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1990 Holds an Important Lesson for Now

The approach into the 1990 recession was remarkably similar to now with no obvious recession imbalances or theme, a recession head fake with preventative Fed cutting, an ensuing economic mini-boom, large deficits, and finally an inflationary shock.

Note: to increase readability, some graphics are linked-to on the internet as indicated by [fig.x], rather than included in the body.

Eric Hickman, 3/3/2025

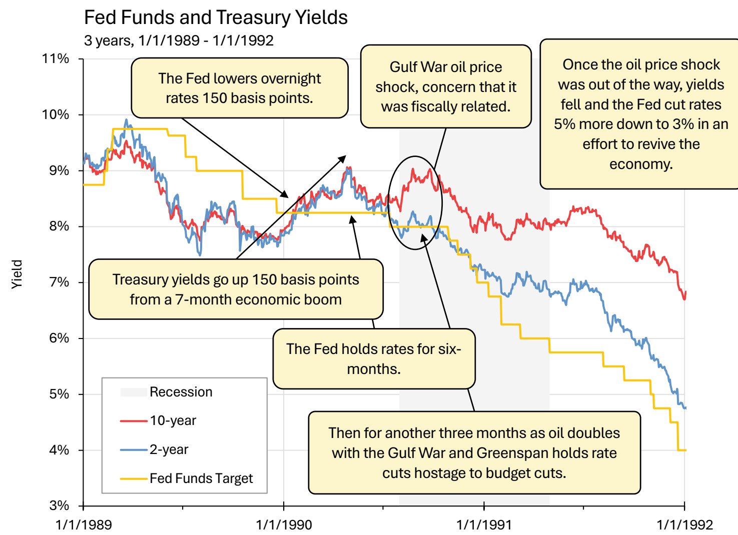
The business cycle is a fact of life. On average, every five years since The Great Depression, the business cycle has shown up as a recession or soft-landing [fig.1]. It has been five years since the last recession and reliable pre-conditions for one (not soft-landing) have arisen. The yield curve de-inverted last year [fig.2], the Leading Economic Index is 16% below its high [fig.3], and the unemployment rate is 0.6% above its low [fig.4]. Payroll gains have been decelerating for 3.5 years in a long glide path into a recession [fig.5] and consumer credit growth has slowed to recessionary levels [fig.6]. In addition, because of how economic strength or weakness tends to sway elections, Republican presidents taking over from Democratic administrations typically have a recession in their first year.

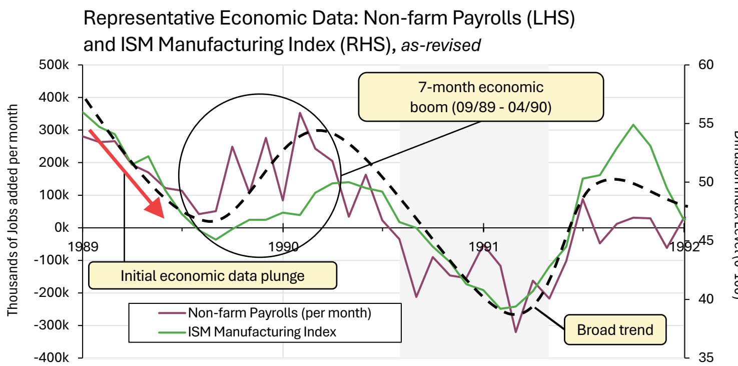
But, unlike the past three recessions, there isn't a singular theme or imbalance to point to. The early 2000s recession had the dot-com bubble with stocks falling for a year ahead of it, The Great Financial Crisis had the housing bubble bursting with home prices falling a year ahead of it, and the COVID-19 recession was amid a global pandemic.

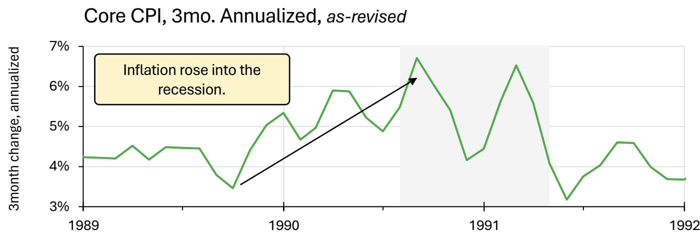
The approach to the 1990 recession shows that things can look just like this and be months away from a recession. The oil price shock from the Iraq War is considered the 1990 Recession's catalyst, but job gain deceleration was headed towards a recession for several years ahead of it and economic data turned sharply down in May 1990, three months before Iraq invaded Kuwait. Credit restriction from the S&L crisis is considered this recession's "cause" but as you will see below, it wasn't thought to be at the time and credit didn't contract until near-to the recession's end [fig.7]. As a percent to GDP, credit is contracting more now [fig.8]. Reasonings for recessions are usually conjured in arrears and over-describe them making them appear that they could've been prevented if the "cause" was removed.

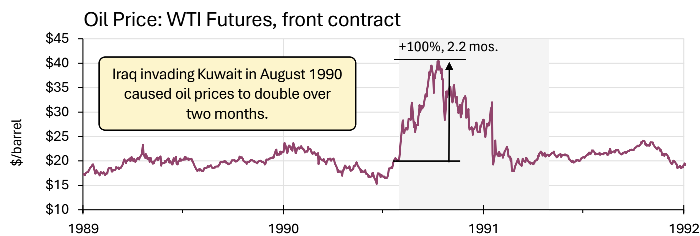
An apt analogy for the business cycle is the life cycle of a forest. Trees continually shed branches and leaves that build up on the forest floor. After a certain amount of accumulation, a fire started at one point can connect through to the rest such that the whole forest burns down. The shedding trees symbolize imbalances built-up through the "good times." Isolating the spark or "cause" of the fire or recession is merely a human-natured attempt to prevent it from occurring again, but whether the fire starts from a campfire or a lightning bolt is less interesting than the fire itself. The accumulation of fuel can be deceptively deep from layers built over a long period of time. The consistent rise of the stock market over the last 16 years fits that bill. Given how much the "forest" was flooded with fiscal stimulus in the aftermath of COVID-19, there is likely unburnt fuel from before it.

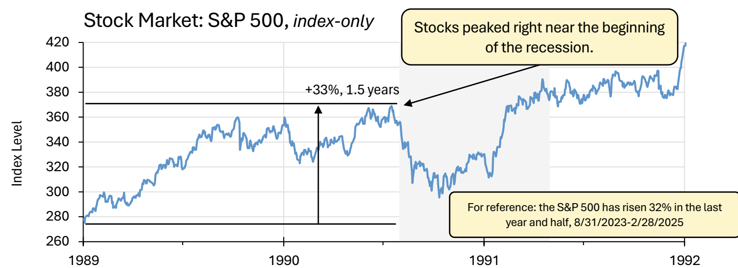
Early-1990s Recession approach and aftermath











Prepared by Lantern Capital LLC | Data Source: Bloomberg | 3/3/2025

Below, I use newspaper quotes to walk through this period chronologically. All quotes come from The New York Times because it is the only newspaper with articles this far back available to subscribers. I exclude article titles and authors for brevity, but the URLs show the title, date, and author. A New York Times subscription is required to read the full articles.

After the 1985 soft-landing, the Fed raised rates about 4% from December 1986 through February 1989 to 9.75%. The yield curve (10-year yield minus 2-year yield) inverted in late 1988. Treasury yields cyclically peaked on 3/20/1989 with a typical concern that rates were only headed higher. Think of this like October of 2023 or April of 2024. The current period has an additional wave. From an article on the day of the cyclical yield peak,

> Credit market analysts contend that the Federal Reserve Board, faced with the threat of rising inflation, has little choice but to push short-term interest rates higher soon, possibly this week.

The Fed didn't raise rates in response to this concern and didn't raise rates again for five years until February of 1994. By mid-1989, economic data had slowed enough that market participants were getting antsy for the Fed to begin lowering rates similar to the environment in August and September of last year. From a 6/3/1989 article,

> In the strongest evidence so far that the nation's economic growth has slackened, the Labor Department reported today that jobs rose only 101,000 in May, about half as much as expected, while employment in factories fell for the second consecutive month.
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> ''The economy is slowing down pretty significantly,'' said Peter P. Kozel, chief economist at the Shawmut Bank in Boston. The news inspired fresh advances in the bond and stock markets in anticipation that interest rates would be eased by the Federal Reserve Board. It also prompted a sharp decline in the dollar. With the economy slowing and inflation contained, ''I don't see how the Fed can sit around too much longer,'' said Robert H. DeFina, senior economist at the Security Pacific National Bank in Los Angeles.

On 6/5/1989, the Fed lowered rates for the first time in that cycle. The Fed starting to cut rates before a recession led many to think that a soft-landing would be the result. From an article on 6/16/1989,

> Is the United States economy, with Alan Greenspan of the Federal Reserve at the controls, coming in for a soft landing? The exuberance that the financial markets have shown in recent weeks - yesterday's 28.36-point slide in the Dow Jones industrial average notwithstanding - would seem to indicate that many investors think so. The Investors Relations Company of New York said: ''The recent euphoria in the stock market is right in line with what appears to be an economic consensus: inflation is back under control, interest rates are coming down, and we're headed for a soft landing with no real recession, thanks to marvelous timing on the part of the Fed.''

Economic data continued to weaken through early August. From an article on 8/2/1989,

> For a third consecutive month, the purchasing managers' survey fell to a level that indicates declining activity in the manufacturing sector of the economy. The overall economic index

> of the National Association of Purchasing Management dropped in July to 46, which was also its lowest level in six and a half years.
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> and,
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> Both the bond and stock markets rallied after the purchasing report was released in the morning on the prospect that new evidence of the slowing economy would lead to further reductions in interest rates. Indeed, in comments before the Senate Banking Committee yesterday, Alan Greenspan, chairman of the Federal Reserve Board, signaled further rate declines, reiterating that avoiding a recession was of greater concern now to the economy than was rising inflation.

The Fed had cut 75 basis points by this time and economic data began to recover. The Fed cut another 75 basis points through December but 50 basis points was in response to the 10/17/1989 San Francisco earthquake and 25 basis points on 12/19/1989 was essentially to ensure a soft-landing, similar to the Fed's December 2024 lowering. It was a close call and had two dissents; the Fed's December 2024 lowering had one. From the Fed's December 1989 Record of Policy Actions report,

> In the Committee's discussion of monetary policy for the intermeeting period ahead, the members focused on the possible need to ease reserve conditions slightly further to provide greater assurance that weaknesses in demand did not persist or deepen.
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> and,
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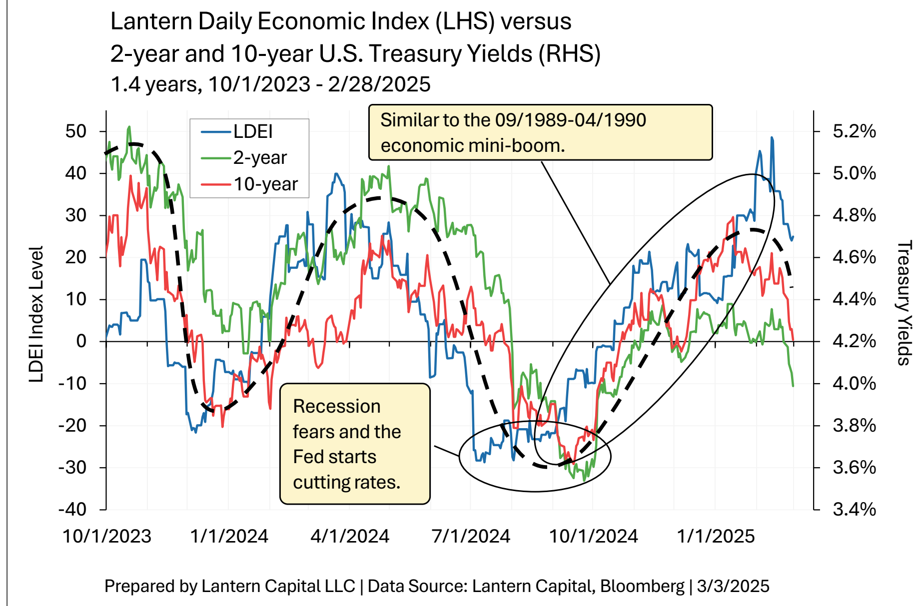
> Several members observed that the choice between some slight easing at this time or waiting for additional evidence that the economy might be weakening further was a close one.

Starting after that December rate cut, Treasury yields began to rise quickly to catch-up with strong economic data, essentially pricing out the recession that had been priced-in the year before. This continued through the end of April. All told, Treasury yields rose about the same amount that they were cut, 150 basis points. This is similar to the Fed cutting rates 100 basis points and them rising 100 basis points last year. The 9/1989-4/1990 period mirrors the 7-month mini-economic boom from 8/2024-2/2025. This recent boom can be seen in the Lantern Daily Economic Index (LDEI) below:



Riding this wave of economic improvement in 1990, Alan Greenspan gave testimony to Congress in January suggesting the chances of a recession had diminished and there weren't sufficient imbalances in the economy to cause one. His testimony was characterized in a 1/31/1990 article,

> He said today that by one gauge the chances of recession in the next six months are about 20 percent, down from 30 percent last spring, and that by another gauge the chances have fallen to about 10 percent. Both of these probabilities, Mr. Greenspan observed, ''are much smaller than those occurring at the beginning of each of the four recessions'' of the last 20 years, the last of which was in 1981 and 1982. ''I wouldn't want to bet the ranch on such statistical measures,'' Mr. Greenspan added in a statement prepared for the committee. ''But **such imbalances and dislocations as we see in the economy today probably do not suggest anything more than a temporary hesitation in the continuing expansion.**''

Economic data continued to improve. From a 2/5/1990 article about the strong January jobs report,

> Analysts said any chance that the Fed might have been pursuaded [sic] to allow interest rates to ease a bit further at some point later this month was virtually eliminated with the release of January's employment report, which indicated that the economy is still firm.

Inflation rose too. From a 2/22/1990 article on the CPI report,

> Heavily affected by harsh early-winter weather, consumer prices soared 1.1 percent in January, the biggest monthly advance in more than seven years, the Labor Department reported today. The increase in the Consumer Price Index was at the upper edge of the range of expectations, and analysts said it appeared to extinguish any remaining chance that the Federal Reserve Board would seek further cuts in interest rates anytime soon.

The February jobs report was even stronger with 372k jobs added. From a 3/10/1990 article, on the jobs report and a suggestion of the bond market rejecting the Fed's cuts similar to the market narrative last November and December,

> Prices of Treasury securities tumbled yesterday after the Government reported an unexpectedly large rise in civilian employment in February. Traders said the jobs report unnerved investors in fixed-income securities because it was taken as a sign of economic strength that raised fears of inflation and higher interest rates, either of which would reduce the value of existing fixed-income debt issues.
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> and,
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> "Allowing for the possible distortions in the latest jobs data, it still shows that the economy is not fading as fast as some think,'' said Leif H. Olsen, who heads an investment management firm bearing his name in New Canaan, Conn. Given indications that the Fed has not done anything to cause, or prevent, rising interest rates, Mr. Olsen said, ''We can only assume that the bond market, in demanding higher rates, is **questioning the Fed's anti-inflation policy**, because the Federal funds rate is the cheapest rate in the money market.''

Inflation, released in April, was hot. From an article on 4/18/1990,

> Consumer prices climbed five-tenths of 1 percent in March to make the annual inflation rate 8.5 percent for the first three months of 1990, the most rapid increase in a quarter in nearly eight years, the Labor Department reported today.

By the end of April, there was a renewed sense that the Fed needed to raise rates imminently. From an article on 4/25/1990,

> Government reports provided fresh evidence today that the economy has successfully skirted recession but that it now confronts a problem of stepped-up inflation that may prompt the Federal Reserve to tighten monetary policy this spring.

This was a day before the 2, 5, and 10-year made yield peaks that haven't been reached since. The 10-year would rise back up to nearly this level (3 bps less) in August and September and the 30-year yield made its ultimate peak on 9/24/1990, 13 basis points higher than at this point because the price of oil doubled from Iraq invading Kuwait. More on this later.

This was an important point in time, because three months before the 1990 recession began, there was no acute weakness in economic data or the stock market to suggest a recession was coming. Many thought the Fed should raise rates, not unlike many calls for the same recently. In early May, without any reason except the passage of time and perhaps high interest rates, economic data started to weaken again enough to be noticed.

This is similar to how economic data has weakened in recent weeks. While it is being conflated with the Trump administration's trade war and DOGE efforts, most of the weakened data (consumer spending and housing) has come from January, before any of that happened.

After a second consecutive low payroll report was released on 5/4/1990, an article characterized it this way,

> Just when it seemed clear that the economy had once again avoided sliding into recession, thereby further confounding those who still profess belief in business cycles, President Bush appears to have decided that the seven-and-a-half-year expansion is, in fact, at risk.
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> and,
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> To be sure, one statistical report -albeit probably the most important indicator of monthly economic performance - is not by itself weighty enough to prompt a major shift in policy. In this case, moreover, the lack of real job growth last month resulted perhaps as much from exceptionally warm weather as from the beginnings of **an oft-predicted but elusive business downturn**. But Friday's report came at a particularly inappropriate time, coinciding with ever-escalating estimates of the cost to the Government of rescuing savings and loan depositors, the arrival in town of foreign central bankers and finance ministers for a meeting of the Group of Seven industrial nations and a disconcerting rise in inflation.
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> and,
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> **The lack of a widespread recession recently has prompted some to wonder whether the traditional business cycle - booms that end in inflation-arresting busts - has become a relic.**

This quote shows that after avoiding recession the prior year, some had begun to question if the business cycle still existed, just like now. Then, data started weakening more broadly. From an article on 5/12/1990,

> Retail sales, held back by another big drop in auto demand, fell by six-tenths of 1 percent in April, the biggest setback in six months, the Commerce Department reported today.

From a separate article on 5/12/1990,

> 'What a difference a week makes,'' said David Jones, senior vice president of Aubrey G. Lanston & Company, a Wall Street bond house. ''Before the unemployment numbers, the fear was that the economy was too strong, inflation too high and the Fed might raise interest rates. But now it appears the economy is on just the right track.''

Regarding the idea that credit restriction from the S&L crisis was the cause of the 1990 recession, the Fed did a study of this issue in May of 1990. An article from 5/19/1990 about it wrote,

> ...the Fed's study of 60 banking institutions found that while loan growth to some businesses this year had slowed, total lending had not declined, indicating that **warnings of a recessionary nationwide credit tightening are unfounded.** ''The bottom line is that you don't see the kind of horror stories in the data that you've seen in the anecdotes,'' said Robert E. Litan, senior fellow and a banking expert at the Brookings Institution. ''There has

> been some moderate degree of tightening, but there has not been the systemic kind of credit crunch we've heard about.''

On 6/11/1990, Martha Seger, a Federal Reserve Governor, warned that economic weakness had broadened and should be heeded by the Fed. Importantly, in an article written about it, her language makes it clear that no particular theme was being monitored as the cause of a recession a month before it began with ‘a lot of sleepers out there’,

> A member of the Federal Reserve Board warned today of the dangers posed by the weakness of the United States economy and urged a relaxation of the central bank's monetary policy by the end of the year. There have been isolated weak spots before in the seven and a half years of American economic expansion, but now **several important sectors are showing a slowdown at the same time**, said Martha R. Seger, the Fed official, who is attending the annual meeting of the Bank for International Settlements in Basel. ''I personally believe that before this year is out we shall have to ease,'' she added. But she said she did not know if a majority of the 12-member Federal Open Market Committee, which decides American monetary policy, would agree with her. Warning of the dangers of keeping monetary policy too tight, Ms. Seger said, ''**There are a lot of sleepers out there, and any mistakes could put the economy into recession.**''

The stock market made its cyclical peak the following month on 7/16/1990 and Greenspan was very guarded over any further rate cuts because of fiscal concerns and inflation ratcheting higher. An article from 7/19/1990 characterized his thoughts,

> Despite increased pressure from the Bush Administration for a quick reduction in interest rates, Alan Greenspan, chairman of the Federal Reserve Board, suggested today that rates would not be lowered soon, except to offset unusually restrictive commercial lending practices. The main risk to the economy is ''a shade more'' in the direction of recession than it was last winter, Mr. Greenspan told the Senate Banking Committee.
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> and,
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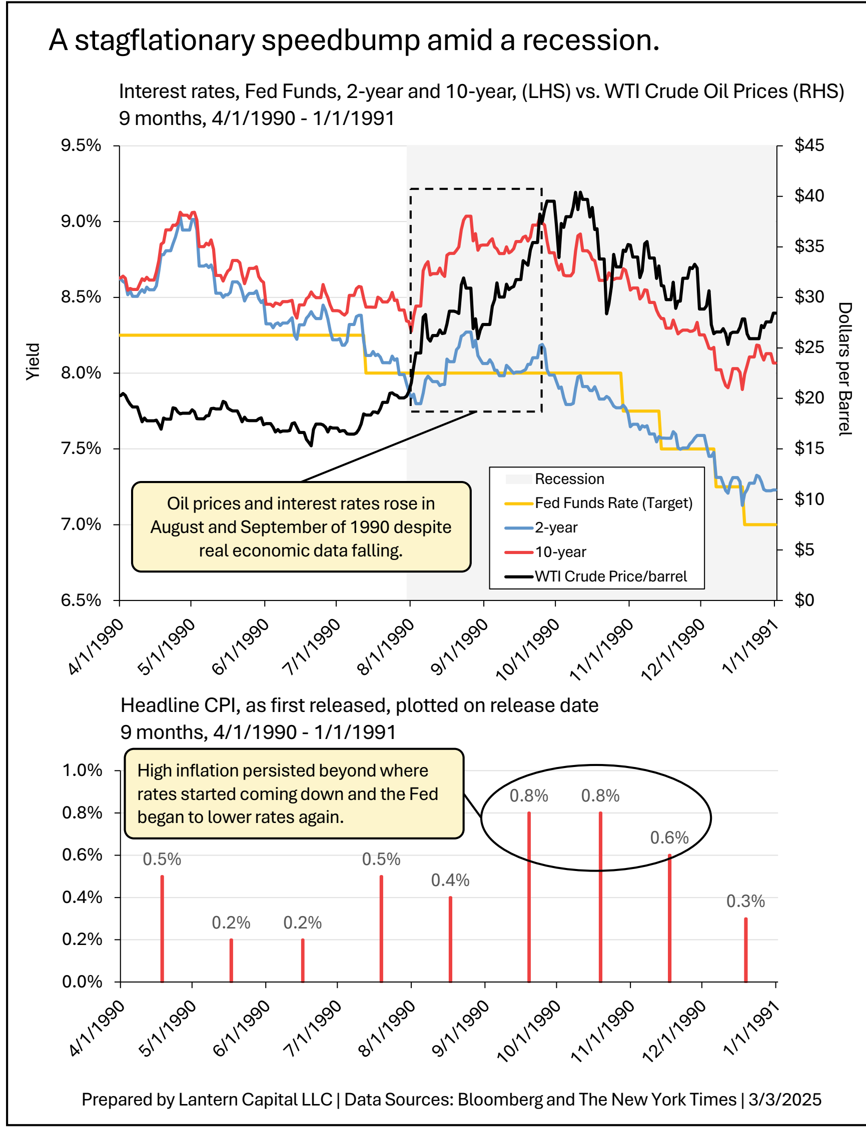
> The chairman insisted that despite the economy's sluggish growth this year, ''things are not doing all that badly.'' And he said, ''The likelihood of a near-term recession seems low.''

This was the month of the peak of the business cycle, from where the recession began.

A second chapter to this story that I call a “stagflationary speedbump” began when Iraq invaded Kuwait on 8/2/1990 and the price of oil doubled over the next two months. This takes on a new significance now, because it shows how an inflationary shock is treated by markets and the Fed amid a decrease in demand. The 1990 to 2025 similarity extends in-that the Iraq *war* in 1990 is similar to the trade *war* in 2025. It is an inflationary shock happening right as economic data has begun to weaken naturally and can serve as a spark for a recession.

Interest rates rose for about two months in relationship to this before the recession’s demand destruction won the battle and rates fell. The 2-year rose 47 basis points, and the 10-year 76 basis points in August of 1990. They didn’t sustainably fall again until late September.



The rise in oil prices coincided with a fight over the 1991 budget which included the largest nominal budget deficit up to that point (not as a percent to GDP, however.) Debt service to GDP, the ultimate measure of a country's ability to borrow was at an all-time high in the aftermath of the high inflation of the 1970's and early 1980's. It has nearly reached this same level recently [fig.9]. As the yield curve steepened in August and September with long rates moving higher faster than short rates, there was tremendous concern this was for fiscal reasons. The fiscal concern at that time exceeded what it has been lately because interest rates rose with the dollar falling which is more concerning. Interest rates and the dollar have been well correlated lately. Some quotes help to describe the period.

From an article on 8/6/1990, four days after Iraq invaded Kuwait,

> The credit markets are expected to be whipsawed again this week by the powerful prospects of recession and inflation. Recession fears were heightened last week by increasingly negative economic indicators, which were topped Friday by the Government's

> report of a sharp rise in unemployment last month. The inflation fears were unleashed by the surge in oil prices that followed Iraq's seizure of Kuwait.
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> and,
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> ''The Mideast situation that erupted in midweek turned the bond market completely around,'' said William V. Sullivan Jr., senior vice president at Dean Witter Reynolds. ''After bond investors had been lured into thinking that the prospect of a recession would diminish, their hopes were dashed by the new specter of oil-fueled inflation.'' Now, Mr. Sullivan added, bond investors have to worry about the effects of higher oil prices, the reduced chances of cutting military spending and the Federal budget deficit, as well as a recession that will reduce tax revenues on the Federal, state and local levels. ''The prospect of stagflagtion is not very promising to the bond market,'' he said.

From an article on 8/23/1990, the day before local yield peaks,

> Long-term interest rates rose to their highest levels in nearly four months yesterday and Treasury bond prices fell sharply, pushed by a sharp rise in oil prices and heightened fears that war may soon break out in the Persian Gulf.' 'The market is trading on raw nerves,'' said John P. Costas, director of the taxable fixed-income department at the First Boston Corporation. ''People are very skittish.'' In addition to worrying about the inflationary implications of higher oil prices and the possible outbreak of fighting in the Middle East - a development many traders said could happen this week - the prospect of sharply higher Federal budget deficits also weighed on the credit market yesterday.

From an article on 9/25/1990, the day of the 30-year yield peak with expectations of rates rising further,

> Prices of Treasury securities fell again yesterday and long-term interest rates rose to their highest levels in 18 months, pushed by a phalanx of negative developments. Market participants selling notes and bonds cited the sharp rise in oil prices, a larger-than-expected Federal budget deficit for August and news articles affirming that the Federal Reserve Board has no immediate intention of easing interest rates. ''There is bad news for everybody today,'' one trader of government bonds said.

The longer a trend goes on, the more it is thought to extrapolate. From an article on 10/15/1990, two trading days after crude oil peaked, a sense that interest rates would stay high for a long time,

> Credit analysts say that despite mounting evidence of a recession, long-term interest rates are likely to remain mired around 9 percent for some time, unless the confrontation in the Middle East is suddenly resolved.
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> News reports said last week that, in early October, members of the Federal Reserve's Open Market Committee voted to ease monetary policy once a budget package was passed by Congress and signed into law. But since then the policy makers have gotten further evidence that inflation remains a serious problem, including a report last Friday that showed that producer prices rose by 1.6 percentage points in September. As Mr. Fine

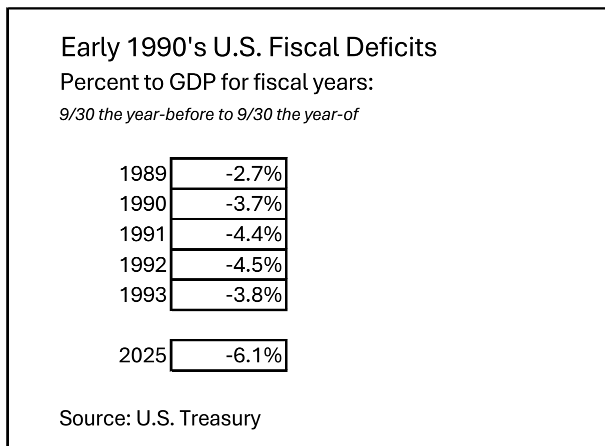
suggested, those fresh facts are likely to make the Fed less generous than it might have been earlier.

> **Aside from inflation worries, long-term interest rates most likely will have to remain high if the Treasury is to sell what likely will be a record amount of securities in the fourth quarter.** Particulars of the Treasury's quarterly refunding auctions will not be announced for two weeks. Still, some market participants are already fearful that with the dollar falling and confidence in the United States shaken, foreign demand for the new Treasury issues will be modest at best, and that **interest rates may have to go even higher to sell the new issues.**

Then, on 10/29/1990, the Fed ended their 10-month pause (with one cut in the middle on 7/13/1990) by cutting from 8% to 7.75% on their way to 3% two years later. The 2-year and 10-year yield fell about another 3.5% from this point over the next three years. Note: the Fed didn't announce their moves the day-of at that time. On that same day, markets didn't think the Fed could lower much for fiscal reasons as told in a 10/29/1990 article,

> "The Fed might be able to cut the Federal funds rate by one-quarter of a percentage point without upsetting the market," said Jerry L. Jordan, a senior vice president at First Interstate Bancorp in Los Angeles. "But people who think there will be a big payoff on interest rates based on this budget package are in for a disappointment." The Fed will be reluctant to move faster because market participants, especially long-term investors, see little reason to believe the budget package will generate the advertised $500 billion in savings over the next five years. Moreover, with the dollar under pressure and fears about inflation still strong, **the Fed would be running a substantial risk of pushing up long-term rates if it quickly cut short-term rates by more than a quarter of a percentage point**, the analysts argued.

In the end, interest rates rose in August and September because of oil prices. The concern surrounding fiscal issues was mis-placed as evidenced by the fact that fiscal deficits grew for the next two years while rates fell a lot more.


Early 1990's U.S. Fiscal Deficits

Percent to GDP for fiscal years:

9/30 the year-before to 9/30 the year-of

Year	Deficit
1989	-2.7%
1990	-3.7%
1991	-4.4%
1992	-4.5%
1993	-3.8%
2025	-6.1%

Source: U.S. Treasury

This is a common feature of the Treasury market. Fiscal fears appear in nearly every US Treasury sell-off these days, but then interest rates fall as the real reason (in this case, a doubling of the oil

price) recedes. Real fiscal crises as evidenced from other countries are associated with debt service ratios to GDP near double-digits and/or falling currencies [fig.10]. In the US, this is in the 3-4% range now (depending on source) and the dollar is strong. This ratio will fall as a recession unfolds.

2024 and 2025 hit a remarkable number of notes that were hit in 1989 and 1990 showing that trends in economic data are fleeting, a recessionary economy can have a final boom right before a recession begins, and that a theme or obvious imbalances aren't needed to have one. It further shows that inflation can be high right as a recession strikes and that ultimately, the Fed responds to falling demand over inflation because they know a recession will eliminate inflation in the future.

The current cycle has an added negative factor that 1990 didn't have, an old bull stock-market super-cycle. Stock market supercycles ('super' because they span a few business cycles) tend to last an average of 15 years (bull or bear). The current one has been going 16 years since February of 2009. When the 1990 recession began in July of 1990, the stock market was just 8 years into its then bull supercycle and only retracted 20% (S&P 500). It made a new high before the recession was over. The end of bull-market supercycles often have splashy large drops like 1929 or 2000 in the 40-80% range. The stock market itself can end up being the imbalance that nobody could see ahead of time. As the forest analogy goes, there is a lot of dry tinder lying in wait. I continue to expect a recession by the middle of this year.

But, in the near-term, the bond market has to grapple with stagflation as the Trump administration enacts tariffs and inflation rises. Once inflation expectations have tamed, the Fed will be free to lower rates. I see an extended period of rate cuts down to 2% or lower amid a recession and much lower Treasury yields.