HIGHLIGHTS OF 1990 ECONOMIC DEVELOPMENTS, 1991 OUTLOOK
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Review of 1990

On the **domestic front**, it was a year of realization that numerous **past accounts were coming due**.

Protracted negotiations over **federal budget deficits** leading to some tax increases brought home the realization that the costs of past government fiscal imbalances had to be paid.

Revelations of abuses in the S&L industry increased our awareness that we were not receiving deposit insurance protection without at the same time carrying an enormous contingent liability.

Concerns that commercial banking needs to be sufficiently cushioned from the types of weaknesses that beset many thrifts led **regulators to take a second look at some banks' loan portfolios**.

The **credit crunch** began as a rumor in the spring, and has become an established fact at year's end.

Elsewhere in financial circles, we witnessed the **collapse of the junk bond market**, which has become symbolic of the extent to which debt had underwritten the economy of the 1980s.

It was in this context that **talk of a recession began to gather steam** even before the beginning of August.

In particular, the **construction industry**, which had been operating in an overbuilt environment for some time, **ground to a halt**.

Meanwhile there were **significant developments**, to say the least, **in the global market**.

The **invasion of Kuwait** and the ensuing **rise in energy prices** added a new degreee of uncertainty to the economic picture.

The **dollar hit record lows** at a time when our major trading partners were experiencing good growth; thus, **U.S. exports benefited**.

The former communist countries of Eastern Europe began to work toward consolidating the victories of late 1989.

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Most notably **East Germany was united economically and then politically with West Germany**.

It became apparent, though, that **other countries in this bloc have farther to go** than East Germany and no one to finance them.

The **Soviet Union now appears to be in rather bad condition**.

The U.S. government announced its **"Enterprise for the Amreicas"** concept, and prospects for Latin America seem more hopeful to me than at any time in the past decade.

Unfortunately, we have just experienced a **disappointing conclusion to the Uruguay Round of GATT**, although talks may be extended into the new year.

The resolution of agricultural and intellectual property differences is critical to the continued expansion of the global economic order.

Outlook for 1991

The obvious **uncertainty** with regard to the **Middle East** makes forecasting particularly difficult.

I expect a **slow period in the early months of the year and some acceleration later**.

We have experienced a significant economic shock, both in terms of actual price hikes and of expectations for future activity.

Fundamentals--strong production in oil producers other than Iraq and Kuwait--should contribute to an **ultimate drop in energy prices**.

Still, oil prices are not likely to return to their pre-August, 1990 levels.

Prices had already been trending up when Iraq invaded.

The politics of oil have changed to the extent that oil-producers seem inclined to support the price even if they disapprove of Hussein's tactics.

Absent a shooting war in the Middle East, I see **several sources of strength** for the U.S. economy.

For one thing, **business inventories are relatively lean**.

Exports should remain source of strength as **Japan and West European**

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trading partners experience relatively robust expansion.

The trade sector should thus contribute to growth **in spite of recessions in Canada and the United Kingdom.**

Spending on Operation Desert Shield will probably **on balance be a stimulus**, although there are obvious drawbacks--budgetary pressures, the displacement of workers from civilian to military status, and, of course, the weighty risks of war.

I look for **construction to bottom out**, and, while not providing substantial support to the economy, the industry is **not as likely to exert a drag in 1991.**

Fed's recent easing moves, which work only after long and variable lags, should make themselves felt over time.

Aside from the effects of the oil price shock, there are **several other weaknesses** in the outlook.

Demographic trends--should restrain near-term growth and reduce our long-term capacity to grow as well.

At present, **aging of baby boom implies less demand for first-time home, auto purchases.**

Already noticed in 1990, likely to remain a factor in 1991 outlook.

Cohort following baby boom is smaller and will provide **fewer entry-level workers**; this suggests **price-pressures will continue** to be factor over time.

On the positive side, though, this demographic trend **should help keep unemployment down.**

One other negative factor is the **level of debt among households and corporations.**

Consumers unwilling to add to their debts are likely to make fewer purchases.

Combined with tighter lending standards at many banks, corporate debt could limit investment from firms.

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