Utah posted the highest employment growth rate in the Twelfth District at 7.7 percent, while Arizona's employment base posted the largest decline in the District at 1.7 percent. These changes in employment compare to an increase of 1.9 percent for the nation as a whole.

**Sources of strength**

Consumer spending throughout the nation was robust in 1985, and the western region was no exception. Consequently, employment in trade and services, which together account for almost 50 percent of total non-agricultural employment in the Twelfth District, performed well. While November employment for the District as a whole was 1.6 percent above its year-earlier level, employment in trade and services grew 3.7 percent over the same period.

Employment growth in construction also was greater than the District average. Strength in the construction sector stemmed primarily from lower interest rates and, in some cases, an attempt to put projects in place before potential tax law changes made their tax treatment less favorable. Construction activity was distributed unevenly throughout the District, however. Washington, with a generally strong economy, saw almost a 10 percent increase in monthly average residential permits through November over the year-earlier level, and a 42 percent increase in the monthly average value of nonresidential contract awards during the same period. In contrast, Alaska, whose economy is more troubled, saw declines of 37 percent in average residential construction permits and 8 percent in the average value of nonresidential contract awards during the same period.

Another source of strength in the Twelfth District in 1985 was the aerospace and defense industry. In 1984, the Twelfth District received 25 percent of all prime defense contract awards in the U.S., or $37 billion. These outlays, as well as improved demand for commercial airlines, kept the aerospace sector healthy and provided an important boost to the California and Washington economies. In California, for example, aerospace jobs account for an estimated 35 percent of all manufacturing jobs and almost 7 percent of total nonagricultural employment.

A number of industries in the West failed to share in the prosperity created by strong consumer and defense spending. These industries, which include agriculture, semiconductors and electronics, forest products, oil, and mining, suffered because the international value of the dollar remained high despite a decline throughout most of the year. They were also adversely affected by greater foreign production, sagging world demand, and in some cases high U.S. costs.

**Agriculture**
In the agricultural sector, increases in the worldwide production of many important crops reduced commodity prices to exceptionally low levels. Soft export demand due to increased production abroad and the high exchange value of the U.S. dollar slowed the industry severely. In addition protectionist trade barriers and subsidies granted by U.S. trade partners have hurt the sales of some U.S. agricultural products. For example, in 1984, the value of California farm exports fell to $2.8 billion from the peak of $4.2 billion in 1981. Between 1983 and 1984, California net farm income fell 5 percent to $3.3 billion; in 1985, it is estimated to have fallen further to $3 billion or even lower according to some analysts.

Farmland values throughout the District, which rose as expectations of accelerating inflation became widespread during the late 1970s, have fallen over the last few years as the profitability of agriculture has waned. Nationwide, farmland values fell 12 percent between April 1984 and April 1985. The Twelfth District fared somewhat better, with an average drop in value of 10 percent for Twelfth District states other than Alaska and Hawaii. Many farmers who borrowed at high interest rates against the inflated value of farm real estate during the late seventies found themselves unable to service this debt in the less prosperous environment of the eighties. Several large commercial banks in California have been forced to write off large volumes of loans as a result of the financial crisis in the agricultural sector.

**Electronics**
The non-defense electronics industry, which was a source of exceptionally strong growth in 1984, stagnated in 1985, primarily due to a slump in semiconductor activity. Weakness in this industry is due to decelerating sales of microcomputers as well as a severe inventory imbalance caused by stockpiling and overproduction during the rapid growth periods of 1983 and 1984. In addition, U.S. manufacturers are suffering from intensified Japanese competition.

This weakness has been reflected in widespread layoffs, reduced work weeks, and plant shutdowns throughout the District. In California's Santa Clara Valley, which includes Silicon Valley and hence a high concentration of electronics firms, more than 5 percent of the jobs in electronics manufacturing were lost during the first ten months of 1985. In response, most firms have ceded the market for standard memory chips to Japanese producers, and are focusing increasingly on more sophisticated chip designs and customized products.

**Resource-based industries**
Throughout the Pacific Northwest, the forest products industries have been experiencing a prolonged shake-out, and continue to suffer structural problems. Contract prices in the Pacific Northwest were bid up during the boom years in the 1970s, and consequently high stumpage costs enabled producers in Canada and the southeastern United States to take a larger share of the market. Relatively slow overall demand has further weakened the forest products industries. Between 1979 and 1983, for example, the Oregon forest products industry lost approximately 20,000 jobs and saw almost one-third of its plywood mills and 20 percent of its lumber mills closed. In 1984, timber stumpage prices for new contracts, which reflect changing expectations of future profits in the industry, averaged 67 percent below their 1980 peak. In the twelve months between the second quarter of 1984 and the second quarter of 1985, stumpage prices fell 15 percent.

Recent signs are more encouraging for the Northwest timber industry. Price indices for various forest products are no longer falling as rapidly as they once were, and in some cases, they are even rising. The dollar's depreciation in 1985 is expected to result in increased demand from Japan and China, although against the yen, the Canadian dollar has fallen roughly in line with the U.S. dollar and all foreign producers continue to face Japanese import restrictions.

Softness in oil prices caused largely by the breakdown of OPEC production limits has created considerable uncertainty in the District's oil producing areas. In Alaska, government revenues depend heavily on oil taxes, and state and local government jobs account for 20 percent of all employment in the state. Consequently, weakness in the oil market caused Alaska's employment base to stagnate during 1985. Construction activity, an important source of Alaska's employment growth over the past several years, is also down sharply. In Southern California, particularly Kern County, oil is less critical to the area's economic well-being. Nevertheless, signs of the downturn are evident, both in lost jobs and in lower prices for used oil drilling equipment.

A continuing excess supply of metals worldwide has resulted in lower prices and profits for the mining industry. Foreign competition, especially in the copper industry, forced many domestic firms to reduce their production and employment significantly. One major firm shut down all its copper divisions in Utah for an indefinite period of time, causing the state to lose nearly one-third of its mining employment and an estimated 1,800 secondary jobs, totalling approximately 0.7 percent of total state employment. Parts of Nevada and Arizona likewise suffered from a virtual standstill in parts of the mining sector.

**Outlook**

For the Twelfth District's economy, 1985 was a mixed year. Strong consumer and defense spending more than offset the weakness in many of the region's goods-producing sectors. Preliminary signals suggest that 1986 also will present a mixed picture. In general, it appears that most sectors will grow moderately, in contrast to last year's dichotomous performance.

This year's sources of strength should continue to provide employment growth. Growth in consumer spending, however, is likely to slow in the coming months. In contrast, construction and defense spending are likely to continue to bolster the Twelfth District because the decline in long-term interest rates in late 1985 should help stimulate further residential construction, and possible federal government spending reductions probably will not have a major impact on military spending until after 1986.

The reduced foreign exchange value of the dollar, together with the leanness which has resulted from industry shake-outs, should cause the agriculture, forest products, and electronics industries to stabilize next year. Continued lower interest rates could even cause timber production to increase. Many believe that the inventory adjustment in the semiconductor industry is essentially over. If so, and if low interest rates encourage a continuation of high business investment activity, electronics industries also could resume their growth trends.

The outlooks for the mining and oil industries remain more clouded. The future of metals mining rests to a large extent on the course of inflation. If inflation remains low, demand will likely remain low, and metal prices are unlikely to rise substantially. The future of the oil industry is even harder to predict since oil prices depend not only on demand but also on the possibility of agreement among OPEC members.

Overall, the Twelfth District economy is likely to continue along its current moderate growth path, although the composition of that growth is likely to change in 1986. Consumer spending, as mentioned before, will probably grow only modestly in 1986. The prospects of some of the troubled goods-producing sectors, however, are likely to brighten. In particular, the forest products industries may rebound slightly, and the high tech sector may show significant—although not spectacular—growth.

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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 1/1/86 | Change from 12/25/85 | Change from 1/2/85 Dollar | Change from 1/2/85 Percent[7] |
|---|---|---|---|---|
| Loans, Leases and Investments[1 2] | 203,699 | 3,778 | 14,378 | 7.5 |
| Loans and Leases[1 6] | 184,253 | 2,720 | 13,133 | 7.6 |
| Commercial and Industrial | 53,423 | 1,498 | 477 | .9 |
| Real estate | 66,177 | 109 | 4,208 | 6.7 |
| Loans to Individuals | 38,784 | 285 | 6,520 | 20.2 |
| Leases | 5,519 | 20 | 237 | 4.4 |
| U.S. Treasury and Agency Securities[2] | 10,877 | 313 | — 329 | — 2.9 |
| Other Securities[2] | 8,569 | 747 | 1,574 | 22.5 |
| Total Deposits | 210,554 | 7,020 | 10,049 | 5.0 |
| Demand Deposits | 57,735 | 5,879 | 6,693 | 13.3 |
| Demand Deposits Adjusted[3] | 35,882 | 1,712 | 3,787 | 11.7 |
| Other Transaction Balances[4] | 15,052 | 441 | 1,733 | 13.0 |
| Total Non-Transaction Balances[6] | 137,767 | 699 | 1,622 | 1.1 |
| Money Market Deposit Accounts—Total | 45,826 | — 87 | 3,734 | 8.8 |
| Time Deposits in Amounts of $100,000 or more | 38,044 | 296 | — 2,489 | — 6.1 |
| Other Liabilities for Borrowed Money[5] | 27,198 | 1,484 | 6,400 | 30.7 |

| **Two Week Averages of Daily Figures** | Period ended 12/30/85 | Period ended 12/16/85 |
|---|---|---|
| **Reserve Position, All Reporting Banks** | | |
| Excess Reserves (+)/Deficiency (−) | 97 | 56 |
| Borrowings | 84 | 44 |
| Net free reserves (+)/Net borrowed(−) | 14 | 12 |

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