

FRBSF WEEKLY LETTER

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Western Update

The recovery in the Twelfth District gathered momentum as 1994 came to a close. Employment growth accelerated in the District and the unemployment rate continued to fall.

This *Weekly Letter* looks at the recent performance of the District state by state. Most of the improvement in overall economic activity during 1994 was the result of an acceleration of growth in California, which accounts for about 65 percent of the District's economy. Oregon, Washington, and Arizona also experienced a pickup in economic activity. In Idaho, Nevada, and Utah, economic growth was brisk in 1994, though not as robust as in 1993. Near the end of 1994, relatively few jobs were being added in Alaska, after moderate gains early in 1994. In Hawaii, labor market conditions appear stabilized, after deteriorating in 1993 and early 1994.

California

The economic news continues to be generally positive, as economic conditions improved in Northern as well as Southern California during 1994. In December, the unemployment rate fell further to 7.4 percent, or almost 2 percentage points below the state's average unemployment rate during the first quarter of 1994.

Much of the recent improvement in the state unemployment rate is due to better labor market conditions in Southern California, where the unemployment rate dropped about 1½ percentage points from the first to fourth quarters of 1994. (See Figure 1.) However, most of the strength was in the Los Angeles area, while the San Diego area showed some signs of weakness. Although labor market conditions deteriorated more in the Los Angeles area than in San Diego in the early stages of the recession, Los Angeles has seen quicker improvement since unemployment rates peaked in late 1992. Accordingly, the unemployment rate differential between Los Angeles and San Diego has narrowed to about 1 percentage point, half a percentage point less than at the beginning of 1994. (See Figure 2.)

Retail sales showed a similar pattern for California. Nominal retail sales in the state posted a

Figure 1
Unemployment Rates within California

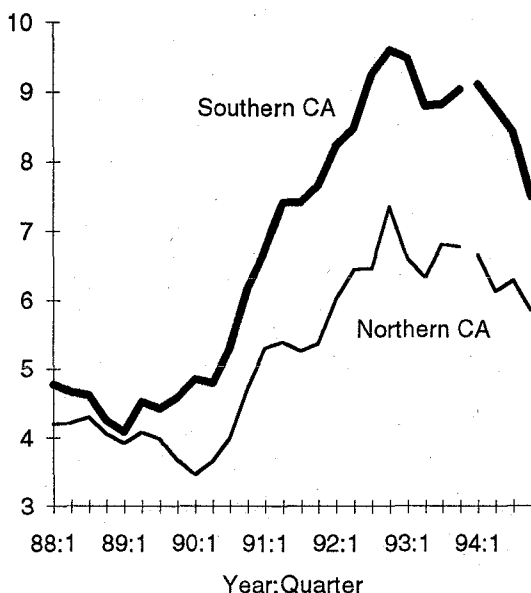
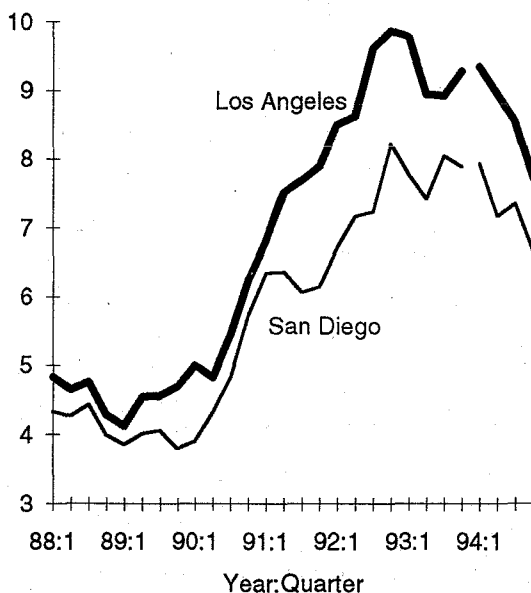


Figure 2
Unemployment Rates within Southern California



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strong gain in the third quarter of 1994, climbing to a level about 7 percent above a year earlier. Partial data and anecdotal evidence suggest that sales improved further in the fourth quarter. Compared to a year earlier, retail sales gains last year in Southern California were even larger than in Northern California. The strength in Southern California was due to a resurgence in consumption spending in Los Angeles. In contrast, retail spending in San Diego weakened in 1994.

The housing market shows more mixed signals about the extent of growth in the state economy. Housing prices stabilized in 1994, but they did not increase by as much as might be expected in a period of growth. The decline in San Diego home prices paused in 1993, a bit earlier than in Los Angeles, but the latest reading for San Diego shows renewed weakness. Existing home sales in the major metropolitan areas of California increased rapidly in early 1994. In the third quarter, there was a broad-based slowing of California home sales, leaving sales 2½ percent above the level of a year earlier. Even with the slowing in sales, new home construction in California continued to expand rapidly in late 1994; the number of residential construction permits issued in the state moved up to 8,100 units in the fourth quarter, 9 percent higher than a year earlier.

Oregon

The state unemployment rate moved down to 5 percent in September and remained near this lower level in the fourth quarter. Payroll employment growth accelerated in 1994 to a 3.8 percent pace, fueled largely by a surge in construction employment, continued rapid gains in the services sector, and a pickup in manufacturing and government employment.

Although the strength in Oregon manufacturing lies outside the forest products sector, employment in the lumber and wood products industries held up relatively well in 1994. The inventory of timber under public contract dwindled so much that some analysts in the state report "no public timber supply in sight," but increased cutting of private timber made up for much of the loss. Looking ahead, lumber manufacturers appear concerned that the increased cutting of private timber is unsustainable.

Washington

During 1994, labor market conditions appeared to be improving. The state unemployment rate dropped below 6 percent late last year, and payroll employment increased 2.1 percent in

1994, about three-fourths of a percentage point faster than in 1993. Job growth accelerated last year in the construction, transportation, trade, and government sectors. Also, manufacturing employment was about unchanged last year, after falling 2¾ percent in 1993. (This, of course, does not account for Boeing's recently announced plans to cut 6,500 jobs in Washington in 1995, as production is scaled back on its 737 and 767 jetliners.) Toward the end of 1994, gains in manufacturing employment were only partly offset by declines in the construction sector.

The recent drop in Washington construction activity appears largely due to a lull in the residential sector. In the fourth quarter, the number of residential construction permits declined to 3,700 units, slightly below the level of a year earlier; in contrast, non-residential construction awards continued strong, as the value of non-residential awards increased to a level about 20 percent above a year earlier.

Washington's agricultural sector appears vibrant. Major crops, such as apples, potatoes, and grapes, are reported to be in strong supply now. Many agricultural producers also expect to benefit soon from the recent GATT accord, which opens access to foreign markets by harmonizing some agricultural inspection standards.

Arizona

The pace of growth continues to accelerate. Payroll employment grew 4.9 percent during 1994, significantly faster than the 4.1 percent growth posted in 1993. As a result, Arizona ranked third nationally in payroll employment growth, the first time in several years that it has ranked among the top five states in the country.

Arizona's accelerating growth in recent months is reflected in a sharp reduction in office vacancy rates in both Phoenix and Tucson. In 1992, vacancy rates were well in excess of 20 percent in downtown and suburban markets in both cities. While downtown vacancy rates remain high (18.9 percent in Phoenix and 24.6 percent in Tucson, compared with a 16.3 percent national average), suburban vacancy rates are well below the national suburban average of 15.6 percent. The suburban office vacancy rate is 14.0 percent in Phoenix and 11.8 percent in Tucson.

Idaho

Economic growth has moderated slightly, but the expansion remains faster than average. During 1994, employment grew 4.5 percent, down from 5.5 percent in 1993, but still ranking as the seventh fastest job growth in the nation. Employment growth picked up slightly in November and December after flattening between July and

October. Service sector job growth has been especially strong in the last two months. Business service employment grew 7.1 percent in 1994, but that is down from over 14 percent during 1993.

Much of the slowing is the result of an easing in the rapid pace of construction activity. Residential building activity appears to have peaked in the first quarter of 1994, but the level of activity remains above the level of the last several years. Similarly, construction employment has been flat since June, but still increased 13.2 percent in 1994.

Nevada

The pace of economic expansion also has eased the state. Employment grew 4.2 percent during 1994, down from 7.2 percent in 1993. Much of the slowing in employment has come in the construction and real estate sectors. Construction employment increased 4.7 percent in 1994, compared with a rise of 11.6 percent in 1993. Similarly, the number of finance, insurance, and real estate jobs rose 1 percent in 1994, down from 8.1 percent in 1993. Expansion of gold mining operations in Nevada during 1994 led to the first annual increase in mining jobs since 1989. Total mining employment rose 4.8 percent during 1994, compared with a drop of 3.1 percent in 1993.

The slowing in building activity is not surprising given the number of new hotels and casinos built before 1994. Las Vegas now claims ten of the eleven largest hotels in the world, each with over 2,500 rooms. With the new capacity, gaming revenues show strong growth from earlier figures. Revenues increased 16 percent in the fourth quarter of 1994 from a year ago.

Utah

Economic growth has slowed slightly, but the level of activity remains among the highest in the nation. During 1994, employment increased 6.2 percent, down from 6.9 percent in 1993, but still the fastest job growth in the U.S. Residential construction activity peaked in the first quarter of 1994. The number of residential building permits in the fourth quarter was down 13 percent from the first quarter. Commercial construction activity continues strong, however. Vacancy rates in Salt Lake City at the end of 1994 remain low at just 7.5 percent.

Population grew 2.7 percent in 1994, with 46 percent of the increase due to net in-migration.

Strong economic growth and population gains have led to state government budget surpluses in recent years.

Alaska

Job growth appears to be slowing. Nonfarm payroll employment is estimated to have edged up only 0.7 percent in 1994, after increasing 3.2 percent the previous year. The government sector shed jobs last year, while growth in construction employment slowed and manufacturing and mining operations were scaled back. Although the federal, state, and local government sectors each cut employment in Alaska last year, the cutbacks at the state level were not as severe as at other levels of government, despite the pressure on the state budget from declining oil-related revenues.

Hawaii

The economy shows signs of a modest upturn. Payroll employment grew in December, for the second consecutive month, bringing the number of jobs to a level just 0.3 percent below a year-earlier. In addition, the unemployment rate fell to 5.5 percent toward the end of the year; however, this unemployment rate is still more than twice as high as the rate before Hawaii's recession. One reason for the apparent turnaround is that the number of visitors to Hawaii continues to climb. A survey of consumer confidence indicates that 60 percent of respondents expect economic conditions to improve during the next 12 months, compared with 40 percent who expect them to deteriorate.

On Kauai, economic activity has increased substantially from the low levels following Hurricane Iniki more than two years ago, but the level of activity remains lower than its pre-Iniki level. After the hurricane, the number of visitor arrivals fell by more than four-fifths, but the number of visitors has now climbed back up to about two-thirds of its pre-Iniki level. The number of hotel rooms on the Island is up to 80 percent of what it was before Iniki. Correspondingly, the burst of construction activity that followed the hurricane has subsided, although the pace of activity remains well above its pre-Iniki level.

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