

Research Department Federal Reserve Bank of San Francisco

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Western Scene

The first-half scorecard for the Western economy contained a mixed bag of statistics. The overall trend of activity generally paralleled the national performance—declining during the winter months and recovering somewhat during the spring—but there were also significant differences. Here are some of the highlights:

- Total employment in the nine Westernmost states increased at more than a 2-percent annual rate, somewhat faster than nationally.
- Factory output, although rising this spring, lagged behind the national pace over the entire six-month period.
- The Western economy as a whole, and especially California, continued to be beset by structural problems of high unemployment and severe inflation.

Regional manufacturing production declined sharply during last winter's fuel shortage, but then recovered at least partway as the supply situation improved this spring. Even so, regional production this spring still lagged 4 percent behind last fall's peak, compared with a 2-percent decline nationally.

Western durable-goods producers—especially producers of fabricated metals, machinery and transportation equipment—recorded the sharpest declines last winter and the sharpest recoveries this spring. In contrast, production held up well last winter in food processing and other nondurable-goods industries, but then weakened in recent months.

Nonfarm payroll employment rose by 75,000 (to 12.0 million) during the first half, with about one-half of the gain occurring in government—Federal, state and local. The gain would have been greater except for a noticeable drop this spring in manufacturing jobs. Cutbacks in California's aerospace industry and reduced activity in the Pacific Northwest's forest-products industry accounted for much of the decline.

Problems: jobs and prices

The overall job expansion was accompanied by a considerably faster rise in the labor force, so that the regional jobless rate in recent months reached 7.3 percent—up from 6.6 percent last fall. (In the same period, the national rate rose from 4.6 percent to 5.2 percent.) Not surprisingly, 24 of 35 metropolitan areas in the West were classified this spring as areas of "substantial or persistent" unemployment. This sluggish condition reflected, among other factors, the continuation of a relatively modest recovery in the key aerospace-manufacturing sector, following the severe decline recorded around the turn of the decade. The job situation in the last several years has not been helped by an increase in in-migration, although the flow of newcomers still lags considerably below the very heavy pace of the 1950's and 1960's.

This year's job expansion, along with a rising wage trend, caused a significant rise in consumer incomes

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in dollar terms, but incomes apparently declined in real terms because of a 12-percent annual rate of increase in prices. With purchasing power held down in this fashion, retail sales in the West rose at only a 3.5-percent annual rate from last fall, compared with a 5.4-percent increase nationally. Sales of non-durable goods increased substantially, mostly as a reflection of sharply rising food costs, while purchases of durable goods (especially autos) actually declined.

Strength in farming

The farm sector continued to lend solid support to the regional economy, although in some cases declining prices caused receipts to fall somewhat below the unprecedented levels of last summer and fall. Cash receipts of farmers and ranchers reached \$5.5 billion in the January-June period—25 percent above the comparable year-ago figure—at least in part because of the wheat-and-potato boom of the Pacific Northwest. Farm exports, although trending downward this spring, are still about two-thirds above year-ago levels.

Western crop prospects appear favorable in view of a record expansion of acreage and favorable growing weather, but livestock prospects are somewhat somber because of a rapidly developing cost-price squeeze. For 1974 as a whole, gross cash receipts could increase about 14 percent to \$14 billion—somewhat better than the prospect for farmers nationally. However, net

farm income may be slightly lower than last year, in view of a sharp rise in production costs and a substantial drop in government payments.

Another basic Western industry, aerospace manufacturing, reduced its payrolls slightly to 595,000 during the first half of the year. However, the decline was much smaller than had been anticipated early in 1974, when a business slowdown, fuel shortages and cutbacks in scheduled flights threatened a sharp cutback in airline passenger traffic and thereby in commercial-aircraft orders. The decline centered in California, where the postponed delivery of nine L-1011 jetliners forced layoffs at Lockheed Aircraft and its subcontractors. Meanwhile, Western aerospace firms captured about \$1.9 billion in military prime-contract awards during the first quarter, and thus maintained their roughly 27-percent share of total Pentagon spending.

Weakness in homebuilding

A third major support of the Western economy, homebuilding, lagged considerably during the first-half period. Housing starts declined at about a 14-percent rate from the second half '73 figure to a level of about 321,000 units (annual rate), while mobile-home sales also fell steeply, after some years of outpacing the fixed-site homebuilding sector. Permit activity held up somewhat better than housing starts, in many areas matching late-1973 levels, but the outlook at midyear nonetheless remained

worrisome, because of financing difficulties and a serious overhang of unsold housing, both of completed and uncompleted units.

For prospective home buyers, steadily rising prices and record borrowing costs were doubly discouraging. Between December and June, conventional new-home mortgage rates jumped almost a full percentage point to 9.60 percent, and at midyear builders had to pay construction-loan rates of 14 percent or more in a number of major markets. The sharp rise in mortgage rates reflected not only the impact of exceptionally heavy credit-market demands, but also the reduced inflow of savings into thrift institutions brought about by the attractive yields available on competing market instruments. The net inflow of savings into the S & L's dropped about 35 percent from year-ago levels.

Strength in basic industry

With a nonresidential building boom offsetting the housing slump, the lumber industry experienced only a modest decline in output during the first half of the year. At the same time, demand for pulp and paper remained exceptionally strong, so that prices in this segment of the forest-products industry rose 21 percent above a year ago.

Tight supply versus strong demand was the scenario in the metals industries. For example, steel demand burgeoned on the basis of continued strength in the nonresidential-construction market and

a reduced inflow of imports into the region, but the supply situation weakened as producers, in their rush for all-out production, suffered furnace breakdowns due to deferred maintenance. Prices soared for steel-mill products, rising 23 percent between April and early July alone. In this situation, major expansion programs were launched at two major regional plants.

Improved availability of hydroelectric power, following the end of the Pacific Northwest drought, enabled aluminum producers to restore operations to full capacity early in the year. Supply expanded not only because of this production increase but also because of producers' purchases of 450,000 tons of government stockpile metal—yet demand rose even more rapidly, so that ingot prices rose 44 percent above year-ago quotations.

On the energy front, petroleum-refinery output lagged considerably below earlier levels, reflecting a decline in domestic crude-oil production, the Arab oil embargo, and a cutback in imports from other countries, such as Canada. Not surprisingly, prices of refinery products by mid-year were 82 percent higher than a year ago. Meanwhile the Alaska pipeline boom finally got underway, six years after the discovery of the Prudhoe Bay bonanza, as a frenzied pace of construction and related activities took hold in Alaska and in such supply centers as Seattle.