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Economic Outlook Update
1988–1990

Dataquest

a company of
The Dun & Bradstreet Corporation

BCSIS Reports

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Preface

This report is an update to the *Economic Outlook 1988-1989* that was published by Dataquest in early 1988. As such, many references and definitions in this report assume the reader will use it as a continuation of the data and projections in the previous report.

Highlights contained in this report are:

- Real U.S. GNP growth will continue at an average 3.4 percent annualized rate through the first quarter of 1989 then will slow through the last three quarters of that year. Overall 1989 real GNP will be 2.8 percent greater than the record for 1988. A recession is forecast in the first two quarters of 1990, followed by a sharp rebound led by consumer spending and private investment in the second half of the year.
- The rate of U.S. domestic spending on capital equipment and production capacity improvement that saw double-digit growth in the first half of 1988 will gradually slow until reaching negative growth in the fourth quarter of 1989. Investment spending will continue to decrease in early 1990, particularly in the second quarter. Improvement will follow in the second half.
- The U.S. trade deficit will show steady improvement toward a negative $50 billion annualized level by mid-1990, when higher interest rates and a stronger dollar will begin to attenuate the rate of progress.
- The U.S. federal budget deficit will be largely unaffected by the national elections and existing Gramm-Rudman legislation. New federal programs in 1990 will be funded by additional consumption taxes, changes in personal income tax ceilings, reductions in some personal tax credits and federally mandated shifts in some worker-related program funding to corporations.

Introduction

The last years of the 1980s are an exciting time. Political and economic events are unfolding in the United States and throughout the world in a vast interactive network. The influence of these economic developments is significant in our daily lives, in the prospects for business endeavors, and from the perspective of strategic national interests. The international influence of nations is based on their relative economic strengths, and long-term economic changes are resulting in unmistakable geographical shifts of power.

During autumn of 1988, we will see developments on many issues important to the nations listed below, that may cause reverberations in the economic outlooks of other nations:

United States

In the United States, Americans are wrestling with massive deficits in the federal budget and in international trade. Both problems will be treated with platitudes in the upcoming national elections due to the political realities of playing for votes and avoiding special-interest sensitivities. However, after the election, both issues will affect greatly the programs of the new president and his administration's performance rating.

Canada

Political debate is reaching a climax in Canada and the United States on the pending free trade agreement between the two countries. The Liberal opposition to Prime Minister Mulroney has threatened to delay action until Mr. Mulroney calls parliamentary elections, which in effect is a national referendum on free trade.

Japan

What country is the world's biggest donor of foreign aid, the second-largest contributor to the United Nations, and has the world's third-largest defense budget? Answer: Japan, with a $10 billion budget for foreign aid in 1988, pushing past the United States' $9.2 billion program. The Japanese are just beginning to formulate the manner and direction in which they will exercise their new economic power and wealth.

U.S.S.R.

The fascinating cultural and political experiments by Mikhail Gorbachev in attempt to rejuvenate the Soviet economy, coupled with the warming of U.S.-Soviet relations, have already resulted in benefits to U.S. electronics companies through a relaxation of U.S. technology export regulations.

Iran and Iraq

Iran and Iraq appear to be approaching a cease-fire that, if realized, will directly affect crude oil production and prices as the two countries boost output to help recover from the destruction and $300 billion expense of their eight-year war.

EEC

The 12-country European Economic Community (EEC) is proceeding steadily toward its target of standardizing internal financial regulations and eliminating *internal* trade restrictions by 1992. There are growing indications that the Europeans will implement strong protectionist measures to favor European "national champion" computer and telecommunications companies in the form of import quotas, bidding restrictions on government contracts, and minimum local content requirements on hardware.

In effect, they may replace national trade barriers with one large trade barrier around the entire community.

Taiwan and the Peoples' Republic of China

Taiwan and the Peoples' Republic of China are quickly warming to the possibilities of increased cooperation in bilateral trade, investment, and travel. China has raw materials, cheap labor, and is starved for foreign capital, while Taiwan needs to reduce manufacturing costs and continue to expand into new markets.

How will these events affect the electronics industry? What new opportunities will emerge? What are the best strategies to anticipate these changes? For U.S. multinational companies, the answers are based in part on expectations for the outlook for the U.S. economy through 1990.

United States International Trade

U.S. exports continue to surge ahead in the third quarter of 1988, at a pace 30 percent greater than the same period to date in 1987. U.S. industry's export record in 1987 was itself the largest one-year increase this decade: an 11 percent increase over 1986. The bulk of U.S. export volume is in chemicals, auto parts and subassemblies, industrial machinery (including computers and associated hardware) and raw materials. Many of these exporting industries were forced to restructure and upgrade production processes earlier in the decade in order to stay competitive when the dollar's value was peaking. The dollar's three-year (1985-1988) slide has since been accompanied by an acceleration of international sales.

Exporting companies began to feel the effects of the cheaper dollar in mid-1985, as the dollar began to decline and significant international orders followed shortly thereafter. This key relationship between dollar exchange rates and export sales is illustrated in Figures 1 and 2. Dollar exchange rates reached bottom in early 1988 and have shown a recent tendency to creep upward. Dataquest expects the index of dollar exchange rates against trade-weighted currencies will remain close to current levels through 1989, before mid-1990 increases bring the dollar back up to 1986 levels.

Where are U.S. exports going? Figure 3 ranks geographical markets in descending order by aggregate merchandise export value from January through May this year, compared with the same period last year. Western Europe alone accounts for more than $7 billion of the $30 billion export increase so far in 1988. When U.S. exports to Canada and Japan are included, these three market areas constitute 62 percent of the export trade, and 52 percent of the 1988 year-to-date increase. Percentage increases in export values through May of 1988 compared with the same period in 1987 are graphed in Figure 4.

It is worth noting in the midst of this success that most of the 1988 improvement in U.S. international trade has come in established markets, such as Western Europe, that are growing at slower rates than Pacific Rim economies. U.S. companies still focus their export strategies largely toward Europe, and think of Asian countries primarily in terms of defensive marketing strategies. U.S. exporters must quickly recognize that the Pacific Rim is a top priority market equal in value to the U.S. export trade with Western Europe, and will be twice the value of U.S.-European trade before the turn of the century.

U.S. import activity for 1988 to date is compared with the same period in 1987 in Figure 5, reflecting some percentage shifts toward new sources of imports from Asia and South America.

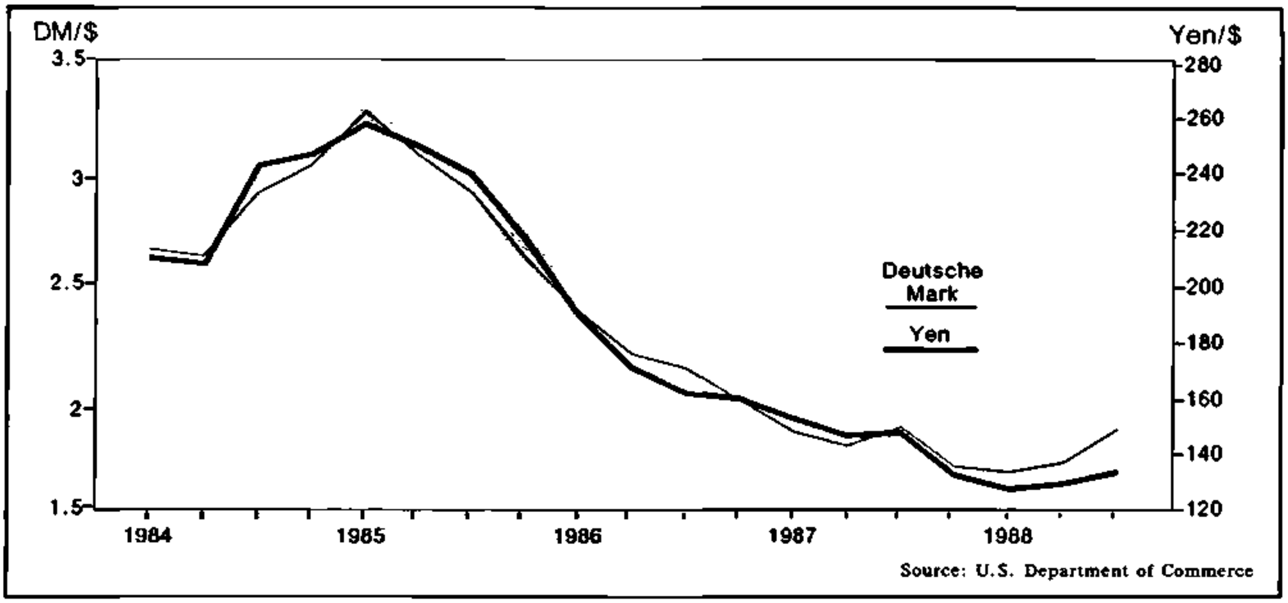

Figure 1. Dollar Exchange Rates (Quarterly Averages) 1984-1988

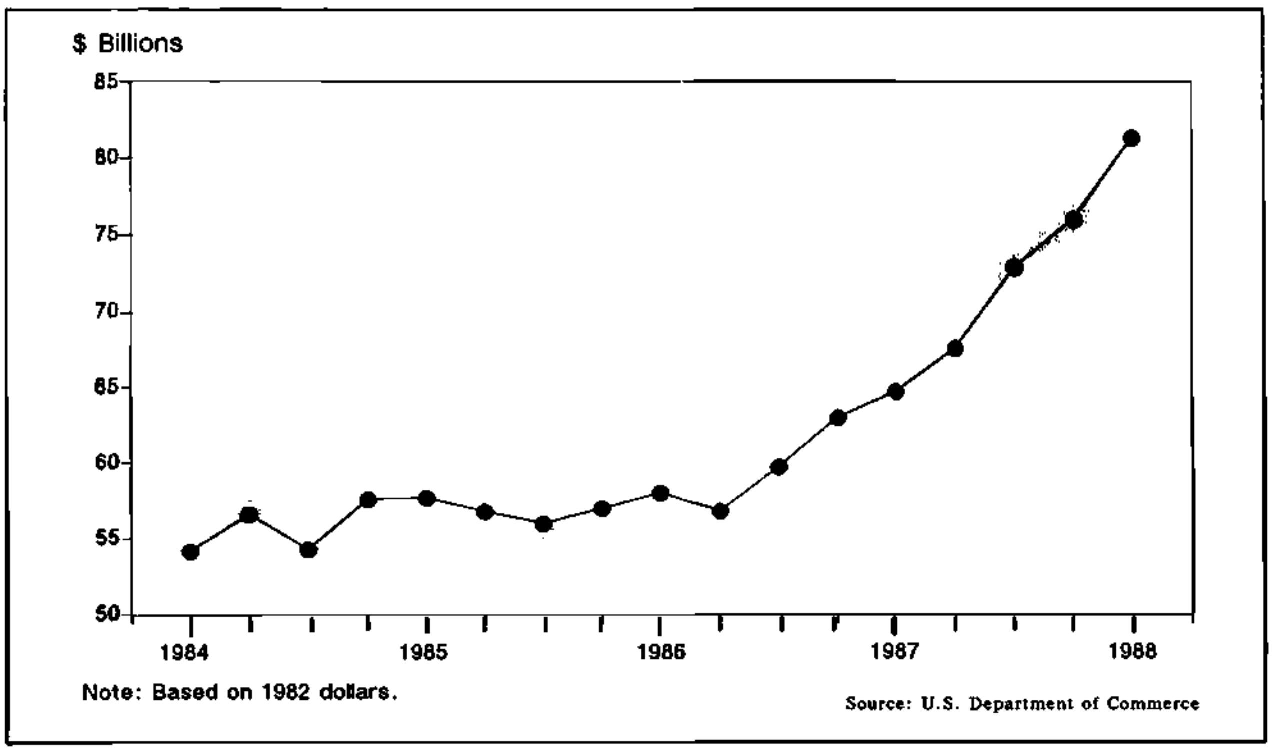

Figure 2. U.S. Merchandise Exports (Quarterly) 1984-1988

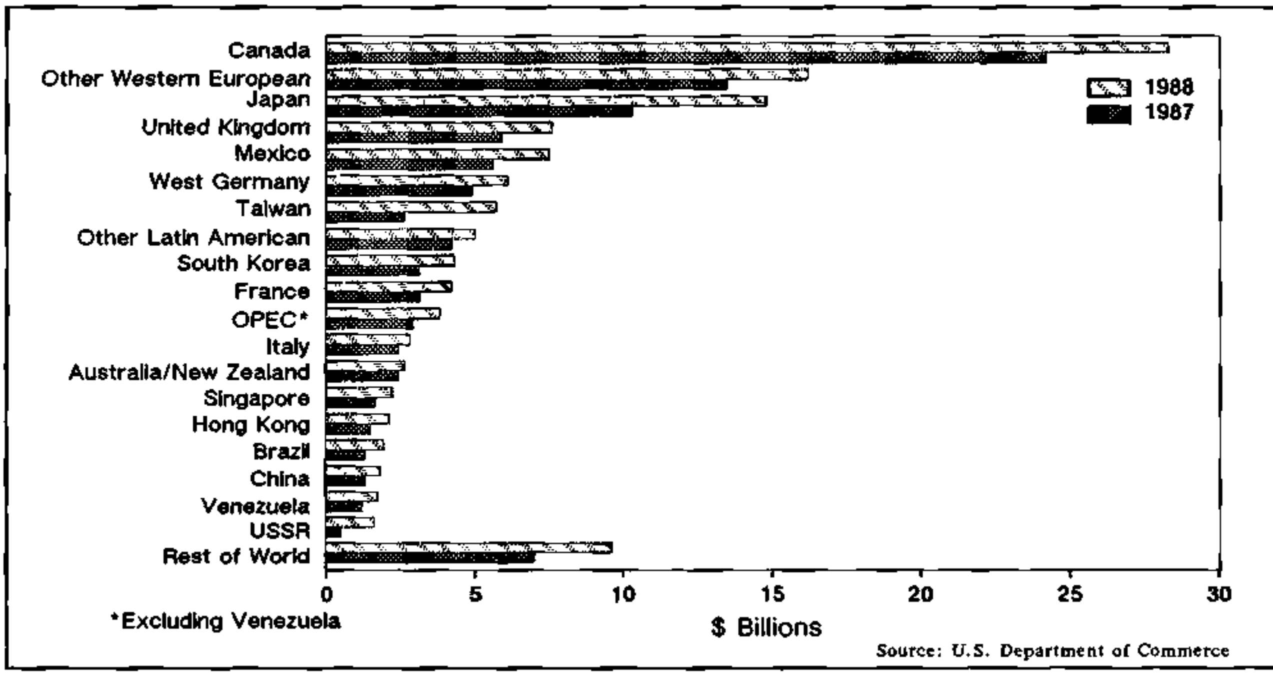

Figure 3. Comparison of U.S. Export Markets, January-May 1988 versus January-May 1987 (Bilions of Dollars)

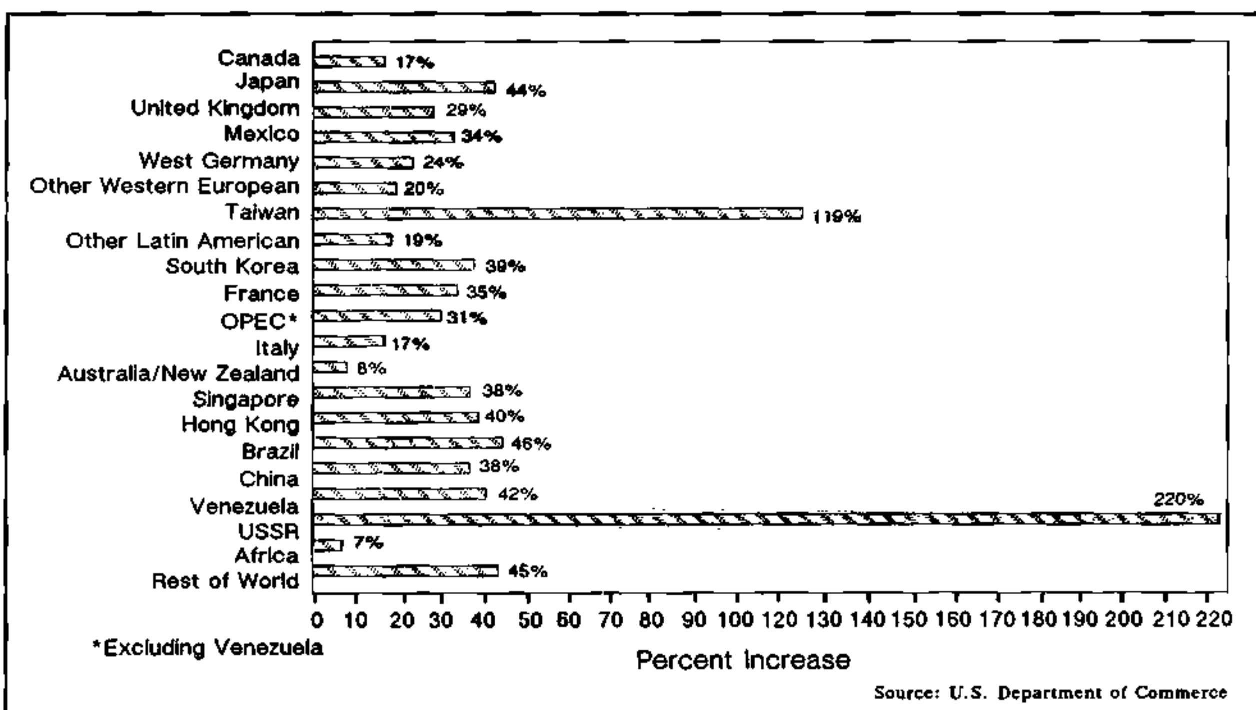

Figure 4. U.S. Merchandise Exports—Percentage Increases January-May 1988 versus January-May 1987

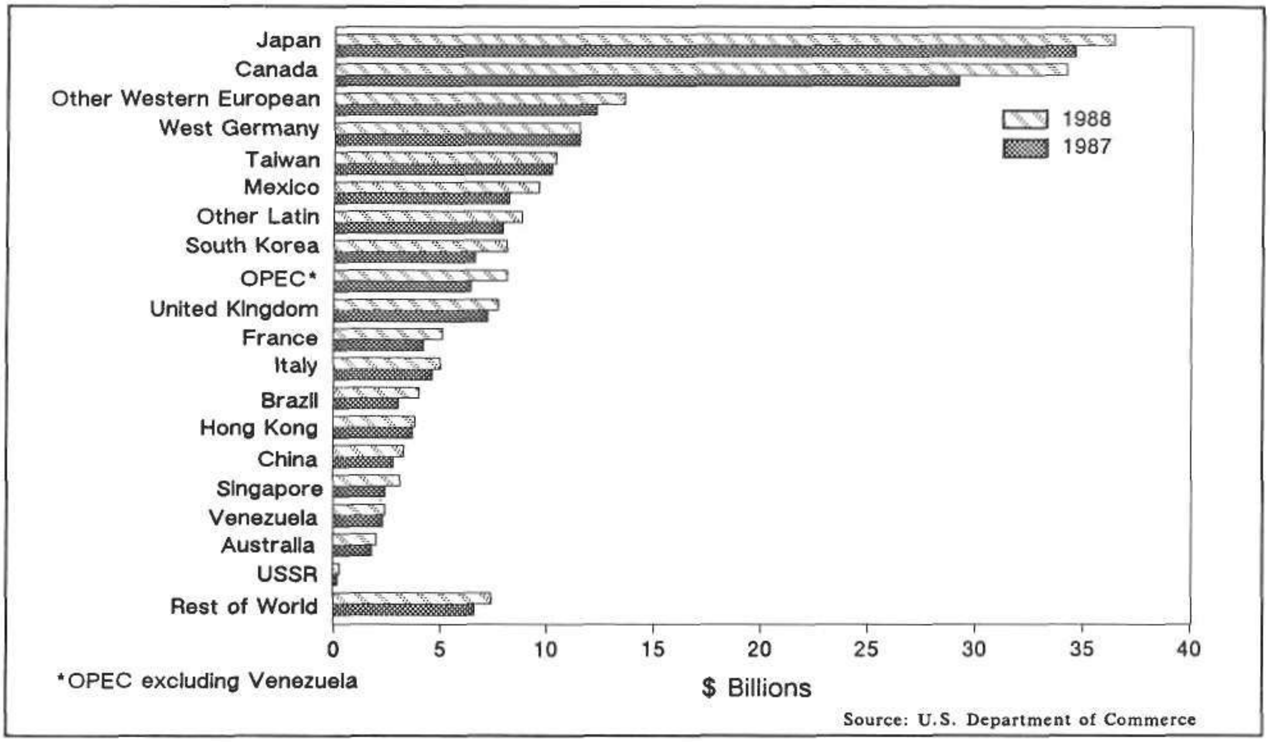

Figure 5. Comparison of U.S. Import Activity, January-May 1988 versus January-May 1987 (Bilions of Dollars)

What about the specific markets for electronics goods? Figure 6 ranks the top twelve national markets for three basic categories of American electronic products: computers, semiconductors, and telecommunications equipment. Canada, the United Kingdom, and Japan remain the top three markets in a pattern and product mix very similar to that of 1987. Figures 7 and 8 compare 1988 and 1987 electronics import and export activity through April of each year. In general, computer equipment shows the largest absolute increase: $1.9 billion in exports so far this year compared with the same period in 1987, a 36 percent increase. Telecommunications equipment accounted for the largest rise with an increase in export value of 40 percent.

Imports of foreign goods into the U.S. have slackened slightly, as importers have struggled to remain price-competitive in the face of weak dollar exchange rates. A significant part of this process has been a growing shift toward less-expensive imports from newly industrializing countries, particularly the Republic of Korea, Brazil, Singapore, and China. The American consumer's passion for imports has not diminished; it has been transferred to other, cheaper, sources of supply.

Figure 9 demonstrates the continuing close linkage between U.S. consumption, measured by final sales to domestic purchasers, and the value of imported goods into the United States. Final sales is an accurate measure of domestic demand in that it includes import sales and excludes unsold inventory and exports. Dataquest forecasts diminishing annual rates of increase in final sales, measured quarterly, through the remainder of 1988 and into early 1990. These and other projections are contained in Table 1. Along with a forecast of continued export strength, a corresponding decrease in the U.S. international trade deficit is projected, lowering it to an annualized $50 billion level by the middle of 1990. Figure 10 shows the history and Dataquest forecast of total merchandise trade on a quarterly basis through 1990.

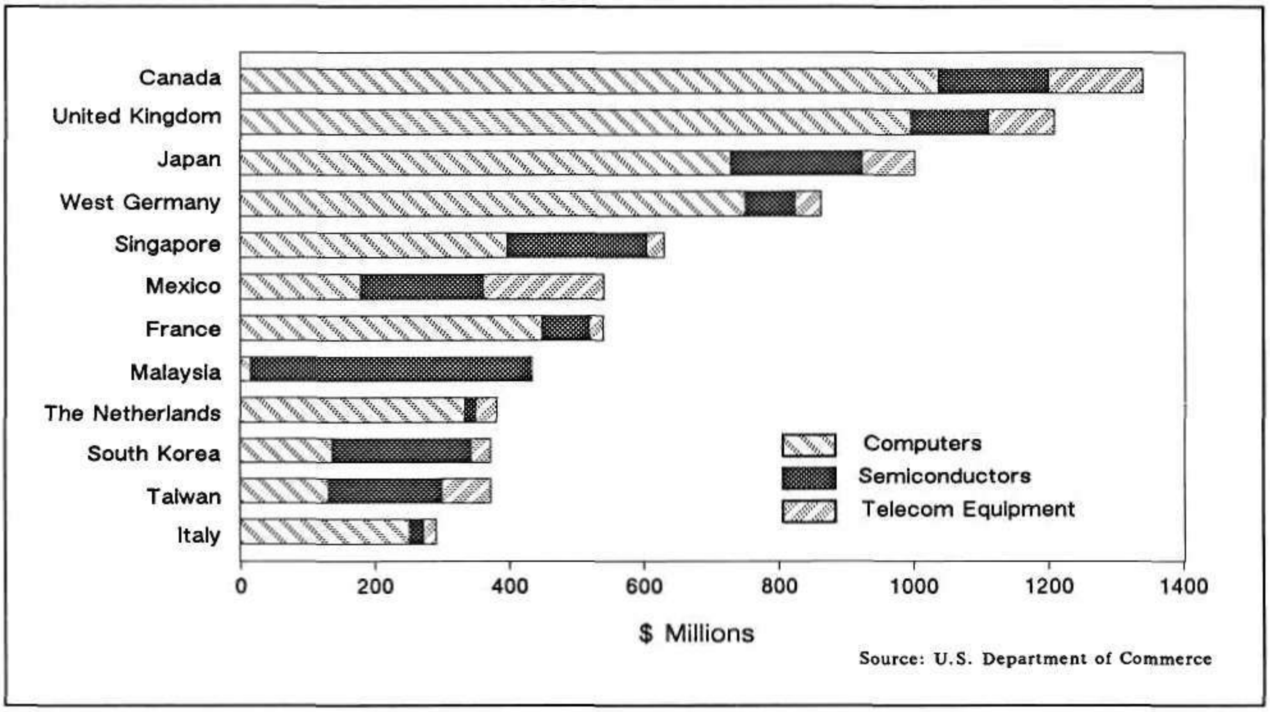

Figure 6. U.S. Electronics Exports—January-April 1988, Top Twelve Markets

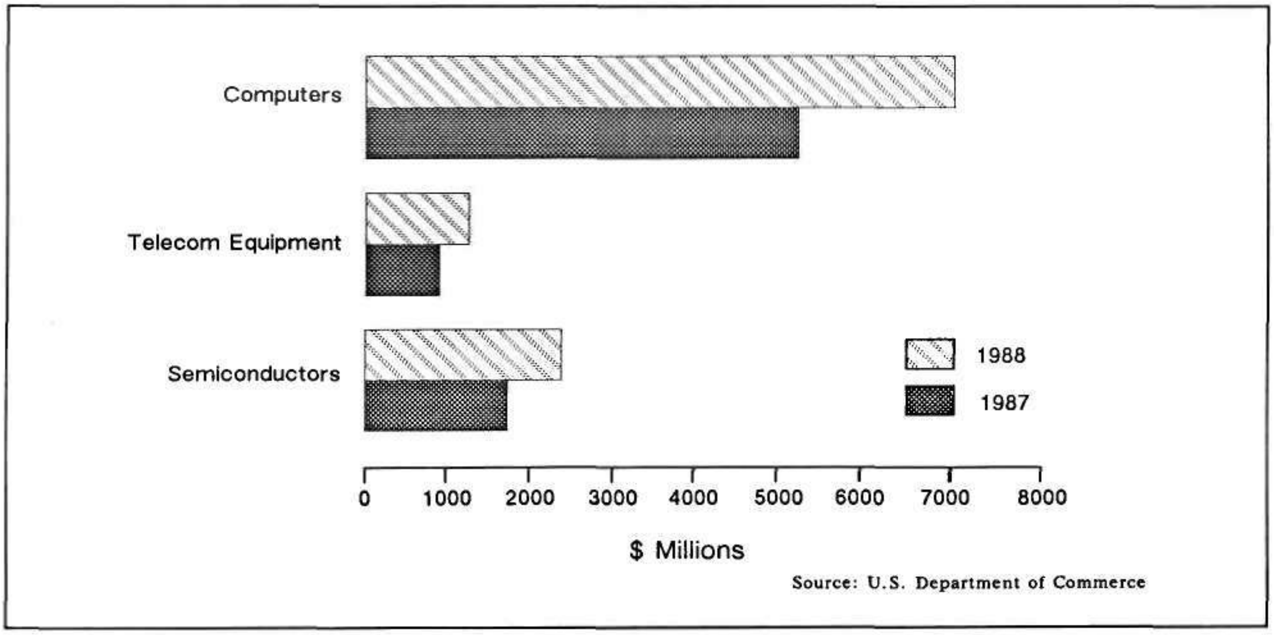

Figure 7. U.S. Electronics Exports January-April 1988 versus January-April 1987

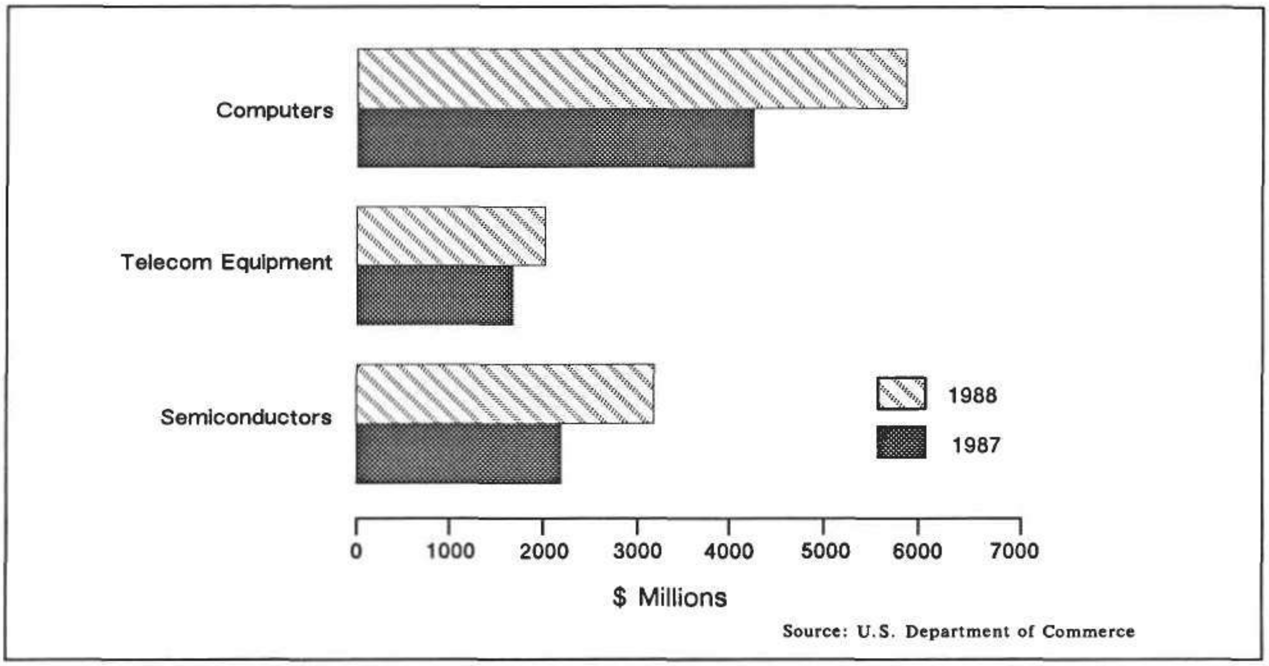

Figure 8. U.S. Electronics Imports January-April 1988 versus January-April 1987

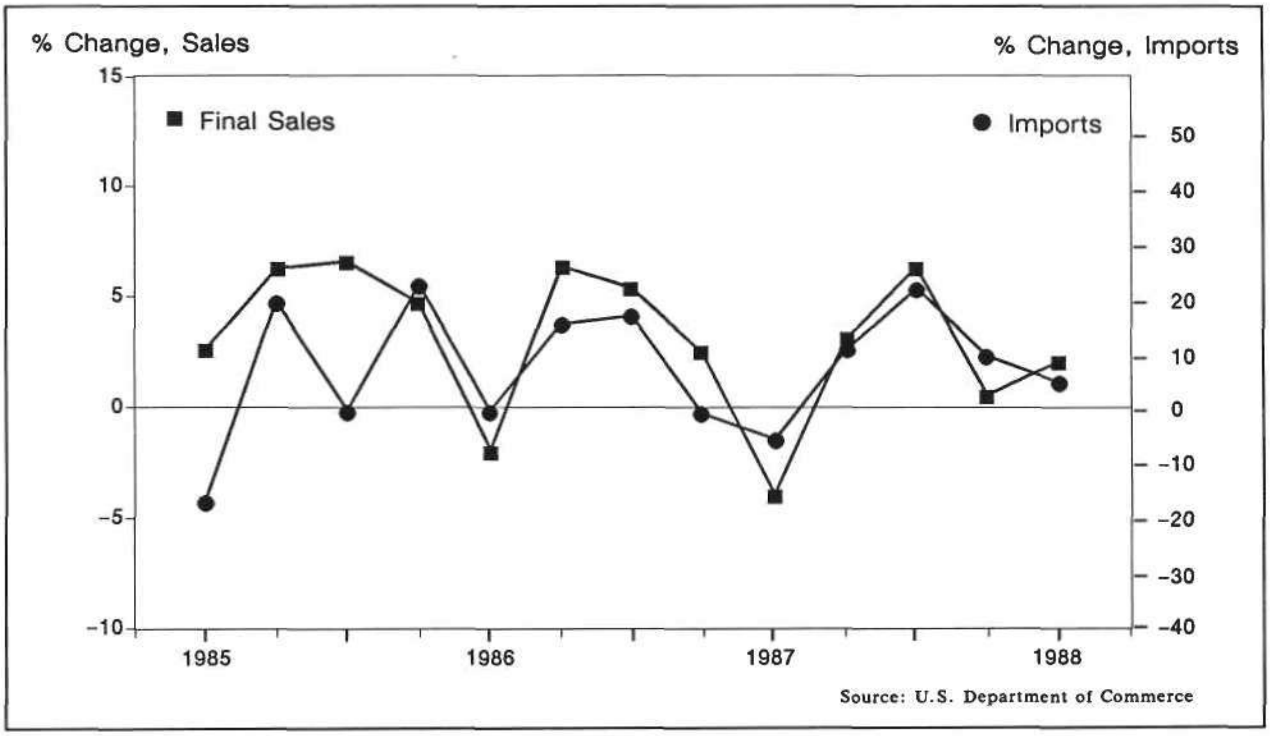

Figure 9. Final Sales to Domestic Purchasers versus Imports (Quarter-to-Quarter Changes) 1985-1988

Table 1. Dataquest Economic Forecast, 1988-1990

	1988				Average	1989				Average	1990				Average
	Q1	Q2	Q3	Q4	1988	Q1	Q2	Q3	Q4	1989	Q1	Q2	Q3	Q4	1990
Real GNP, SAAR	$3,956	$3,988	$4,015	$4,049	$4,002	$4,084	$4,110	$4,127	$4,134	$4,114	$4,109	$4,092	$4,132	$4,185	$4,129
% Change, Year Ago	4.8%	4.3%	3.9%	3.2%		2.4%	3.0%	2.8%	2.1%		0.6%	(0.4%)	0.1%	1.2%	
% Change, Annual Rate	3.4%	3.3%	2.6%	3.4%		3.4%	2.7%	1.7%	0.7%		(2.4%)	(1.6%)	3.9%	5.1%	
Consumer Spending	2,560	2,576	2,591	2,612	2,585	2,630	2,643	2,651	2,656	2,645	2,641	2,638	2,668	2,703	2,663
% Change, Year Ago	2.8%	2.4%	1.8%	3.2%		2.1%	2.7%	2.3%	1.7%		0.5%	(0.1%)	0.6%	1.7%	
% Change, Annual Rate	4.5%	2.5%	2.3%	3.3%		2.7%	2.1%	1.2%	0.7%		(2.1%)	(0.3%)	4.4%	5.0%	
Fixed Investment	473	489	501	512	494	520	526	529	527	525	518	503	505	514	510
% Change, Year Ago	13.2%	12.5%	8.2%	10.2%		9.8%	7.6%	5.7%	2.8%		(0.3%)	(4.5%)	(4.6%)	(2.3%)	
% Change, Annual Rate	7.6%	16.0%	9.7%	9.7%		5.8%	5.3%	2.1%	(2.0%)		(6.2%)	(11.3%)	1.5%	7.7%	
Equipment Investment	349	362	372	384	367	392	399	402	400	398	392	377	379	388	384
% Change, Year Ago	17.6%	15.3%	11.2%	15.3%		12.1%	10.3%	8.1%	4.3%		0.1%	(5.5%)	(5.7%)	(3.0%)	
% Change, Annual Rate	21.6%	14.8%	12.2%	12.8%		8.4%	7.5%	3.2%	(2.0%)		(7.3%)	(14.5%)	2.1%	10.1%	
Residential Investment	190	191	190	189	190	190	190	191	191	190	189	190	195	204	194
Government Purchases	776	777	792	796	785	799	802	810	812	806	806	808	815	820	812
% Change, Year Ago	0.5%	0.6%	1.2%	0.4%		2.9%	3.1%	2.3%	2.0%		0.9%	0.8%	0.5%	1.0%	
% Change, Annual Rate	(7.9%)	0.4%	8.0%	1.8%		1.5%	1.4%	4.4%	0.8%		(3.1%)	1.1%	3.3%	2.8%	
Net Exports	(109)	(90)	(96)	(93)	(97)	(88)	(83)	(77)	(67)	(79)	(55)	(48)	(48)	(51)	(50)
Inventory Change	66	45	37	33	45	33	32	23	15	26	10	1	(3)	(5)	1
Final Sales to Domestic Purchasers	3,975	4,019	4,049	4,077	4,030	4,093	4,101	4,117	4,132	4,111	4,136	4,157	4,196	4,235	4,181
% Change, Year Ago	3.0%	3.3%	2.5%	3.1%		3.0%	2.0%	1.7%	1.3%		1.1%	1.4%	1.9%	2.5%	
% Change, Annual Rate	1.9%	4.5%	3.0%	2.9%		1.6%	0.8%	1.5%	1.5%		0.4%	2.1%	3.8%	3.7%	
Dollar Exchange Rate Index	147	149	150	149	149	146	143	140	140	142	144	148	152	156	150
% Change, Year Ago	(0.3%)	1.8%	0.5%	0.4%		(0.7%)	(4.0%)	(6.7%)	(6.0%)		(1.4%)	3.5%	8.6%	11.4%	
% Change, Annual Rate	0.1%	5.4%	2.7%	(2.7%)		(8.1%)	(8.2%)	(8.4%)	0.0		11.4	11.1%	10.8%	10.5%	
Unemployment Rate	5.7%	5.4%	5.3%	5.2%	5.4%	5.4%	5.5%	5.7%	6.0%	5.7%	6.6%	7.4%	7.4%	7.3%	
Interest Rates															
3-Month T-Bills	5.7%	6.2%	6.9%	7.0%	6.5%	7.2%	7.9%	8.4%	8.9%	8.1%	8.6%	8.1%	7.7%	7.3%	7.9%
30-Year T-Bonds	8.6%	9.1%	9.2%	9.6%	9.1%	10.2%	10.6%	10.9%	10.1%	10.4%	9.3%	9.0%	8.8%	9.0%	9.0%
Savings Rate	4.7%	4.4%	4.3%	4.3%	4.4%	4.4%	4.6%	4.7%	4.3%	4.6%	4.4%	4.5%	4.4%	4.2%	4.4

Note: Values shown are billions of 1982 dollars and are seasonally adjusted annual rates.

Source: U.S. Department of Commerce
Dun & Bradstreet
Dataquest
September 1988

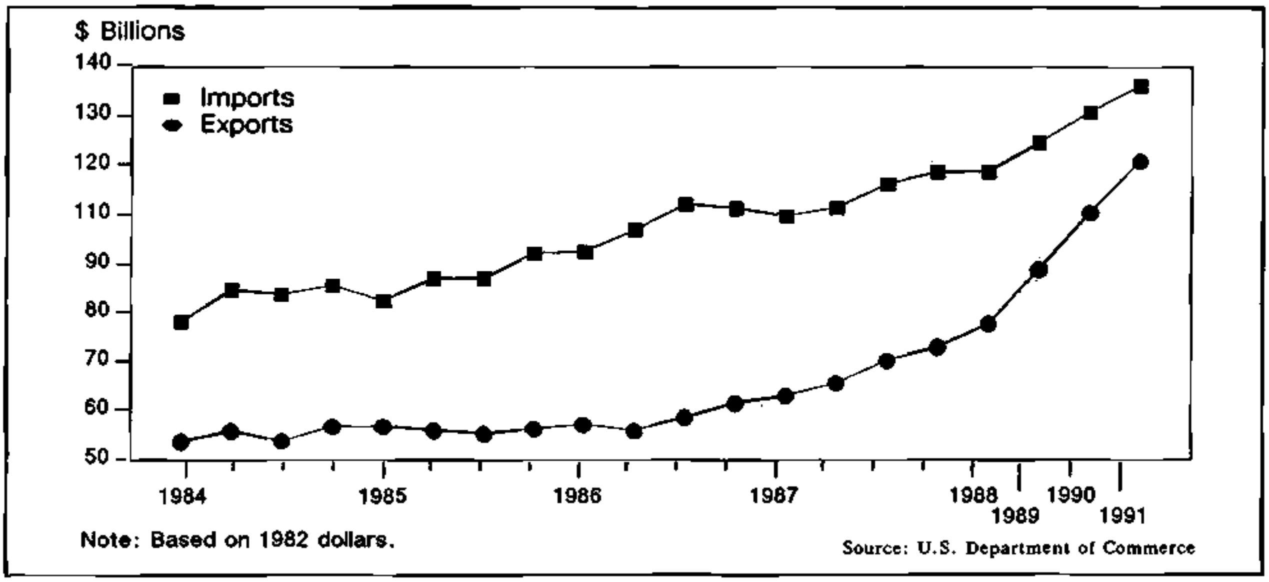

Figure 10. U.S. Merchandise Trade, Quarterly 1984-1990

The status of U.S. trade from February through May 1988 is shown in Figure 11. The predominant roles of Japan and Canada in the current U.S. trade position can be seen clearly, as can the broad distribution of the U.S. deficit across many markets. The fruitful relationship between the United States and Canada offers the United States more near-term possibilities for improved trade activity than does the U.S.-Japan trade relationship. This potential improvement centers on the pending free-trade agreement now being debated in both national legislatures. Seventy-five percent of the $140 billion value of goods passing between the two countries is currently duty free, while the remainder is subject to Canadian duties averaging 9.9 percent and U.S. duties of 3.3 percent. The agreement will remove all tariffs and many nontariff barriers to bilateral trade over 10 years, establishing rules for trade in services, investments, hydroelectric and petroleum energy, and government procurement activity. Studies by the two governments have concluded that this stimulus to direct trade ultimately could add as much as 10.0 percent to the Canadian GNP and 1.0 percent to that of the United States. Congress likely will approve the measure by September, but Liberal and New Democratic opposition leaders in the Canadian Parliament may force national elections this fall as a trade referendum. Canadian objections to final approval relate to the regulation of subsidies, procedures for settlement of disputes, and deep Canadian concern about dilution of their cultural and economic sovereignty by their southern partner.

More than 24 percent of U.S. exports go to Canada, while 17 percent of imports into the U.S. come from Canada, but in 1987 the net difference was a U.S. trade deficit of $12 billion. By comparison, 11 percent of U.S. exports are shipped to Japan, and 21 percent of U.S. imports are Japanese goods. U.S. exports to Japan are accelerating much faster than imports, 44 percent from January through May 1988 compared with the same period in 1987. However, the United States has a huge gap to bridge against the higher aggregate value of imported Japanese goods into the U.S., which rose only 5 percent.

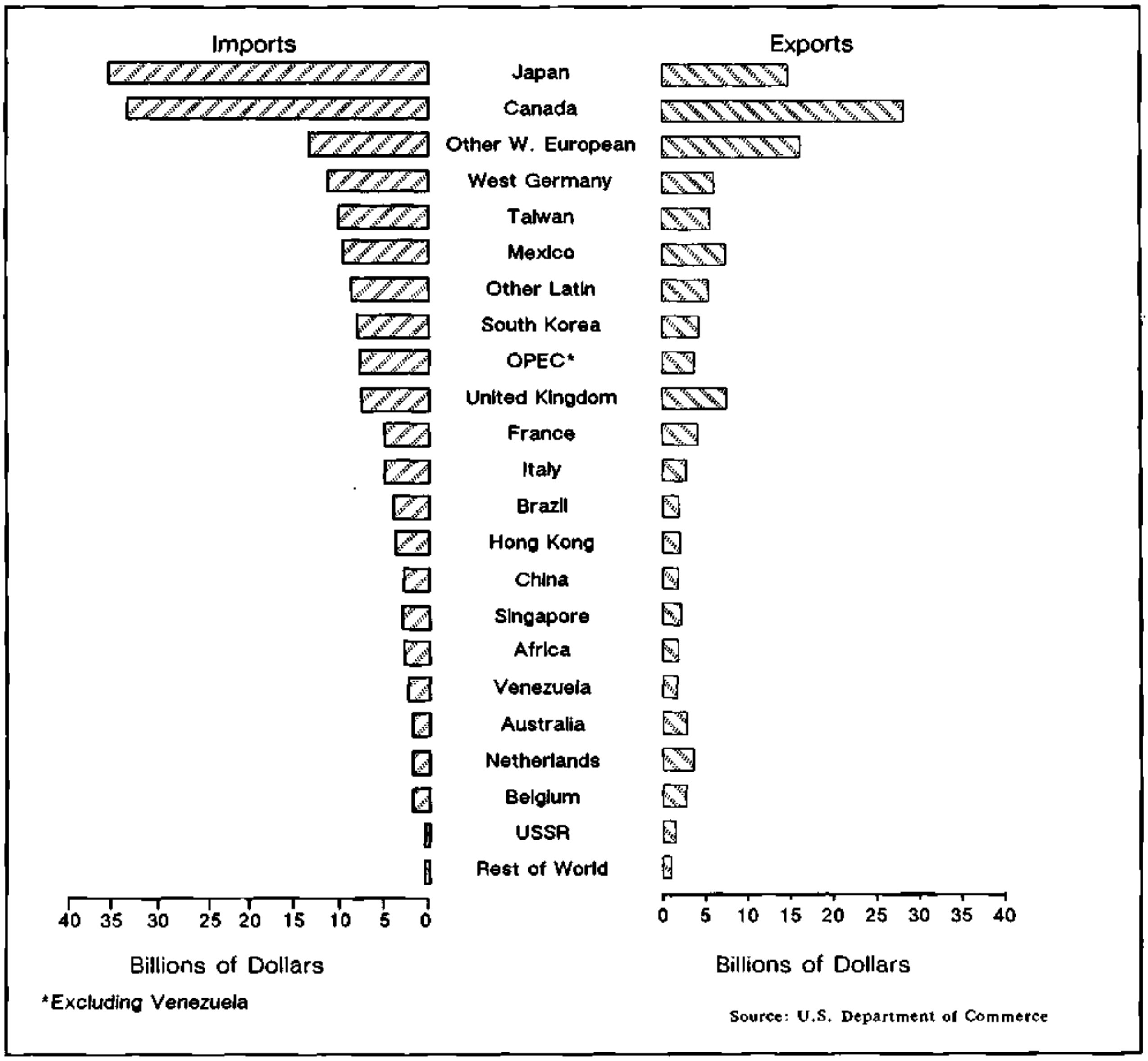

Figure 11. U.S. Merchandise Trade—January-May 1988 (Dollars in Billions)

U.S. Domestic Economic Outlook—downturn In The First Half Of 1990

The Dataquest outlook is for continued strong economic growth through the first three quarters of 1989. Robust exportation and domestic capital spending, coupled with healthy employment growth and a moderating level of consumer spending on imports, all translate into an optimistic economic forecast, particularly for sales of electronic goods and equipment.

There are, of course, many potentially destabilizing factors. When demand for skilled workers exceeds supply and limitations on production capacity are reached, manufacturers must train new workers and invest in additional plant and equipment. To the extent that these additional costs are not reflected directly in additional production, they are inflationary. A continuing deficit at the federal level itself creates inflationary pressures and affects consumer and business confidence. Any increases in the discount rate by the Federal Reserve Board in attempts to keep economic growth and inflation rates within reasonable limits are followed closely by increases in general interest rates. As interest rates in the United States increase, thedollar becomes more attractive and its exchange value against other currencies rises. Ultimately, a stronger dollar makes imported goods less expensive and U.S. goods more costly in foreign markets, tending to reverse U.S. trade gains.

Aside from catastrophic external events, the onset and magnitude of a general economic downturn are caused by the *coincident* rise of many of these separate factors to significant levels. Dataquest believes that the likelihood of a downturn is increasingly probable by late 1989, as outlined in the introduction to this report and in Table 1. Dataquest anticipates that the most likely scenario involves 1989 increases in interest rates by the Federal Reserve Board, coupled with plans for higher taxes and continued government spending. Declines in consumer sentiment and spending will result in a more pessimistic mood in the business community and subsequent capital spending cuts from the fourth quarter of 1989 through the second quarter of 1990.

The negative GNP growth is forecast to last only two quarters, with a maximum quarterly decrease of 2.4 percent. However, the equipment investment component of the economy is hypersensitive to interest rates and demand and will have a longer cycle of decline, consisting of three consecutive negative growth quarters. The Dataquest forecast shows equipment investment declining to negative 14.5 percent annualized growth in the second quarter of 1990 before beginning recovery in the third quarter. Purchases of computers, peripherals, and telecommunications equipment represent about 45.0 percent of U.S. equipment investment spending, and while they are more resistant to recession than many capital items, they will still be affected adversely by an economic slowdown.

As discussed in the *Economic Outlook 1988-1989*, Dataquest sees little prospect for significant improvement in the U.S. federal budget deficit through 1990, regardless of who become the new occupants of the White House and congress. In an election year, no one in Washington expects to gain any votes with tough talk about the deficit. After the election, there will be strong bipartisan interest to increase spending in a number of domestic areas that have seen lean times over the last eight years, such as health care, drug enforcement, environmental issues, and construction. The most likely budget scenario through 1989-1990 is one in which new program increases are balanced by raising personal income tax ceilings, elimination of some existing personal tax credits, increasing consumption taxes on tobacco, alcohol and gasoline, and modifying the corporate tax structure. Some programs that might otherwise have been federally funded, such as child care and worker retraining, will be shifted to corporate shoulders.

Dataquest projects federal deficits of $166 billion in 1988, $160 billion in 1989, and $145 billion in 1990, measured in current dollar terms. Figure 12 shows the 1976 to 1987 federal budget history, and projects the budget picture through 1990.

While Dataquest sees no perceptible slowdown in federal spending for computers, peripherals, and telecommunications equipment in civilian programs, the outlook is not good for the military budget. There is growing congressional sentiment for cuts of as much as 20 percent in the Pentagon's current annual spending level of $300 billion. Dataquest projects that the military's budget will be held to no real growth over the next two to three years. Our recommendation to related industries is to diversify into more commercial applications where possible, and into international markets where opportunities present themselves.

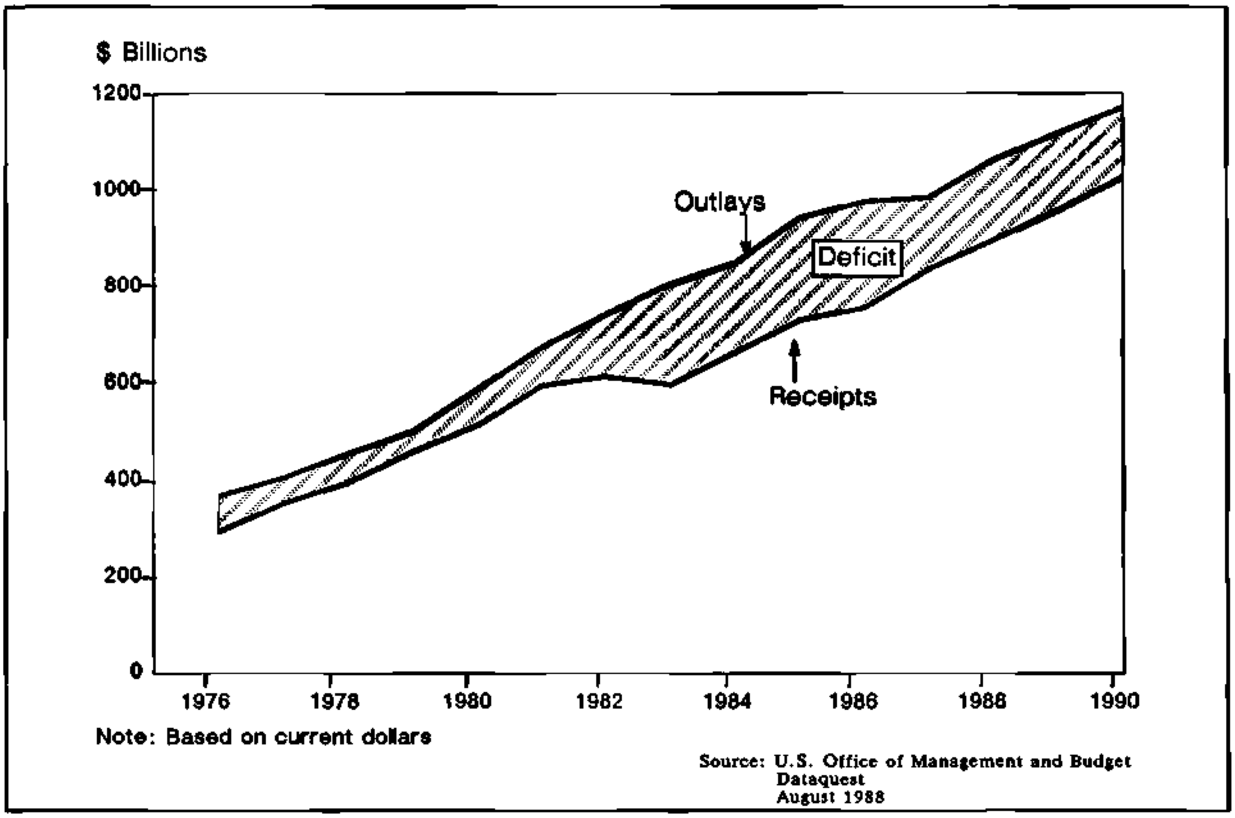

Figure 12. Federal Budget Receipts and Outlays—1976-1990

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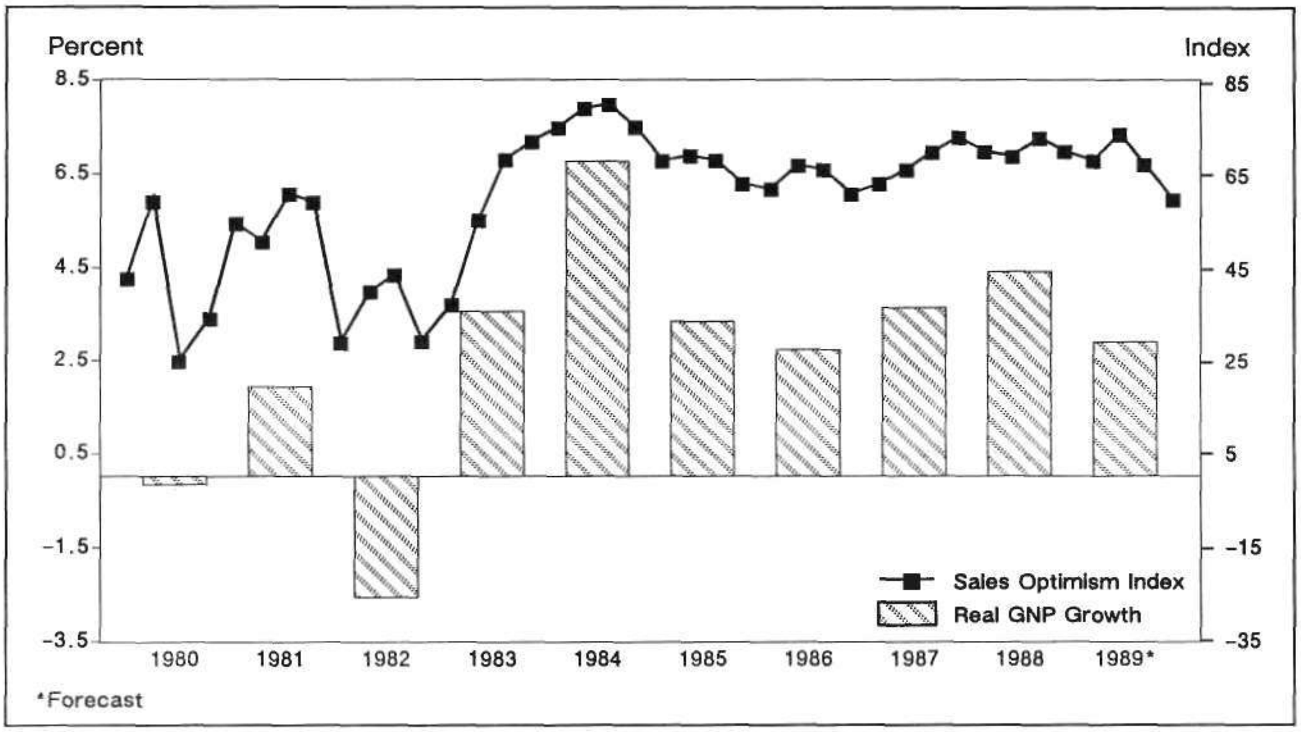
Research Newsletter

ECONOMIC OUTLOOK: . . . AFTER THE SOFT LANDING

SUMMARY

Economic indicators are sending mixed signals about the possibility of a recession in the short-term future. The Dun & Bradstreet Corporation's survey results indicate that the current economic lethargy probably will continue during the coming months, although a contraction is not likely in the near term. Compared with prerecession periods earlier this decade, business executives' expectations about future business conditions remain relatively positive. Furthermore, inflation and inventory overhang, two important precursors of recession, are relatively stable and minimal. Real gross national product (GNP) growth in 1989 is shaping up to be between 2.0 and 2.5 percent and is expected to remain in this range in the early months of the new year (see Figure 1).

FIGURE 1
Business Expectations and the Economy



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Source: U.S. Department of Commerce
The Dun & Bradstreet Corporation

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INTRODUCTION

Although the growth of the economy has slowed significantly since the first quarter of 1988, a descent into a recession has been avoided thus far. This slowing without reason characterizes the soft-landing scenario of economic growth that we have read and heard about so much recently. It is difficult to infer from recent macroeconomic data whether the slowdown will develop into a recession or reverse itself in the near future. Using survey techniques to ask decision makers directly about conditions in their businesses helps to resolve this uncertainty. Although many government economic indicators show a muddled picture of the economy, survey data gathered by Dataquest's parent company, Dun & Bradstreet (D&B), clearly indicate that the soft-landing situation probably will be sustained through the next several months.

RECENT ECONOMIC DATA ARE AMBIGUOUS

One of the important, albeit murky, macroeconomic gauges that measure industrial activity is the value of new orders for manufactured goods. This indicator is useful because it is highly predictive of investment expenditures, the most volatile component of GNP. Through May 1989, new orders had been averaging 8 to 10 percent ahead of levels for the same period in 1988. In June, new orders were only 3.1 percent ahead of 1988 levels, but orders rebounded in August to 4.5 percent ahead of year-ago levels. This upturn would be considered a good omen, except that new orders for nondefense capital goods, considered an especially vital component of total new orders, fell 15.3 percent in August and September and rose only 1.2 percent in October, which is the latest reported month.

Similarly, future consumer spending growth has been difficult to discern from recent personal consumption expenditure data. As with new orders, recent growth rates have rebounded from a summer slowdown. But a substantial part of this rebound resulted from increased sales of automobiles as a result of vigorous price-incentive programs from car manufacturers—certainly not a sign of sustainable growth.

Meanwhile, employment growth has slowed substantially. The economy generated an average of 250,000 new jobs each month during the first half of this year. Since July, average monthly job growth has dropped below 150,000. Furthermore, the unemployment rate edged up by one-tenth of a percentage point in November to 5.4 percent, the highest level since January, and factory jobs fell for the eighth straight month. On the positive side, inflation and interest rates have been edging downward in recent months, transitory fluctuations notwithstanding. In short, it is ambiguous whether the economy is entering a period of accelerating or decelerating growth.

More conclusive evidence can be found in recent Dun & Bradstreet Business Expectation Survey results. These results indicate that although a period of economic weakness is anticipated, it is not pronounced enough to indicate that a recession is imminent.

BUSINESS EXPECTATION SURVEY RESULTS

The Dun & Bradstreet Business Expectation Survey is a random survey of 1,500 executives in the manufacturing, wholesaling, and retailing sectors. (The survey sample will be expanded to 3,000 executives beginning with first quarter 1990 data and will add additional service-sector coverage.) These executives are asked if they expect sales, profits, selling prices, and employment and inventory levels to increase, decrease, or remain the same in the upcoming quarter. From these results, a sales optimism index is compiled.

D&B's optimism index is a valuable leading indicator of economic activity, because it quantifies business executives' expectations of future business conditions. This survey's strength is that it is composed mostly of small and medium-size businesses, which account for more than 97 percent of all businesses. If business executives are feeling relatively uncertain about future business conditions, most investment plans probably will be curtailed. For purposes of forecasting future economic activity, the root causes of this uncertainty matter comparatively little—only the resulting behavioral changes are relevant.

The optimism index for expected sales reached 60 points for the fourth quarter of 1989—down from 74 points for the second quarter. The current index level is noteworthy for two reasons. First, despite the slow decrease, the overall level of optimism remains high. Second, the magnitude of the decline is significantly smaller than the declines typically associated with a recession. These observations are illustrated in Figure 1. So, the recent 14-point decline indicates that economic growth probably will remain positive, although sluggish. The economy is not likely to crash-land into a full-blown recession.

Comparing these results with the two previous recession years of 1980 and 1982 gives credence to this analysis. In 1980, the sales optimism index fell from 61 to 26 between the second and third quarters, acutely portending the contraction that followed. Similarly, the index fell from 59 to 30 between the fourth quarter of 1981 and the first quarter of 1982, again providing some early warning of the coming recession.

THAT WAS THEN; THIS IS NOW

Two precursors of recessions are unexpected changes in inflation (and resulting unexpected changes in interest rates) and excess inventories that trigger sharp production cutbacks. The D&B Business Expectation Survey optimism index for selling-price increases has declined in each of the last two quarters, falling from 46 points in the second quarter to 34 points in the fourth. This decrease corroborates recent economic statistics that show inflation rates abating (or at least not accelerating). Furthermore, current expectations for selling-price increases pale by comparison with levels in the 70- to 80-point range seen between 1980 and 1982.

Current inventory accumulation survey results reveal a similar picture. The inventory expectations index dropped 10 points over the past two quarters. Diminished inventory accumulation likely will slow economic growth in the near term, but it also probably will diminish the chances of a contraction-inducing inventory overhang.

THE OUTLOOK: SLOW GROWTH TO CONTINUE

Real GNP growth averaged more than 3 percent in the first half of this year, with the second quarter markedly slower than the first. Dataquest believes that this weakness will continue through the remainder of 1989, with the economy expanding at a 2.0 to 2.5 percent annual rate. We believe that declining inventory accumulations in the fourth quarter will be a major factor in this continued weakness in growth. In addition, a slowdown of income growth also will hamper consumer spending through the Christmas season.

Terrance A. Birkholz

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Research Newsletter

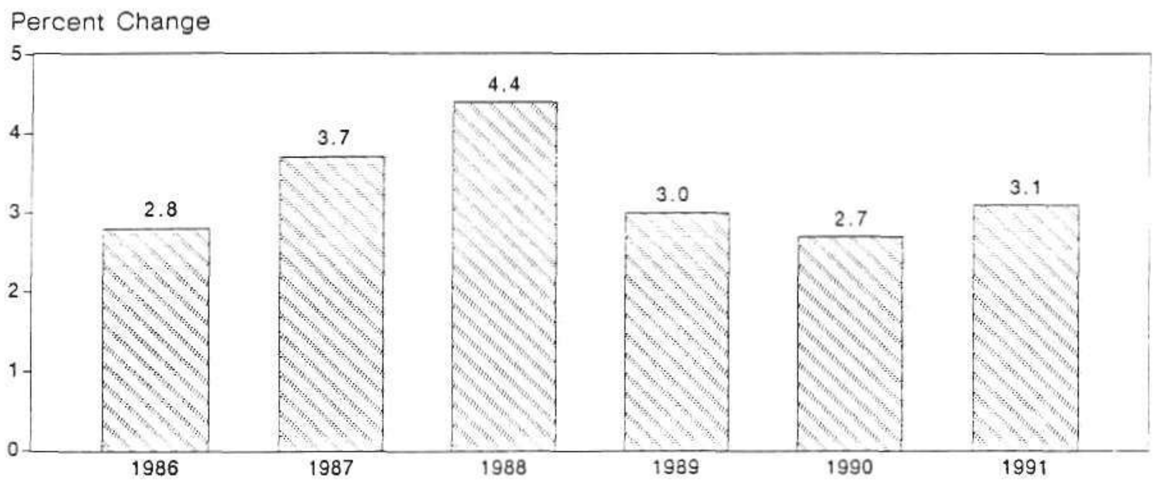
ECONOMIC OUTLOOK: THE ECONOMY HAS LANDED

SUMMARY

Real U.S. Gross National Product (GNP) growth is forecast to be 3.0 percent in 1989 and 2.7 percent in 1990 (see Figure 1). Quarterly growth is expected to decelerate through the end of this year and slowly pick up in the first quarter of 1990. Lower interest rates in 1990 should stimulate household expenditures on consumer durables and business investment in plant and equipment. As the investment climate improves, Dataquest expects electronic equipment production to follow suit, growing at a 6.4 percent pace in 1990, up from 6.1 percent this year.

Figure 1

Real GNP Growth



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Source: The Dun & Bradstreet Corporation

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BETTER SHAPE THAN WE THOUGHT

GNP data, recently revised by the U.S. Commerce Department, indicate that during the period between 1986 and the first quarter of 1989, the economy was almost $30 billion larger than previously reported. Most of this increase was in the balance of trade, and most of that was due to an improvement in exports. The revision reflects two things. The first is a broader definition of exports that now includes more financial and business services trade (e.g., accounting and consulting). The second thing the revision shows is that consumer and investment spending increased slightly and, significantly, inventories accumulated at a much slower pace.

Slower inventory growth reduces the probability of any significant downward correction in the remainder of the year. Because inventory corrections typically trigger recessions, the likelihood of a recession beginning any time soon is less than previously expected.

THE U.S. ECONOMY, NOW ARRIVING AT GATE...

The soft landing is a situation where economic growth decelerates but remains positive enough to avert a recession, although slow enough to bring about a reduction of inflation. Second-quarter real GNP grew at a 2.5 percent annual rate, well within the nonaccelerating-rate-of-inflation growth range. This rate was lower than the 3.0 percent growth in the second quarter of 1988. Recent price indexes also show that inflation has stabilized. Thus, both requirements of the soft landing have been met, at least for the time being. Now that we've landed, how long is this stopover going to last? What's the economy's next flight plan?

DEPARTING FOR...

The latest Dun & Bradstreet forecast calls for real U.S. GNP growth to slow further this year, at 2.4 percent and 2.0 percent rates in the third and fourth quarters, respectively, putting 1989 annual growth at 3.0 percent, down from 4.4 percent in 1988.

If recent interest rate decreases are sufficient to stimulate spending without touching off a flight from dollars—and the recent strength in the dollar indicates that this is indeed happening—then the economy's next takeoff is scheduled for the first quarter of 1990. We forecast real growth of 2.3 percent in the first quarter of 1990, accelerating to 3.1 percent in the second. Third- and fourth-quarter growth are expected to be 4.1 percent and 3.7 percent, respectively, which would place 1990 annual growth at 2.7 percent over 1989.

DEMAND COMPONENTS

Consumer Expenditures

The outlook is for a modest pickup in spending. Growth has been slowing each quarter since the beginning of 1988, yet consumer confidence in the economy remains relatively optimistic. Rising interest rates were responsible for this slowdown in 1988. More recently, however, weakening spending has been attributable to increases in personal tax payments resulting from deferrals of income from 1986 and 1987 into 1988 and to a spurt in food and energy prices earlier this year. In 1990, tax rates still will increase, but only slightly, and expected lower interest rates should ease consumers' debt burdens.

Investment Expenditures

Business investment spending should improve, but not dramatically. Capital spending remained strong throughout the first half of 1989 following a period of weakness in late 1988. As in the consumer sector, lower interest rates should help stimulate this sector. However, the rally in the dollar that began last spring, if it persists, will make exploiting new export markets more difficult in 1990. Also, sharply higher (domestic) automobile prices will inhibit growth in this important area.

Government Expenditures

Last year, inflation-adjusted government expenditures fell primarily because of cutbacks in defense spending. This trend has accelerated this year and is likely to continue in 1990, given the (credible?) threat of across-the-board budget cuts, if Gramm-Rudman-Hollings deficit reduction goals are not met. Spending by state and local governments will provide some (minimal) stimuli, but their own fiscal problems will limit any significant offset.

Foreign Trade

Growth in net exports (i.e., exports less imports) also will stall compared with recent years. In 1988, net exports contributed $41 billion to real GNP growth; a $25 billion contribution is forecast in 1989. In 1990, the contribution is expected to continue to fall to less than $1 billion. Because of the recent appreciation of the dollar, export growth, while still healthy, is not likely to match the strong performance of the past two years. Meanwhile, as the economy takes off, the demand for imports will grow also.

DATAQUEST CONCLUSIONS AND RECOMMENDATIONS

Dataquest expects growth of business fixed investment in equipment to decelerate through the end of this year. Starting in the first quarter of 1990, however, we expect the pace of capital equipment spending growth to accelerate through the end of the year.

The faster rate of capital spending should, in turn, translate into a faster pace of growth in electronic-equipment production. We forecast the value of North American electronic equipment production to grow 6.1 percent in 1989, down from 6.6 percent growth last year and to grow 6.4 percent in 1990.

Notably, wide swings in growth are being moderated by manufacturers' efforts to keep a tight reign on inventories. Indeed, because equipment inventories are appropriate for the current lull in equipment shipments and orders growth, electronics manufacturers are well poised to take advantage of the quicker pace of business expected during the first half of 1990.

Until that time, however, Dataquest urges the manufacturing community to be vigilant in its commitment to run a lean, nimble shop and compete on intangibles such as customer service and satisfaction. This commitment is the surest bet to catch the next wave and the attendant market share.

Terrance A. Birkholz

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Research Newsletter

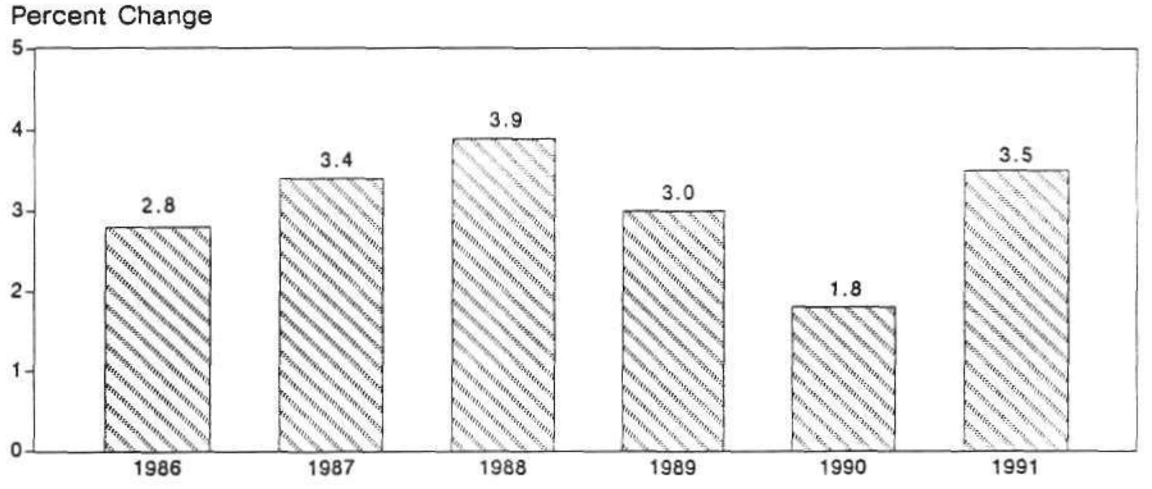
MIDYEAR ECONOMIC REVIEW AND OUTLOOK

SUMMARY

The U.S. economy has been growing continuously since November 1982—the longest U.S. economic peacetime expansion on record—and shows every sign of continuing well into its seventh year. Overall, no recession is foreseen, but an economic slowdown seems to be on the horizon. Real gross national product (GNP) growth in 1988 was 3.9 percent, an improvement from the 3.4 percent growth in 1987. A possible slowdown should result in growth rates of about 3.0 percent in 1989 and 1.8 percent in 1990, as shown in Figure 1. Beyond this, GNP growth is expected to accelerate to a 3.5 percent growth rate in 1991.

Figure 1

Real GNP Growth



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Source: Dun & Bradstreet Corporation

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Dataquest relies heavily on the economic analysis department of the Dun & Bradstreet Corporation, our parent company, to help us develop our economic forecast. A synopsis of D&B's economic outlook is discussed in this newsletter.

A SOFT LANDING IN OUR FUTURE?

Many economists are looking for evidence that the economy will experience a "soft landing" in the near term. This soft landing, which federal economic policy makers are trying to engineer, would involve a gradual slowing of economic growth without the onslaught of a recession. They believe that this policy would decelerate what appears to be recently quickening inflation, without endangering continuing economic growth.

To achieve a soft landing, the economy will have to slow from its strong 3.9 percent growth in 1988. Reduced job creation rates and consumer spending growth in the first half of 1989 indicate that a soft landing may be emerging. Inflation rates jumped upward earlier this year, creating anxiety among those who feared that the Federal Reserve Board would respond with higher interest rates. In retrospect, however, this recent acceleration in inflation is seen as transitory, the result of increases in oil and food prices. Thus, the deceleration-of-inflation component of the soft landing also appears intact.

Nonetheless, the export and investment sectors of the economy should remain relatively strong. Capital spending should continue growing at a healthy pace as manufacturers expand capacity. Also, merchandise exports, responsible for much of last year's growth, have reached new heights recently. The optimism reflected in a recent Dun & Bradstreet business expectations survey and a leveling-off of capacity utilization both suggest that there is room for exports to expand even further.

Continued investment and export growth will depend heavily on future interest rate levels and the dollar's foreign exchange value. The dollar rose about 10 percent against other major currencies from November 1988 to June 1989. A stronger dollar threatens the recent progress made on the trade deficit, because it makes imports relatively less expensive in the United States.

The strengthening dollar and falling interest rates are believed to be short-term aberrations. By year-end, it is likely that both the dollar and interest rates will be near their January levels. This is because the factors involved in this reversal are only temporary. Nothing has changed significantly in the fundamental factors, so long-term trends should predominate once again in the second half of this year.

Improvements in the merchandise trade deficit notwithstanding, the deficit probably will remain large due to increased imports—possibly $110 billion in 1989 compared with $120 billion last year. Furthermore, its position as a net debtor because of cumulative past deficits means that the United States now must service this debt. This mounting debt service now offsets most of the gains on the merchandise components.

The large trade deficit will continue to flood currency markets with dollars, which in turn should keep downward pressure on the dollar. As the dollar falls, however, interest rates are likely to increase, directly because of the Federal Reserve's attempts to stabilize and support the dollar, and indirectly because of some acceleration in inflation resulting from higher prices for imported goods.

Despite these factors, the economy should remain relatively healthy. Although a recession is not forecast, slower growth is expected this year and next year. Real GNP growth will likely slow from 3.9 percent in 1988 to 3.0 percent in 1989. Given the 4.5 percent annualized real GNP growth in the first quarter, a great deal of 1989's growth is believed to have occurred already in the first part of this year. Expected higher interest rates probably will impede growth in the second half of 1989, and growth should slow even further to 1.8 percent in 1990.

This growth path is consistent with the soft-landing expectation. However, as always, the economy is subject to unexpected shocks that could turn the soft landing into the crash landing of a full-blown recession.

THE GNP COMPONENTS

By 1991, the economy is expected to resume a quicker pace, rebounding with 3.5 percent growth. The following is an analysis of the outlook of GNP components. Statistical details of these components are shown in Table 1. Additional indicators of macroeconomic activity are given in Table 2.

Consumer Spending

Consumer expenditures constitute about two-thirds of real GNP. Recently, the volume of consumer expenditure growth has slowed because of slower income growth and higher prices for some goods. On average, 84 percent of consumer expenditures are relatively fixed items and services (e.g., food, clothing, shelter, and gasoline). Because their demand is relatively income inelastic, consumer spending growth in these areas should continue at nearly the current rates. On the other hand, spending for durable goods such as automobiles, furniture, and appliances is likely to slow. Because funds for these goods usually are borrowed, and with the outlook of higher interest rates that will raise finance costs, consumer spending on durables is likely to slow. But because only 16 percent of consumer expenditures are for durable goods, a major disruption in this sector probably will be avoided.

Investment

Dataquest predicts that equipment investment spending will be one of the strongest areas of the economy. Since many investment decisions are made 6 to 12 months in advance, the anticipated interest rate increases should not affect this sector until 1990, if at all. Stimulated by a cheap dollar and strong export demand, equipment sales to both domestic and foreign manufacturers should remain relatively buoyant. Until the dollar and interest rates stabilize, however, investment in additional plant capacity should lag somewhat. Residential investment also will remain flat as a result of higher interest rates. Inventory investment should slow by next year as manufacturers react to a riskier economic environment as a result of higher interest rates.

Table 1

Components of Real GNP and Nominal GNP (Billions of 1982 Dollars)

	Actual		
	1986	1987	1988
Consumption Expenditures	$2,455.2	$2,520.9	$2,592.2
Rate of Change (%)	4.2	1.9	2.8
Business Fixed Investment	$ 433.1	$ 445.2	$ 487.5
Rate of Change (%)	(4.5)	2.8	9.5
Residential Fixed Investment	$ 195.0	$ 195.2	$ 191.8
Rate of Change (%)	17.8	0.1	(1.7)
Government Purchases	$ 760.5	$ 780.2	$ 782.3
Rate of Change (%)	4.0	2.6	0.3
Change in Business Inventories	$ 15.5	$ 34.4	$ 42.5
Net Exports	($ 15.5)	($ 128.9)	($ 100.2)
Equals:			
Gross National Product (1982 $)	$3,721.7	$3,847.0	$3,996.0
Rate of Change (%)	2.8	3.4	3.9
Addendum:			
Implicit Price Deflator (Index, 1982 = 100)	114.0	117.7	121.7
Rate of Change (%)	2.7	3.2	3.4
Gross National Product (Current $)	$4,240.3	$4,526.7	$4,864.3
Rate of Change (%)	5.6	6.8	7.5

(Continued)

Table 1 (Continued)

Components of Real GNP and Nominal GNP
(Billions of 1982 Dollars)

	Forecast		
	1989	1990	1991
Consumption Expenditures	$2,662.1	$2,725.8	$2,812.6
Rate of Change (%)	2.7	2.4	3.2
Business Fixed Investment	$ 514.5	$ 537.1	$ 568.8
Rate of Change (%)	5.5	4.4	5.9
Residential Fixed Investment	$ 191.1	$ 187.9	$ 199.8
Rate of Change (%)	(0.3)	(1.7)	6.3
Government Purchases	$ 805.6	$ 812.2	$ 815.3
Rate of Change (%)	3.0	0.8	0.4
Change in Business Inventories	$ 31.0	$ 4.2	$ 19.8
Net Exports	($ 87.2)	($ 74.6)	($ 76.7)
Equals:			
Gross National Product (1982 $)	$4,116.9	$4,192.7	$4,339.8
Rate of Change (%)	3.0	1.8	3.5
Addendum:			
Implicit Price Deflator (Index, 1982 = 100)	127.6	134.1	140.3
Rate of Change (%)	4.8	5.1	4.6
Gross National Product (Current $)	$5,252.1	$5,623.7	$6,089.1
Rate of Change (%)	8.0	7.1	8.3

Source: Economic Analysis Department
The Dun & Bradstreet Corporation

Table 2

Major Macroeconomic Indicators

	1986	1987	1988
	Billions of Current Dollars		
Nominal GNP	$4,240.3	$4,526.7	$4,864.3
Rate of Change (%)	5.6	6.8	7.5
	Billions of 1982 Dollars		
Real GNP	$3,721.7	$3,847.0	$3,996.0
Rate of Change (%)	2.8	3.4	3.9
	Index, 1982 = 100		
GNP Deflator	114.0	117.7	121.7
Rate of Change (%)	2.7	3.2	3.4
	Billions of 1982 Dollars		
Real Disposable Income	$2,640.9	$2,686.9	$2,788.3
Rate of Change (%)	3.9	1.7	3.8
	Percent		
Personal Saving Rate	4.0	3.7	4.2
	Index, 1977 = 100		
Industrial Production	125.1	129.8	137.2
Rate of Change (%)	1.1	3.7	5.7
	Percent		
Capacity Utilization	79.7	81.0	83.5
Civil Unemployment Rate	7.0	6.2	5.5
	Millions Employed		
Employment, Establishment Basis	99.5	102.2	105.6
Rate of Change (%)	2.0	2.7	3.3

(Continued)

Table 2 (Continued)

Major Macroeconomic Indicators

	1986	1987	1988
	Billions of 1982 Dollars		
Real Final Sales	$3,843.8	$3,941.5	$4,053.7
Rate of Change (%)	3.5	2.5	2.7
	Billions of 1982 Dollars		
Private Domestic Demand	$3,083.3	$3,161.3	$3,271.5
Rate of Change (%)	3.4	2.5	3.5
	Billions of Current Dollars		
After-Tax Profits	$ 129.8	$ 137.8	$ 163.9
Rate of Change (%)	1.5	6.2	18.9
	Interest Rates (%)		
Federal Funds Rate	6.8	6.7	7.6
3-Month Treasury Bills	6.0	5.8	6.7
30-Year Treasury Bonds	7.8	8.6	9.0
	Index, March 1973 = 100		
FRB Exchange Rate	112.3	96.9	92.9
Rate of Change (%)	(21.6)	(13.7)	(4.2)
	Billions of Current Dollars		
Federal Surplus (Unified, Fiscal Year)	($ 221.1)	($ 149.0)	($ 155.0)
Rate of Change (%)	(5.8)	32.6	(4.1)

(Continued)

Table 2 (Continued)

Major Macroeconomic Indicators

	1989	1990	1991
	Billions of Current Dollars		
Nominal GNP	$5,252.1	$5,623.7	$6,089.1
Rate of Change (%)	8.0	7.1	8.3
	Billions of 1982 Dollars		
Real GNP	$4,116.9	$4,192.7	$4,339.8
Rate of Change (%)	3.0	1.8	3.5
	Index, 1982 = 100		
GNP Deflator	127.6	134.1	140.3
Rate of Change (%)	4.8	5.1	4.6
	Billions of 1982 Dollars		
Real Disposable Income	$2,866.4	$2,932.3	$3,034.9
Rate of Change (%)	2.8	2.3	3.5
	Percent		
Personal Saving Rate	5.5	5.8	5.3
	Index, 1977 = 100		
Industrial Production	142.3	145.9	151.5
Rate of Change (%)	3.7	2.5	3.9
	Percent		
Capacity Utilization	83.6	83.1	84.0
Civil Unemployment Rate	5.5	6.2	5.8
	Millions Employed		
Employment, Establishment Basis	108.2	109.5	112.9
Rate of Change (%)	2.5	1.2	3.2

(Continued)

Government

Government spending is expected to be an area of weakness in the economy. As Gramm-Rudman-Hollings (GRH) deficit-cutting measures become increasingly difficult to avoid, either reductions in federal government spending or increases in taxes (or some combination of the two) will have to be enacted, either of which will slow economic growth. The fiscal 1990 GRH target is $100 billion. The actual fiscal 1990 deficit, however, is likely to exceed official estimates by at least $40 billion to $50 billion. This shortfall will have to be made up in fiscal 1991, when the GRH deficit target will fall to $64 billion. Thus, Congress and the Bush Administration may be forced to discover more than $80 billion in federal budget deficit reductions (unlikely), revise the GRH targets (likely), or both (the most likely). In addition, large deficits in many state and local governments—57 percent of total real government spending—will force cutbacks in these areas as well.

Foreign Trade

Net exports, the contributions of the trade balance to real GNP, should improve modestly in 1989. The strong European and Japanese economies are likely to continue fueling demand for U.S. exports, particularly if the dollar weakens. Demand should be especially strong for U.S.-made industrial supplies and manufactured goods. However, imports into the United States also will continue to grow, although not as rapidly as exports. Higher oil prices, in particular, will be detrimental to the U.S. balance of trade.

DATAQUEST CONCLUSIONS

Dataquest anticipates that an economic slowdown primarily caused by higher interest rates will begin approximately at the end of this year or in early 1990. To date, the indications are that the economy probably is headed for a soft landing and that a recession can be avoided. It would be premature, however, to assume that the macroeconomic managers have repealed the business cycle, with the latest round of fine-tuning policy measures. Once interest rates peak, which probably will happen in early 1990, economic growth will slow for several months. After this, the growth pace should pick up steam and improve significantly in 1991.

Terrance A. Birkholz

Table 2 (Continued)

Major Macroeconomic Indicators

	1989	1990	1991
	Billions of 1982 Dollars		
Real Final Sales	$4,173.1	$4,263.1	$4,396.7
Rate of Change (%)	2.9	2.2	3.1
	Billions of 1982 Dollars		
Private Domestic Demand	$3,367.7	$3,450.8	$3,581.2
Rate of Change (%)	2.9	2.5	3.8
	Billions of Current Dollars		
After-Tax Profits	$ 172.1	$ 167.0	$ 179.5
Rate of Change (%)	5.0	(3.0)	7.5
	Interest Rates (%)		
Federal Funds Rate	9.5	9.0	8.5
3-Month Treasury Bills	8.3	8.0	7.7
30-Year Treasury Bonds	8.7	8.7	9.2
	Index, March 1973 = 100		
FRB Exchange Rate	97.4	88.3	84.0
Rate of Change (%)	4.9	(9.4)	(4.9)
	Billions of Current Dollars		
Federal Surplus (Unified, Fiscal Year)	($ 167.0)	($ 150.0)	($ 110.0)
Rate of Change (%)	(7.7)	10.2	26.7

Source: Dun & Bradstreet
U.S. Department of Commerce
Federal Reserve Board

Dataquest
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Research Newsletter

DUN & BRADSTREET'S ECONOMIC OUTLOOK FOR 1988 THROUGH 1990

SUMMARY

The U.S. economic outlook for 1989 indicates slower growth but no recession. The Dun & Bradstreet Corporation, Dataquest's corporate parent, forecasts an economic downshift starting in the second half and continuing into 1990. However, corporate spending for capital equipment, including computers and telecommunications, may not be greatly affected.

The Dun & Bradstreet Dun's 5000 survey on capital spending indicates that most companies plan to maintain or increase their capital expenditures, supporting a trend of the past three years.

A synopsis of Dun & Bradstreet's economic outlook and capital spending survey results is discussed in the following paragraphs.

ECONOMIC FORECAST

The year 1989 will most likely see slower economic growth than 1988. Weaker contributions to GNP gains from the government and trade sectors and higher interest rates are to blame.

Despite this weakness, no recession is anticipated. In 1989, growth in real GNP should slow from 1988's estimated 3.8 percent to about 2.5 percent. In 1990, the slowdown will continue with a 1.3 percent growth rate, largely as a result of a poor jumping-off point at the end of 1989.

Farm production during the last three quarters of 1988 was adversely affected by the drought in many parts of the country. However, with these climatic conditions behind us, a surge in real GNP will result in the first quarter of this year.

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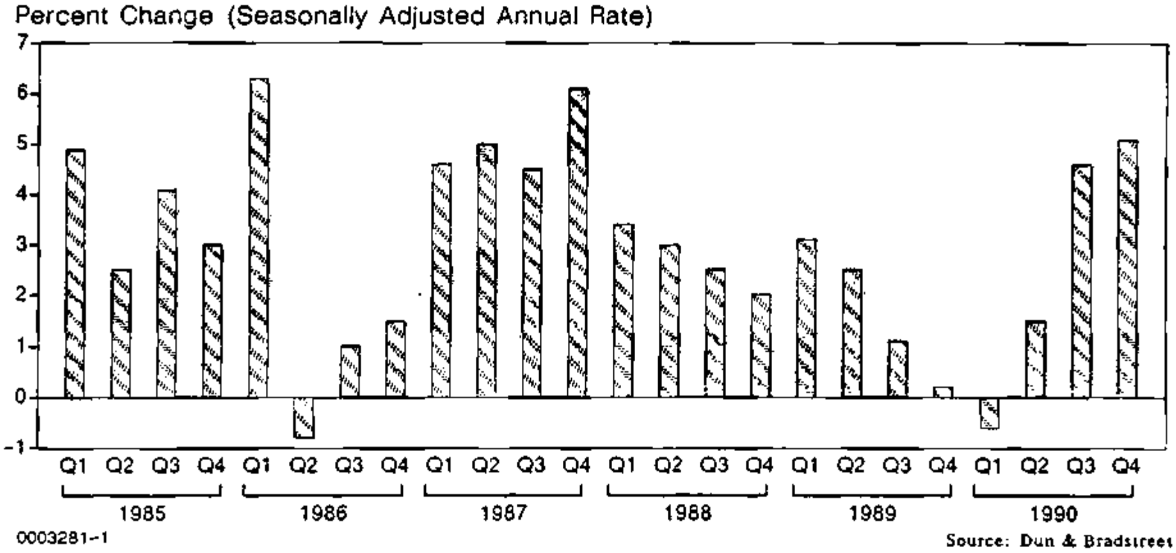
Thereafter, a host of negative factors will come into play, leading to decelerating growth in the remainder of 1989 and through the first half of 1990 (see Figure 1). After these factors have run their course, the economy will resume the moderate-to-strong growth rates that were last seen in 1987 and early 1988.

Figure 1

Gross National Product Growth
(1982 Constant Dollars)



The key factors influencing the economy's short-run performance are as follows:

- Government/fiscal policy
- Interest rates/monetary policy
- Consumer spending
- Capital spending
- Trade/foreign sector

These factors are examined in the following paragraphs.

Government/Fiscal Policy

The fiscal 1989 budget is in place, and, with few exceptions, is largely a clone of the fiscal 1988 budget. In the fiscal 1990 budget, the Bush Administration will stress spending cuts rather than tax increases, although new user fees, excise taxes, and already legislated tax increases appear likely to be included. As a result, the first budget of the Bush Administration will see negligible real growth, if any, in defense and nondefense spending.

Interest Rates/Monetary Policy

By recently raising the discount rate to 7 percent, the Federal Reserve Board has made its strongest statement yet of its determination to hold back inflation. The Fed's tight monetary policy has created a situation in which some short-term interest rates are higher than long-term rates. Experience shows that when this situation persists, economic weakness usually follows. The Fed will maintain its severe anti-inflation policy until it is satisfied that inflation is not accelerating or that recession is on the horizon.

Consumer Spending

Real consumer spending grew 2.8 percent last year and is expected to grow about 2.0 to 2.5 percent in 1989. Expenditures on durable goods are highly interest rate sensitive, and therefore will show less growth this year because of higher rates. But considering that durables account for only 15 percent of all consumer purchases, this slowdown will not have much of an economy-wide effect. Nondurable goods, which account for about one-third of consumer spending, are relatively insensitive to changes in incomes. So, cutbacks in this area will also likely have only a minor effect on the economy. Finally, the diversity of the services category ensures that overall growth of consumer spending in services should be maintained.

Capital Spending

Firms' capital spending plans that are in place are unlikely to be changed by recent interest rate movements. However, the combination of higher interest rates, a stabilizing dollar, and slightly reduced consumer spending likely will adversely affect longer-term capital spending plans that have not been finalized. Real business fixed investment grew 9.5 percent last year, and it is expected to slow to 3.6 percent growth this year and to further slow to 1.6 percent growth in 1990.

Trade/Foreign Sector

Minimal improvement in the trade balance is expected. Capacity constraints among several traditional export industries will make it difficult to expand production. Adding to this, higher interest rates will discourage capacity expansion. These factors, combined with a stabilizing dollar, will dampen continuation of last year's export boom. Meanwhile, demand for imports will likely shrink by a small amount in response to modest consumer and business spending cutbacks.

DUN'S 5000 SURVEY RESULTS

The Dun's 5000 survey has been completed and the results can be summed up in a word—optimistic. The outcome of this survey illustrates a continuing positive trend in capital spending and, in particular, in budget allocations for computers and telecommunications equipment.

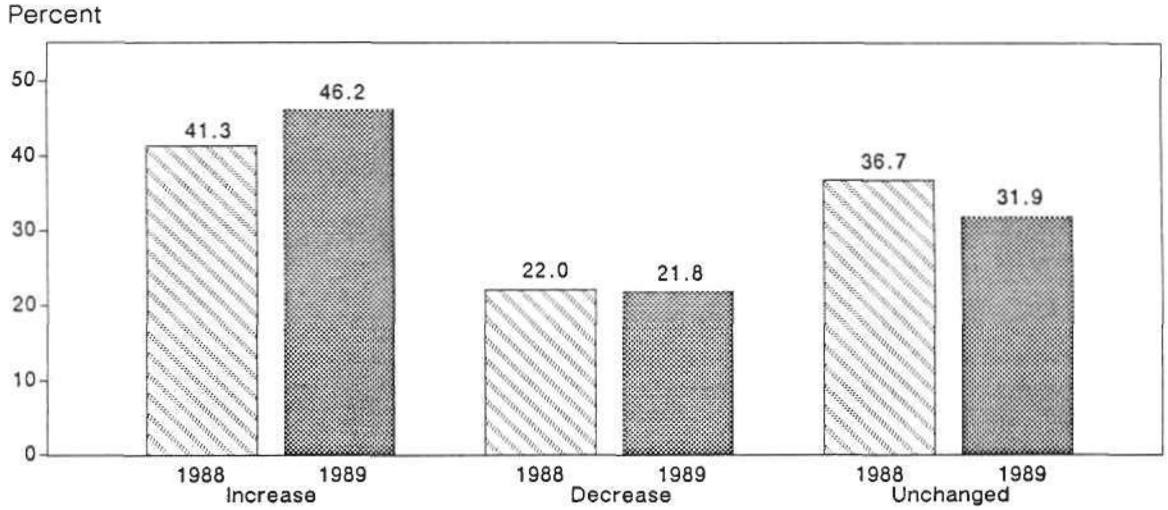
Dun & Bradstreet's Dun's 5000 survey is based on a sample of companies that is statistically representative of the distribution of companies by size in the U.S. economy. The 1989 planned capital spending reflects even greater optimism than was seen in 1988 (see Figure 2). Of the companies surveyed, 46.2 percent plan an increase in capital spending, compared with 41.3 percent one year ago. Plans to decrease capital spending in 1989 were slightly lower than those for 1988—21.8 percent and 22.0 percent, respectively.

According to The Dun & Bradstreet Office of Economic Analysis, the capital spending patterns of 1988 are expected to continue through most of 1989, sustaining an upbeat trend. In 1988, 27.1 percent of companies spent more than planned. The previous year, 25.0 percent of the surveyed companies' actual spending exceeded plan (see Figure 3).

The 1989 capital spending budgets of companies surveyed show that a larger percentage of their budgets is being allocated for computers and telecommunications equipment compared with 1988 (see Figure 4). Although most companies, regardless of size, continue to allocate less than 10 percent of their budgets to computers and telecommunications equipment, the positive shift is toward spending between 11 and 50 percent.

Figure 2

Capital Spending Plans
1989 versus 1988

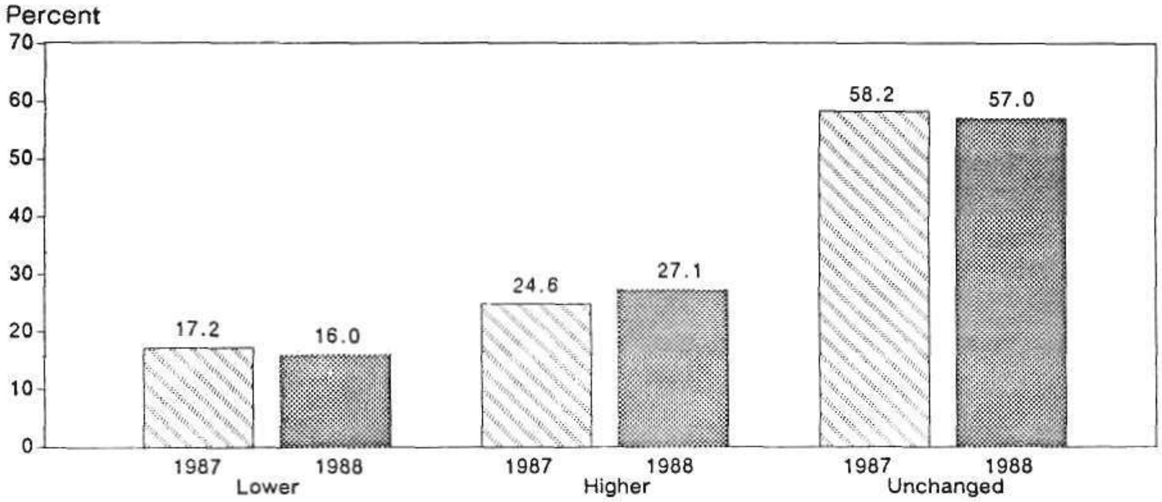


0003281-2

Source: Dun & Bradstreet

Figure 3

Capital Spending—Actual Versus Planned 1987 and 1988

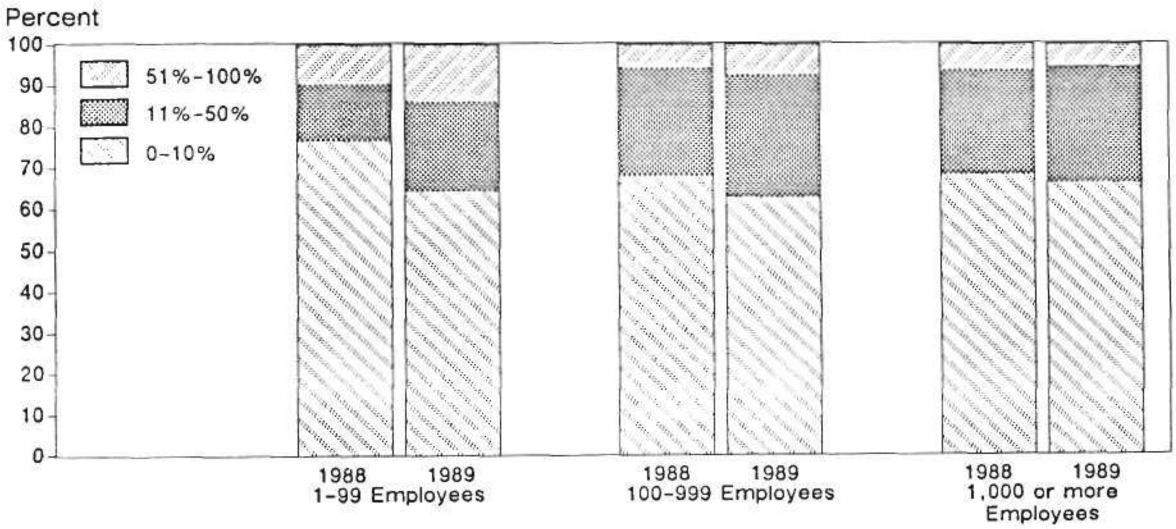


0003281-3

Source: Dun & Bradstreet

Figure 4

Budget Allocation for Computers and Telecommunications Equipment by Company Size



0003281-4

Source: Dun & Bradstreet

CAPITAL SPENDING SURVEY RESULTS

The manufacturing sector was the most positive in spending plans, with 50.3 percent of those companies surveyed planning to increase capital spending. This situation is probably due to continued strength in exports. According to Dun & Bradstreet, the manufacturing sector contributes approximately 60.0 percent of all exports. Although most manufacturing companies plan increases in capital spending, the percentage allocated toward computers and telecommunications equipment has not increased.

Earlier forecasts pointed to economic slowdowns and the possibility of a recession in 1989. Although the current forecasts are more positive, Dun & Bradstreet considers the following scenarios to be areas of concern for the capital spending outlook:

- Higher interest rates, resulting from anti-inflationary monetary policies, could drive up the cost of capital.
- Interest rates increasing in the United States relative to rates in international markets could drive up the dollar and reduce exports.
- Protectionist policies among U.S. trade partners may hinder the ability of U.S. companies to compete in these markets.
- New fiscal deficit-cutting initiatives that increase corporate taxes or reduce investment incentives may affect capital spending.
- A drop in consumer spending growth would free up a sizable amount of productive capacity in many industrial sectors that serve domestic markets. The freed capacity would lessen the demand for new capital equipment.

The overall capital spending picture, as supported by the Dun's 5000 survey, is a positive one. Unless potential pitfalls occur, as outlined by Dun & Bradstreet, these spending plans, should be achieved or exceeded.

DATAQUEST CONCLUSIONS

Although the Dun & Bradstreet forecast calls out a slowing in the economy, the capital spending plans of companies continue to be aggressive. Dataquest clients can still take advantage of this persisting growth pattern in planned capital expenditures while keeping an eye on potentially high-impact economic shifts.

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