An Economic Overview And Outlook

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As 1989 begins, the economy is being influenced by a variety of positive and negative forces. In addition to the usual slowing factors typically present in the mature stage of a short-term business cycle, it is in the midst of a longer period of fundamental adjustment and change.

The adjustment to a more competitive and interdependent worldwide economy has been a disruptive and negative force in the U.S. during this decade. The import of cheaper goods from lower-cost countries has caused the restructuring of major industries and the export of many jobs. This has dampened production and employment but improved efficiency and competitiveness.

The origin of our economic problems can be traced to shortsighted public policies and actions of past decades. The most prominent were excesses in the growth of government spending and money supply. They created the spiral of inflation which peaked in 1980. Since then, there has been a period of disinflation which brought serious economic imbalances and financial distortions along with unusual volatility and speculation.

Some of the more notorious offspring of the inflation/disinflation cycle are the dramatic stock market crash of 1987; the wave of corporate takeovers and leveraged buyouts; and the extraordinary number of troubled or failed thrifts and banks. The impending bail-out of the FSLIC is a major unresolved problem and a huge, unpaid bill.

The developments of the 1980s are disturbingly similar to those during the decade of the twenties. It should be recalled that there was an inflation peak in 1920 followed by a period of disinflation which did not reach bottom until 1933. Unfortunately, the main preoccupation today is with short-term cause and effect. A review of more immediate factors which will influence economic life in the near future may be of greater interest.

The present economic expansion is six years old and is the longest on record in peacetime. Its unusual strength and length are due in significant measure to the stimulative effects of over $1 trillion in federal deficits since 1982. The budget deficit reached a peak of $220 billion, or 6 percent of GNP, in 1986. In addition, explosive growth in consumer, business, and government debt helped drive and extend the expansion.

Growth in the initial three to four years of the expansion was boosted by consumer demand and spending which was deferred from the preceding period of high inflation, stratospheric interest rates, and deep recession. For the past couple of years, a cheaper dollar and a recovery of exports and capital expenditures provided extra stimulation as the consumer sector moderated.

The record expansion also brought some bad side effects. Much of the increased domestic demand was satisfied by higher imports because of a strong dollar until 1986 and American industry's lack of competitiveness.

The result was a rising trade deficit which reached a record $170 billion in 1986 and a rapid build-up of net external debt to a current level of about $500 billion. In 1985, the U.S. became a net debtor nation for the first time since 1914.

Over the past six years, real GNP for the U.S. grew at an above-baseline average annual rate of about 3.8 percent. This also was the approximate rate of growth in 1988, and it is not sustainable indefinitely. In effect, there was considerable borrowing from future growth potential. The increased federal, consumer, and foreign debt must be serviced, and it will serve to restrain the future standard of living for Americans.

Self-discipline in eliminating our budget and trade deficits will be much less painful than an involuntary solution imposed by a dispassionate and unmerciful international marketplace. Some progress has been made, but not enough. The budget deficit has declined to $155 billion, or just under 4 percent of GNP. The trade deficit has moderated to an annual rate of about $130 billion. However, these levels still are dangerously high and must be brought steadily toward balance if serious problems are to be avoided.

The stock, debt, and currency markets are increasingly skeptical of rhetorical promises to reduce the twin deficits and are likely to behave in an erratic and negative fashion until credible action is taken by the new administration and Congress. Unstable financial markets can *be expected for the next several* months, while the politicians posture and maneuver, with periodic pressure down on the dollar and up on interest rates, unless the economy weakens.

As is typical in the advanced stage of expansion cycles, prolonged growth is beginning to cause capacity strains, labor shortages, and inflationary pressures. Several years of above-baseline performance have taken up most of the slack in the economy. The potential for further real GNP growth is limited to the basic and natural forces which normally drive growth.

The baseline real growth potential of an economy is the sum of the rates of labor force increase and productivity improvement. The total of these rates will be in the area of 2 percent to 2.5 percent for the U.S. in the next several years. That is about the best baseline real growth rate which can be expected for our economy on average for some time.

Several years of above-baseline growth, such as has been experienced by the U.S., usually are followed by a period of below-baseline growth to pay back some of the borrowing from the future. That is a likely prospect for our economy in the years ahead. From this point forward, growth above baseline potential simply will fuel inflation and precipitate a recession.

A recession may be avoidable if the budget deficit is reduced steadily and monetary policy is pursued on a delicate middle ground course between excessive tightness and ease. Also, central banks of industrialized nations would have to help stabilize the dollar and permit a gradual elimination of our trade deficit without driving inflation and interest rates upward.

If this extraordinary cooperation can be achieved in an environment of conflicting political and nationalistic interests, the U.S. economy might be able to continue growing for several more years without overheating or recession. The poor record of our political leaders in restraining government spending in the past raises doubts about their doing it now.

If not, a more serious crisis environment probably will be required to force U.S. politicians to take the unpopular actions necessary to control spending. That, unhappily, is the nature and fate of democracies where political leaders lack the will or skill to transform divergent special interests into a national consensus which serves the overall public interest.

Despite these contingencies and some signs that the economy may be slowing, the expansion probably will continue in 1989. The odds seem to favor real GNP growth of around 2 percent to 2.5 percent this year. There is the possibility of a recession beginning in the latter months or early 1990, especially if the rate of advance continues to exceed baseline potential.

Price inflation is likely to average in the area of 4.5 percent to 5 percent. Interest rates will move on an erratic course and could rise a percentage point or so from present levels. The pressure is likely to be more in shorter maturities than in the longer-term range unless inflation expectations worsen.

This year is likely to bring a slightly lower rate of growth in retail sales and the purchase of a few less cars and homes. The unemployment rate should not change very much. A reasonably good Christmas shopping season provides encouragement for the near term.

The slowing in the consumer sector should be offset by sustained strength in exports which are expected to grow around 10 percent compared with 27 percent last year. Also, capital spending should continue to be a positive force as capacity utilization rates rise. However, the ability of these sectors to provide above-baseline growth will diminish as 1989 progresses.

For the years ahead, it may be advisable to get prepared for a slower growing economy at home and abroad than has been enjoyed during the seventies and eighties. There are no strong engines of growth anymore, and it is unlikely the record expansion of this decade can be sustained much longer.

Prepare Forms Carefully

In rounding up the data required for Form 1040, will you be filled with pride once again at the careful organization of *your financial records, or cha-*grined at your inability to put your hands quickly on many of the documents you need?

If you're in the second category, tax preparation is the logical time to do something about putting your papers in order. This year, after tracking down the receipts, canceled checks and all the rest, instead of throwing them back into a shoe box or drawer, it's almost as easy to slip them into manila folders marked "Insurance," "Mortgages," "Securities," etc.

What's to be gained by such neatness? Plenty, including:

- Making sure penalties do not result from overlooking obligations, or losses incurred because of a failure to collect amounts owed you.
- Avoid the loss of documents that almost inevitably result when valuable papers get mixed up with routine bills and other mail.
- Keeping up with ever-growing list of records that the government requires us to maintain.
- Simplifying the fact-gathering chore at future filing times.

Also, organizing one's records contributes to improved financial planning by making it possible to summarize the results periodically. And, of course, it pulls into one place the papers your family would need in your absence.

Such documents, such as contracts or negotiable securities, should be kept in a safe deposit box, letting a summery or photocopy replace them in the home file.

The major headings for a personal finance filing system might include:

Bank Records -- Savings account passbooks, receipts for deposits, cancelled checks and bank statements, along with the checkbook or ledger in which you post transactions as they occur, showing perhaps, their tax consequences.

Stocks, Bonds and Other Securities -- Dates purchased and prices paid, dividend dates and accounts, commissions and other expenses incurred.

Non-security Investment -- Copies of notes held, contracts, papers on real estate holdings.

Home Ownership Records - - Deeds, mortgages, records of capital improvements. A similar file should be kept for a second home.

Records of Major Assets -- Costs of acquiring and holding jewelry, autos, boats, collectible items.

Pension Record -- Employer's retirement arrangements, papers from Keogh plans, IRAs, 401(k)s, Social Security, military or government pension entitlements.

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Tax Pointers And Reminders For Filers

Special To The Post

Mike Mattick of Mel Jackson offers the following tax information to help in preparation for this year's filing.

Minor Children

Minor's Income. Under the '86 TRA, the unearned income over $1,000 of a child under the age of 14, is taxed to the child at the highest marginal rate of the child's parents. The tax is determined by computing the additional tax that the parents would pay if their income included the child's earned income over $1,000. In making this calculation, the amount of the parents' deductions and credits are not affected by this "as if" inclusion of any of the child's unearned income in the parents' income.

Note: Children five years of age or older in 1988 need a social security number or there will be a $50 penalty per child. In 1989 children three years or older need a social security number.

Tax reminder: You can't claim a dependency exemption for a parent if his or her gross income exceeds the exemption amount ($ 950 for 1988).

Principal Residence Exclusion For Certain Incapacitated Taxpayers

To qualify for the over-55 exclusion on the sale of a principal residence, the taxpayer must have lived in the residence for at least three out of the five years before the sale. The Act liberalizes the use requirements for taxpayers, periods which they own the residence and reside in a qualified facility (such as a nursing home) count as time lived in the residence. However, they must actually live in the residence for periods aggregating one year during the five-year period. A qualified facility is one licensed by a state or political subdivision to care for individuals who have become incapacitated.

Mattick

U.S. Savings Bonds: New Interest Exclusion for Education

Starting in 1990, some taxpayers will be able to redeem U.S. savings bonds tax-free if they spend an amount equal to the bond proceeds on higher education for themselves, a spouse, or a dependent. The interest exclusion isn't, however, available to married taxpayers filing separately. And it's phased out for higher income taxpayers.

No Gift Bonds: Bonds purchased by a parent and put in a child's name won't qualify, not will bonds purchased by a grandparent or other relative --- even if the bonds are put in the parent's name. So, if Grandma and Grandpa want to use savings bonds to help finance Junior's education, their best bet is to give the parents the cash and let them buy the bonds.

Life insurance: On investment-type life insurace a 10 percent penalty can exist on certain policies. Before withdrawing money from insurance, check with tax advisor.

Deductions: A tax deduction for personal interest still exist on Master charge, Visa and personal loans.

For more tax information, Mel Jackson's is located at 201 S. King's Drive. Call 377-5209 for an appointment.

Money

Cautious Investing

By Richard Smith
News USA

Bernard Baruch made $3 million on Wall Street back when a million was real money.

He kept it, too. He began selling his stocks two months before the Crash of 1929.

His advice on investing was simple and to the point.

Before buying stocks or bonds, he said, remember the law of supply and demand.

As prices rise, more people decide to sell their stocks. This forces prices to fall. As prices fall, sellers become less willing to sell and prices begin to rise.

Don't try to buy at the bottom and sell at the top. It can't be done.

When the market is right, get the facts on a company before they are generally known and act on them quickly.

Don't act on tips or predictions or inside information—rely only on the facts.

Before you buy a stock, Baruch said, find out everything you can about the company, its management and competitors, its earnings and its prospects for growth.

To have an extra advantage, stick to investing in the things you know best.

Watch Your Money

Bernard Baruch gained wealth by keeping an eye on his investments. The secret, he said, was to invest in just a few companies so they could be watched more closely.

He told investors to make a habit of regularly checking on *each investment to see if anything had happened that might* affect its future value.

To learn from mistakes, Baruch suggested that investors sell all of their stocks from time to time so that they might consider their losses and gains.

By finding out what had worked and what had failed, they would be prepared to make better decisions in the future.

Common Mistakes

According to Bernard Baruch, investors often buy stocks with too little information and risk too much in an attempt to get rich quickly.

Don't speculate, Baruch warned, unless you can make it a full-time job.

As part of this cautious approach, Baruch believed, investors should always keep plenty of cash.

They should also sell stocks that are declining in value as quickly as possible. The best investor knows that no one can be right all the time.

The very human desire to act as others are acting must be resisted by investors.

Don't get caught up in the crowd, Baruch cautioned, think for yourself. Crowds are too optimistic during booms, and far too pessimistic during busts.

Caution protected Baruch from the Crash, and information gave him the chance to profit during the boom periods.

Business Briefs

News USA

Are you earning 166 percent per year? That's the rate of return reportedly earned by the late Charles W. Lubin from the Kitchens of Sara Lee. He invested $21,000 in his new business in 1951 and sold the company to Consolidated Foods for $2.8 million five years later. Lubin, then in his late forties, worked in a space no larger than a typical modern house baking 79¢ cheesecakes—$400,000 worth in his first year.

Bleak for Blacks? Black MBAs describe the companies they work for as unsupportive, indifferent, and reluctant to accept blacks. In a survey reported in *Harvard Business Review*, only one in six found the environment for blacks to be encouraging or positive—nearly half said the company's policy reflected tokenism, a lack of direction, or was supportive in words only.

Buying a new car? A telephone call to a car dealer's fleet sales manager can usually save you from several hundred dollars to several thousand dollars off the price offered to walk-in customers. If you know which car you want and how you want it equipped—but are willing to choose from what is in stock—you'll get the best price with no bargaining required.