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# FRBSF WEEKLY LETTER

August 17, 1990

## California's Recent Performance

Many have begun to worry lately that the Golden State may be losing its luster, and may be poised for a serious recession. They point out that California's economy has grown more slowly than it did a year ago and that construction and real estate markets in the state have cooled considerably. They also suggest that anticipated cuts in defense spending will exacerbate the slowdown.

In this *Letter*, we examine recent and longer-term trends to gain some perspective on the recent economic performance of the state. Although it is true that the state's economy has slowed compared to a year earlier, real estate activity and overall employment growth are relatively sound when compared to conditions before the mid-1988 to mid-1989 period. Thus, the outlook for California's economy hinges on whether the drop in activity from a year earlier reflects a return to a more moderate level, or whether that decline marks the beginning of a regional slide. Our analysis suggests that the first interpretation may be more accurate.

### Employment and real estate

During the past year, California's economic growth slowed from the rapid pace of the preceding year. Between July 1989 and July 1990, employment grew 2.5 percent, down significantly from the 3.4 percent rate during the year that ended in July 1989. However, the current growth rate is not far below the three percent average pace seen between 1985 and 1989. Moreover, California's employment growth still looks strong compared to the 1.8 percent growth seen nationally in the past year.

In addition to slower employment growth, the state has seen construction activity and real estate markets cool off. This cooling looks particularly dramatic for home sales and median home prices. According to data compiled by the

California Association of Realtors, the seasonally adjusted annual rate of home sales in June 1990 was 443,000 homes, down sharply from 539,000 in 1989 and 563,000 in 1988. The statewide median home price in June, at \$195,000, was 2.3 percent below its year-earlier level.

Construction activity also has shown signs of weakening, with the number of housing permits issued during April and May at the lowest level since Spring 1983. The value of new awards for office construction during the first five months of 1990 fell 35 percent below its year-earlier level, a decline that was only partially offset by increased awards for roads and bridges.

Declining real estate values decrease the value of collateral to lenders, and frequently reflect reduced expectations about the future of a region's economy. Moreover, declining construction activity has a direct effect on economic activity, replacing a source of growth with a sector in decline. For these reasons, many are concerned that California may follow the lead of Texas and New England, where real estate problems have been associated with regional recessions.

However, the recent figures are less alarming when viewed in longer-term perspective. For example, the current pace of home sales represents a relatively modest decline from the 488,000 pace of 1986, the last full year before the state's most recent boom. Also, the decrease in the state's median home price is partly due to the changing composition of home sales; a greater proportion of current sales are in lower-priced locations than was the case a year ago.

It also is important to consider that California is coming off an incredible boom in real estate and construction activity which propelled the median home price to a level that is more than double

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**THE WESTERN ECONOMY** *The Western Economy* is a quarterly review of economic conditions in the Twelfth Federal Reserve District. It is published in the *Weekly Letter* on the third Friday of February, May, August and November.

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the current national median and 50 percent higher than California's 1986 median. The current cooling in real estate markets and decline in construction activity thus may mean that the state merely is returning to what might be considered more "normal" conditions.

Slower construction activity may even be a positive development to the extent that the state becomes less vulnerable to the severe overbuilding that generated slumps in many other parts of the country. In Texas and New England, for example, construction activity continued to boom for a few years after key industries began to falter, leading to serious overbuilding. In contrast, California's current slowdown in construction activity coincides with slower overall growth, so severe overbuilding is less likely.

## The impact of defense cuts

Another, frequently-voiced concern is that defense cuts will have a severe impact. California received 19 percent of the value of all Department of Defense prime contracts in Fiscal Year 1989, with more than \$1,000 in new contracts for each resident of the state. Up to 20,000 aerospace jobs could be lost by the end of this year. This loss is larger and more sudden than was the loss of 7,000 aerospace jobs over the past two years. As such, the expected cutbacks may be more difficult for the California economy to absorb than was the case with the earlier loss.

At the same time, however, much of the expected loss probably will be offset by gains in other sectors. A loss of 20,000 jobs during the year is modest compared with an average gain for the California economy as a whole of over 26,000 jobs each *month* during the last year, mostly in service-producing industries.

The impact of the defense cuts would be quite different in different parts of the state, however. While many rural counties have virtually no defense contracts, Los Angeles County alone accounted for 44 percent of the state's prime defense contracts in 1988, with almost \$1,500 in contracts for each county resident. In Santa Clara County, the total volume of contracts was much smaller, but the value per resident was more than \$3,000 in 1988. The concentration of defense jobs in the San Francisco Bay and Los Angeles areas has raised fears that important parts of the state are at the brink of a downturn.

## Varied performance

To assess conditions in various parts of the state, California's 16 major Metropolitan Statistical Areas were combined to form five sub-regional groups: Southern California (Los Angeles-Long Beach, Anaheim-Santa Ana, and San Diego), southern fringe (Riverside-San Bernardino, Oxnard-Ventura, and Santa Barbara-Santa Maria-Lompoc), San Francisco Bay (San Francisco, Oakland, and San Jose), northern fringe (Vallejo-Fairfield-Napa, and Santa Rosa-Petaluma), and the Central Valley (Bakersfield, Fresno, Modesto, Sacramento, and Stockton).

Consistent with the defense-related concerns, growth has been slower in the Bay Area and Southern California regions than it has been in the Central Valley and fringe regions. Between May 1989 and May 1990, total employment grew 2.2 and 2.6 percent in the Bay Area and southern California, respectively. In contrast, during the same period employment grew 5.1 percent in the southern fringe, 6.0 percent in the northern fringe, and 4.0 percent in the Valley.

Home price data also suggest greater robustness in the fringe areas and in the Valley. Between June 1989 and June 1990, the median home price fell by 2.4 percent in Los Angeles, 1.9 percent in Orange County, 1.0 percent in the San Francisco area, and 3.9 percent in Santa Clara. In contrast, in the Central Valley, the median price rose 25 percent, and in counties north of the Bay Area, it rose 37 percent. These patterns also are consistent with the longer-term trend towards increasingly intensive development of the state's lower-cost, inland areas, as deteriorating air quality, the rising cost of space, and increased congestion and crime make the coastal areas less attractive.

## Outlook

In summary, economic activity in California appears to be returning to a more moderate level from the unusually strong level in the 1988-89 period. Impending defense cuts will put a further dent in the state's growth rate, particularly in the Los Angeles and San Francisco Bay areas. But most of the recent growth in the economies of these areas has been in services and trade, so unless the national economy experiences a recession, continued growth in the service and trade sectors probably can offset the loss of defense-related manufacturing jobs.

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**DISTRICT INDICATORS**  
(Seasonally Adjusted)

	90Q2	90Q1	89Q4	89Q3	89Q2	89Q1	88Q4	88Q3	% CHANGE FROM:	
									90Q1	89Q2
<b>AGRICULTURE</b>										
U.S. CROP PRICES, 1985=100	118.1	119.0	115.1	112.9	115.0	116.4	112.5	112.1	-0.76	2.72
DISTRICT CROP PRICES, 1985=100	113.6	131.0	117.0	114.9	122.6	121.1	112.2	112.1	-13.27	-7.32
FARM CASH RECEIPTS, MILLION \$	N/A	2446.4	2537.7	2421.9	2530.3	2431.7	2471.3	2361.0	N/A	N/A
CATTLE ON FEED, 1985=100	90.1	90.4	90.3	92.8	90.5	93.3	96.2	95.8	-0.32	-0.39
CATTLE PRICES, CALIFORNIA, \$/CWT.	65.9	63.6	62.4	62.7	61.8	61.7	60.1	61.4	3.67	6.63
<b>FORESTRY</b>										
LUMBER PRODUCTION, MILLIONS BOARD FEET	1668.6	1744.2	1788.3	1810.8	1693.2	1628.7	1768.7	1588.6	-4.33	-1.45
NORTHWEST LUMBER INVENTORY, MIL. BOARD FEET	2626.0	2608.3	2519.1	2539.7	2447.7	2420.0	2569.2	2460.8	0.68	7.28
U.S. LUMBER PRICES, 1986=100	132.0	130.3	128.1	123.8	119.5	123.4	122.4	120.0	1.24	10.39
<b>ENERGY</b>										
SPOT PRICE OF OIL, \$/BARREL	17.8	21.8	20.3	19.3	20.5	18.5	14.8	15.2	-18.50	-13.53
U.S. RIG COUNT	1017.5	909.5	1017.6	904.7	807.1	753.4	912.3	941.5	11.87	26.07
DISTRICT RIG COUNT	71.3	56.2	70.3	75.6	66.7	62.0	72.8	92.7	26.93	6.96
FUEL MINING EMPLOYMENT, 1985=100	80.3	79.5	79.3	80.8	79.7	77.8	78.8	82.0	1.00	0.80
U.S. SEISMIC CREW COUNT	129.3	126.1	128.0	131.3	129.9	137.3	152.9	180.7	2.47	-0.50
<b>MINING</b>										
MINERAL PRICES, 1986=100	125.6	123.3	125.5	131.8	134.3	147.4	147.7	138.2	1.91	-6.49
METAL MINING EMPLOYMENT, 1985=100	200.9	200.9	190.9	187.7	182.7	176.3	168.5	162.5	-0.03	9.95
<b>CONSTRUCTION</b>										
NONRESIDENTIAL AWARDS	1617.3	1790.4	1427.4	1677.2	1533.3	1432.5	1334.0	1571.0	-9.67	5.48
RESIDENTIAL PERMITS	25989	32741	33475	30509	31304	31065	35414	32858	-20.62	-16.98
WESTERN HOUSING STARTS, THOUSANDS	30.7	30.7	29.3	35.2	37.7	29.6	33.0	36.3	-0.11	-18.64
CONSTRUCTION EMPLOYMENT, THOUSANDS	1045.1	1052.4	1029.0	1013.9	1003.2	983.7	968.3	949.7	-0.70	4.17
<b>MANUFACTURING</b>										
WAGES, CALIFORNIA, \$/HOUR	11.4	11.3	11.3	11.2	11.1	11.0	11.0	10.9	1.09	2.82
EMPLOYMENT, THOUSANDS	3143.9	3164.1	3151.2	3151.9	3152.9	3148.0	3142.1	3122.3	-0.64	-0.29
DURABLES, 1985=100	103.1	104.0	103.6	104.0	104.1	104.0	103.6	102.8	-0.93	-0.94
CONSTRUCTION DURABLES, 1985=100	111.3	114.0	111.1	111.3	110.9	111.6	111.5	109.3	-2.41	0.33
AEROSPACE, 1985=100	115.9	116.6	116.1	115.8	115.3	113.8	115.1	114.0	-0.62	0.50
ELECTRONICS, 1985=100	94.6	95.2	94.8	94.7	95.2	95.7	99.8	98.8	-0.68	-0.63
SEMICONDUCTOR ORDERS, MILLIONS \$, NOT S.A.	1309.7	1227.7	1197.9	1166.3	1300.0	1300.0	1066.0	1222.0	6.68	0.74
WHLs/RETAIL TRADE EMPLOYMENT, THOUSANDS	4833.3	4810.0	4755.0	4718.7	4681.8	4654.9	4598.2	4539.0	0.48	3.24
RETAIL SALES, PACIFIC DISTRICT, MIL. \$	24676	24685	23961	23815	23417	22730	22000	21076	-0.04	5.38
<b>SERVICES EMPLOYMENT, THOUSANDS</b>										
HEALTH CARE, 1985=100	123.8	122.6	120.6	118.9	117.7	116.9	115.7	114.4	0.95	5.23
BUSINESS SERVICES, 1985=100	113.8	113.0	110.3	109.8	109.4	108.8	123.8	123.1	0.71	3.98
HOTEL, 1985=100	134.0	133.7	131.9	128.7	127.1	126.2	125.2	121.8	0.24	5.47
RECREATION, 1985=100	128.1	126.6	128.5	125.9	125.9	125.1	109.1	105.4	1.25	1.81
<b>FINANCE, INSUR. AND REAL ESTATE EMPLOYMENT</b>										
	1267.4	1265.5	1256.1	1244.6	1232.7	1227.4	1223.4	1206.7	0.15	2.82
<b>GOVERNMENT EMPLOYMENT, THOUSANDS</b>										
FEDERAL GOVERNMENT	657.4	626.9	623.1	619.0	625.2	624.8	620.8	614.9	4.87	5.16
STATE AND LOCAL	2780.5	2759.5	2731.8	2700.3	2663.6	2644.8	2619.9	2594.1	0.76	4.39

Data are weighted aggregates of available 12th District state data and are expressed as monthly rates unless otherwise noted. District indicator data are constructed by FRBSF research staff from public and industry sources.

Correction: Some statements in the May 18, 1990 *Weekly Letter* were incorrect due to revisions in industry classifications. Specifically, some employment in electrical equipment was reclassified as employment in instruments. As a result, declines in electrical equipment employment and increases in instruments employment were overstated. These two industries combined added 57 thousand jobs during the 1983 to 1989 period, a gain of 11 percent.

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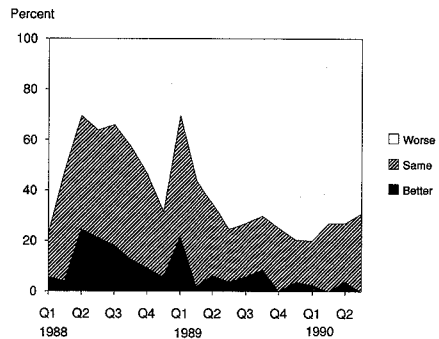
# San Francisco Bank of Federal Reserve Research Department

**PERSONAL INCOME**  
ANNUALIZED PERCENT GROWTH RATES

	90Q1	89Q4	89Q3	89Q2	89Q1	ANNUAL GROWTH		
						1990*	1989	1988
ALASKA	8.8	-8.2	14.2	27.3	11.7	8.8	10.5	4.4
ARIZONA	9.4	7.5	5.7	5.7	11.3	9.4	7.5	5.5
CALIFORNIA	12.0	4.9	8.7	7.3	7.7	12.0	7.1	7.7
HAWAII	6.5	9.2	11.6	12.5	8.9	6.5	10.5	9.1
IDAHO	15.6	20.0	-3.5	6.1	18.6	15.6	9.9	9.2
NEVADA	12.6	14.4	9.8	12.1	16.4	12.6	13.1	11.8
OREGON	7.0	12.7	3.6	9.7	6.3	7.0	8.0	9.1
UTAH	6.9	11.7	4.9	10.3	6.5	6.9	8.3	6.5
WASHINGTON	11.4	10.6	7.8	8.6	14.0	11.4	10.2	7.4
12TH DISTRICT	11.3	6.6	8.0	8.0	8.9	11.3	7.9	7.7
U.S.	8.0	8.3	4.5	6.9	8.7	8.0	7.1	6.7

\* Year-to-date

**Twelfth District Business Sentiment Index\*  
GNP**



\* The index is constructed from a survey of approximately 75 business leaders in the 12th Federal Reserve District.

**NON-AGRICULTURAL EMPLOYMENT**  
ANNUALIZED PERCENT GROWTH RATES

	90Q2	90Q1	89Q4	89Q3	89Q2	ANNUAL GROWTH		
						1990*	1989	1988
ALASKA	11.9	7.8	-3.1	7.0	13.3	10.0	5.7	3.2
ARIZONA	1.3	4.6	5.2	2.3	0.5	3.0	3.0	1.6
CALIFORNIA	1.7	2.5	3.1	2.1	1.8	2.1	2.4	4.3
HAWAII	3.2	1.9	3.4	5.5	4.9	2.5	5.5	3.7
IDAHO	-1.5	9.2	7.0	5.9	6.2	3.9	6.1	5.1
NEVADA	0.3	9.6	8.9	8.9	8.6	4.9	8.5	7.9
OREGON	2.1	6.7	2.4	3.2	4.3	4.4	3.4	5.2
UTAH	7.7	4.0	4.0	3.7	6.8	5.9	4.7	3.9
WASHINGTON	1.9	6.0	6.0	5.0	5.7	4.0	5.9	4.3
12TH DISTRICT	2.0	3.7	3.7	3.0	2.9	2.9	3.3	4.2
U.S.	1.7	3.0	1.8	2.1	2.4	2.4	2.4	3.2

\* Year-to-date

**UNEMPLOYMENT RATES**  
AVERAGE QUARTERLY DATA

	90Q2	90Q1	89Q4	89Q3	89Q2	ANNUAL AVG.		
						1990*	1989	1988
ALASKA	7.1	7.1	6.7	6.4	6.3	7.1	6.7	9.2
ARIZONA	5.3	4.8	4.6	5.4	5.1	5.0	5.2	6.3
CALIFORNIA	5.2	5.1	5.1	5.0	5.4	5.2	5.1	5.3
HAWAII	2.6	3.1	2.6	1.8	2.7	2.8	2.5	3.1
IDAHO	5.9	5.0	5.0	5.1	5.1	5.5	5.1	6.1
NEVADA	4.9	4.5	4.8	5.3	4.8	4.7	5.0	5.1
OREGON	5.0	5.1	5.5	5.7	5.7	5.1	5.7	5.8
UTAH	4.6	4.3	4.1	4.0	4.4	4.5	4.2	4.9
WASHINGTON	5.2	5.5	6.2	6.3	6.1	5.4	6.2	6.2
12TH DISTRICT	5.2	5.1	5.1	5.1	5.3	5.1	5.2	5.5
U.S.	5.3	5.3	5.3	5.3	5.3	5.3	5.3	5.5

\* Year-to-date