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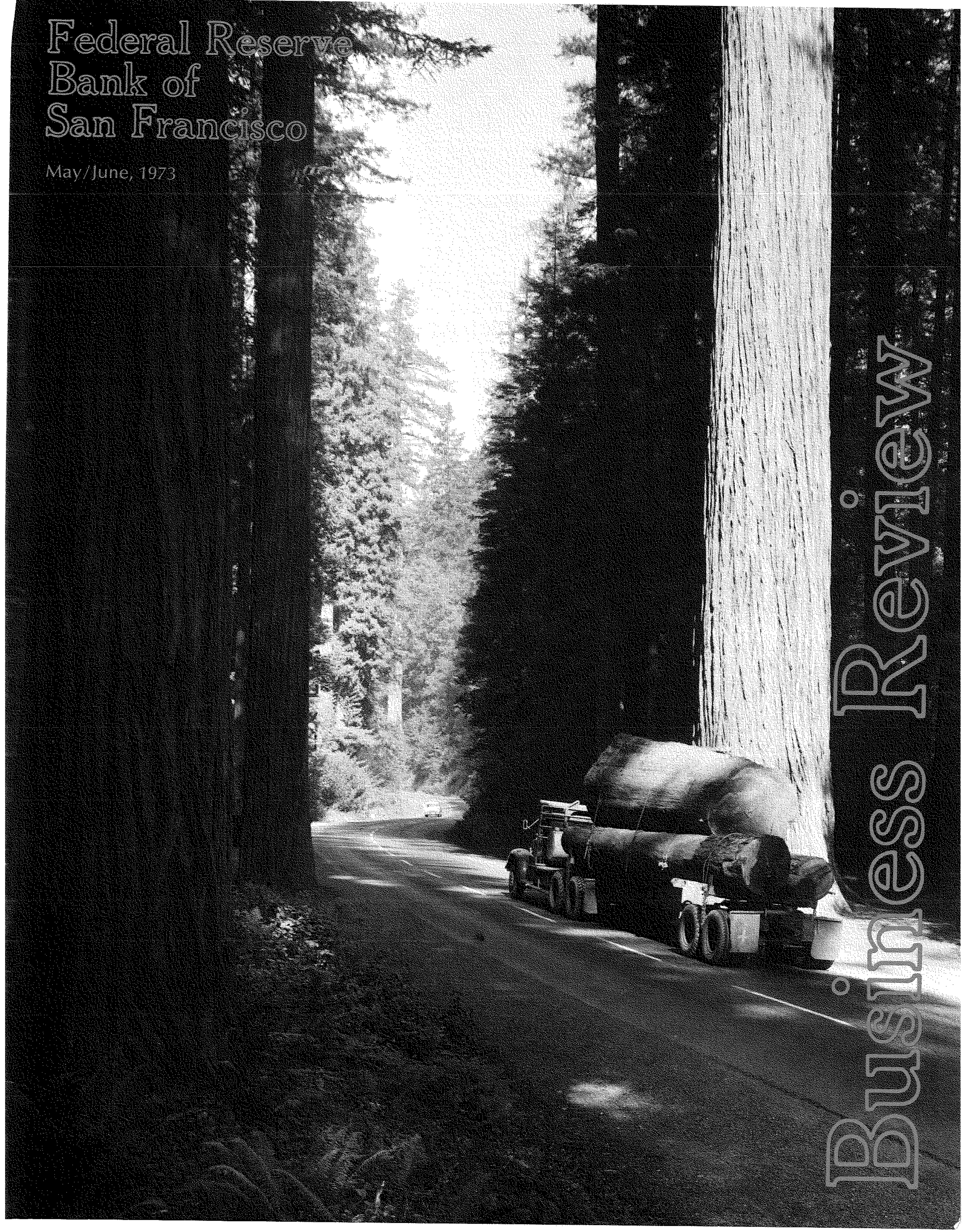
Business Review



Boom in the West

. . . The West participated fully this spring in the nationwide business upsurge.

Banking the Boom

. . . Western banks obtained funds at ever-higher rates to finance the spectacular boom.

Cyclical Patterns

. . . Cyclical swings in income tend to be more moderate in the West than in the nation.

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Boom in the West

The Western boom accelerated this spring, under the impact of strong national and international demand for the products of the region's farms and factories. During the first four months of the year, employment increased significantly throughout the San Francisco Federal Reserve District—the nine western-most states—and preliminary figures for the late-spring months suggest a continuation of this trend.

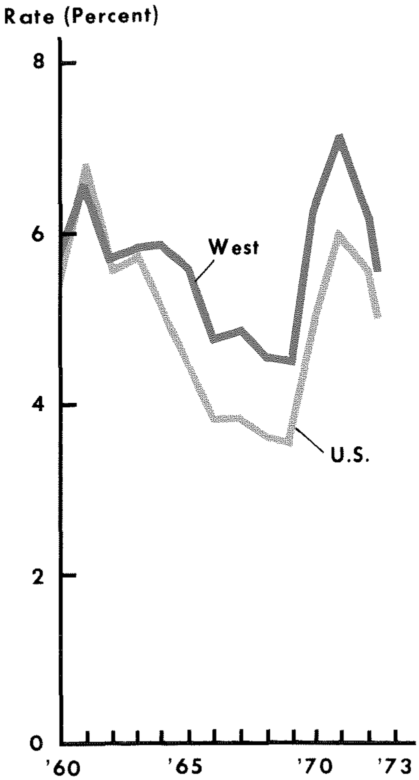
Nonfarm employment increased at a 5-percent annual rate during the January-April period—even faster than the strong 1972 pace—with much of the strength showing up in such cyclical industries as manufacturing and construction. Trade and service industries also added large numbers of new employees, but government employment rose only modestly, reflecting a hold-down on Federal payrolls.

With business activity expanding strongly on every front, unemployment continued to decline steeply, as it had throughout most of the past year and a half. The jobless rate dropped from 5.9 percent in the final quarter of 1972 to 5.4 percent in January-April 1973, and it apparently continued to fall in more recent months, while the national rate still hovered around the 5.0-percent mark. The drop was especially marked in California; the jobless rate in that state fell below the national level in May, in contrast to the situation throughout most of the past decade, when it ranged as much as one full percentage point above the national average.

Boom-level demands

The strong pace of consumer buying was maintained throughout the early months of 1973, as evidenced by sharp sales gains not only for autos but for other types of goods as well. But with prices soaring, real gains were only moderate in most sectors, especially food. The boom was supported by an upsurge in consumer credit—especially for autos—and by massive increases in tax refunds from the Federal and (California) state governments.

Business firms spent substantial sums on plant, equipment and inventories in early 1972, in an attempt to keep up with boom-level demands. In addition, they relied heavily on the banks to finance their operations, accounting for over one-half of the first quarter's total bank-loan expansion. Other factors were involved in their heavy bank borrowing,



Western business expands, narrowing unemployment gap

however—for instance, the attractiveness of bank lending rates as opposed to commercial-paper rates, and the financing requirements of international operations during the foreign-currency crises of February and early March.

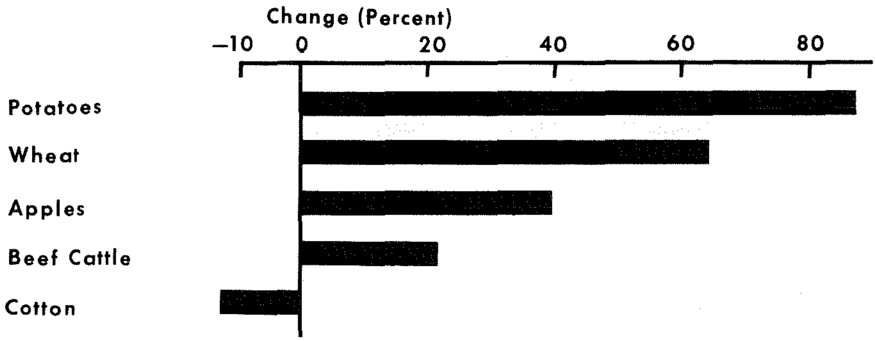
The upsurge in business borrowing was broad-based, both geographically and industrially. Machinery manufacturers and other durable-goods firms were the heaviest borrowers, although loan demand was also strong in the retail-trade and nondurable-manufacturing sectors.

Fiscal ease

State and local governments continued to revel in a position of unaccustomed fiscal ease, with the help of boom-generated tax revenues and Federal revenue-sharing funds. However, the states remained fearful that they would lose more from announced cutbacks in certain Federal programs than they would gain from increases in revenue-sharing funds. Washington organized an Office of Community Development to deal with this problem, and Oregon planned a special legislative session to find ways of financing threatened programs.

Oregon voters meanwhile voted down a tax-revision plan that would have revamped public-school financing by increasing personal and corporate income taxes and by terminating most home owners' property taxes. Hawaii is still the only state that finances its school system on a statewide basis without reliance on property taxes.

Municipal-bond borrowing began to pick up from its moderate 1972 pace, as new issues totalled $988 million for the January-April period. Local governments in California, Arizona and Washington, and state agencies in Washington, Oregon and Hawaii all went to market with fairly sizable issues. By late in the first quarter, growing capital market pressures showed up in sharply rising interest rates, but some easing in rates later developed. In April, yields on rated general obligations reached 5.07 percent, and yields on revenue bonds rose to 5.43 percent—in each case, at least 30 basis points above last December's levels.



Soaring wheat and potato prices boost returns to crop farmers in Northwest, while soaring beef prices boost ranchers' receipts

Farm boom
The farm boom continued to dominate the headlines, as cash receipts jumped 17 percent above year-ago levels to reach $1.9 billion during the first quarter of the year. (Even so, the gain lagged the 25-percent increase recorded nationwide.) Sharply higher wheat and potato prices boosted returns to crop farmers in the Pacific Northwest, while soaring meat prices contributed to higher receipts for California, Arizona and other livestock states.

Significant year-to-year price increases included potatoes (87 percent), wheat (64 percent), apples (40 percent) and beef cattle (22 percent). Among the major crops, only cotton (-12 percent) has suffered a price decline since last spring. (Cotton prices have recently strengthened, however, because of heavy sales to the Far East and flood-caused crop damage in the Mississippi area.) With price increases of this magnitude, the gain in gross farm income considerably exceeded the continued increase in production expenses during the early part of 1973. As a result, net farm income is now expected to show another significant increase this year.

Field-crop production may expand sharply—especially wheat, because of higher prices and the elimination of "set aside" requirements for wheat acreage. Spring-wheat plantings have risen substantially in the Northwest, with acreage doubled in Washington and up by half in Idaho and Oregon. (Yields per acre might decline, however, because of recent drought conditions.) In view of this expansion and the stratospheric level of wheat prices worldwide, wheat crop receipts are expected to rise quite strongly this year.

The number of cattle and calves on feed rose in the early spring months, but the increase was smaller than expected because of heavy rains and muddy feedlot conditions. During the first quarter, California and Arizona recorded 3-percent and 12-percent increases, respectively, in feedlot receipts—far below the gains of early 1972. In view of this relative moderation in supply and the imposition of ceilings on retail meat prices, increases in livestock cash receipts may be somewhat limited over the year as a whole.

Aerospace recovery
Western aerospace manufacturers continued on the recovery path as they added 7,900 workers to their payrolls during the first four months of 1973. This increase brought total employment in the industry to 560,000—about 10 percent above the mid-1971 low but still somewhat below the late 1967 employment peak. Overall gains were substantial in both Washington and California, although in the latter state, layoffs in the aircraft sector partly offset gains in the electronic-equipment sector of the market.

The airlines increased their orders for medium-range transports (especially Boeing's 727 and McDonnell-Douglas' DC-9) at a rapid clip, on the basis of an anticipated 10-percent increase in passenger traffic in 1973. Orderbooks consequently are thick enough to ensure full-capacity operations on these models through at least the latter part of this year. But little help is expected from military and space spending in coming months, especially in view of the windup of the Skylab program and various other budget cutbacks.

Construction upsurge

Construction activity remained very high, in dollar terms, during the January-April period. Contract awards for residential construction rose 4 percent above 1972's pace to an $8.6-billion annual rate, reflecting some increase in the average size of units as well as a continued rise in construction costs. Awards for nonresidential building rose at a much faster pace while heavy construction dropped off, as sharp gains for stores, factories and public buildings offset declines in awards for construction of streets, highways and electric-power facilities. For the year as a whole, industry sources expect some weakening in the residential sector but a record high level of activity in nonresidential construction.

The number of housing starts declined 12 percent below the average 1972 pace during the January-April period, to an annual rate of 465,000 units. (During this period, the market was weaker in the West than elsewhere, in respect both to the number of starts and the number of mobile-home sales.) Housing-permit activity held up well through March, partly reflecting efforts by California builders to get under the wire prior to the April 5 expiration of the moratorium on the state's environmental-impact law, but permits then dropped sharply in April to the lowest level of the past two years.

Mortgages and savings

Even so, the pace of mortgage lending picked up in the winter and early spring months, as a consequence of the earlier boom in starts, as well as the efforts by some borrowers to obtain financing now in anticipation of higher mortgage rates later in the year. Through April, mortgage portfolios of banks and savings-and-loan associations expanded by about $1.0 billion and $2.5 billion, respectively, while S&L loan commitments increased over the period to a record $2.8 billion.

At the same time, weakening savings inflows this spring raised questions about the durability of the mortgage-lending boom. Over the January-April period, net savings inflows into banks and S&L's reached $370 million and $1.8 billion, respectively—substantially below the levels of the comparable year-ago period. During April, in fact, depositors at both types of institutions made net withdrawals, reflecting the need to meet tax obligations and the desire to shift funds into market instruments offering higher yields.

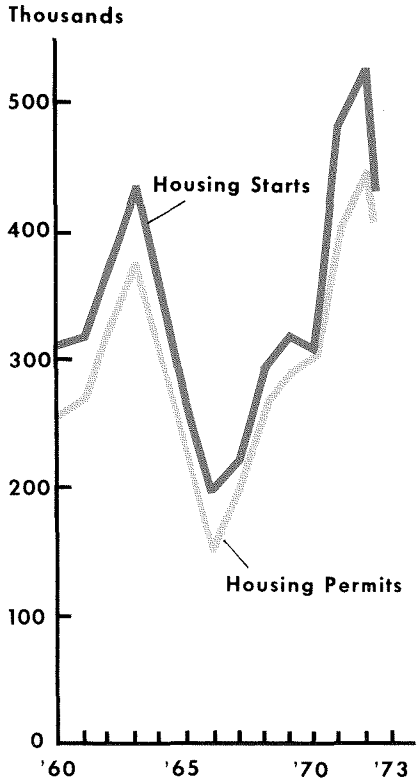
Mortgage lending rates thereupon began to firm, as a consequence of the high level of mortgage demand and the decline in savings inflows, as well as the continued concentration of savings gains in higher-cost certificate accounts. The average rate on conventional new-home loans rose 35 basis points over the January-April period to 8.05 percent. Moreover, non-price terms of lending began to tighten, as lenders increased downpayment requirements and reduced average loan maturities.

Price pressures

The insatiable demand for materials generated by the nationwide business boom caused prices to soar in the Western extractive industries throughout the winter and early spring months. In lumber, the Phase III removal of mandatory controls caused a sudden price upsurge as Northwest mills adjusted to the "free market" levels quoted by Canadian producers. Then, as demand pressures continued, lumber and wood-product prices rose at a 64-percent annual rate over the January-April period.

In early April, the Cost of Living Council acted to reduce Japanese purchases of American logs and to increase timber sales from Federal forests. These actions, together with the slower pace of residential construction, helped improve supply conditions and thereby triggered a price decline. Thus, prices of key homebuilding items dropped as much as 15 percent between early April and late May.

Nonferrous-metal prices rose sharply over the first four months of the year, as a devalued dollar and strong market conditions abroad raised prices of imported concentrates and refined products. Domestic copper producers increased the price of refined copper 19 percent, thereby restoring the quotation to the peak of 60 cents a pound reached three years ago, and zinc and lead producers boosted their prices by smaller amounts. At that point, the Administration announced plans to slash its metals stockpile objectives, in an attempt to get more supplies into the market.



Several measures indicate decline in new housing activity

Metals and oil

Aluminum producers responded to boom-level demands by restoring operations nearly to full capacity, and by obtaining sharply higher prices for ingot and fabricated products. Between December and early April, the selling price of ingot rose almost 22 percent to the published level of 25 cents a pound, ending more than three years of heavy price discounting. A major production problem then developed in mid-April to complicate the industry's operations; Northwest producers were forced to shut down about 245,000 tons/year of capacity, when an abnormally low stream runoff from the mountains caused a 50-percent cutback in the interruptible power supplied by the Bonneville Power Administration.

The Western steel industry experienced boom conditions, especially for construction steel, as production rose above the 1972 pace and even exceeded 1969's previous record level. The import surge meanwhile began to moderate in March, as devaluation plus strong overseas demand induced Japanese producers to turn to other markets. On the price front, domestic producers raised prices on a wide range of structural and tubular products by 5 percent in early January, and later announced similar increases for flat-rolled sheet products for mid-June. Because of the price freeze, however, those June increases did not go into effect.

Western oil refineries, although still operating below full capacity, increased their activity about 8 percent above year-ago levels in the winter and early spring months. Refineries were forced to rely increasingly on foreign supplies to meet their requirements, since crude production from domestic sources continued to decline. The Administration acted in mid-April to help refineries obtain even more foreign supplies, by suspending oil-import quotas and removing all existing tariffs on imported crude and products.

Oil from Alaska remained only a distant possibility. The Supreme Court in April declined to reverse a lower-court decision barring construction of a trans-Alaska pipeline, on the grounds that the pipeline would violate a provision of a 1920 act limiting rights-of-way across public lands. Even if Congress removes this roadblock this year, it could be 1978 before oil starts to flow from Prudhoe Bay.

All in all, the Western economy participated fully this spring in the nationwide business upsurge, the strength of the boom being reflected in the faster-than-national drop in the jobless rolls. With the possible exception of a slowly recovering aerospace industry and a slowly declining housing industry, output of the region's farms and factories expanded at a near-capacity pace over this period. Given the present state of orderbooks, continued substantial gains seem assured for most of the rest of the year.

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