

# BABSON'S REPORTS

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the year, and while we are hopeful of an upturn in the final three months this is by no means certain. It does look as though we will experience a true recession (at least two successive quarters of decline in the "real" GNP).

## INDUSTRIAL PRODUCTION

If we can escape a protracted petroleum shortfall, industrial production may not suffer too badly, but a decline seems inevitable for part of the year. Key areas have already felt the sudden repercussions from the fuel crisis. The downturn in home building will hurt manufacturers of building products and home furnishings. Painfully high consumer prices and the intense need to conserve fuel and energy will produce areas of both strength and weakness in the consumer durables field. Leisure-time products (boats, recreation vehicles, skis, snowmobiles, pleasure aircraft) will suffer from the crunch of scarce and high-cost fuel as well as from consumers' need to establish spending priorities. Auto production is already suffering from lack of demand for "gas guzzlers." There will be high priority on certain items which were once non-essential but are now

a "must," such as siding, insulation, storm windows, doors, and supplemental stopgap spaceheating units. Auto parts replacements should enjoy higher demand, especially where a car's idleness does not necessarily mean longer life for some parts (tires, for instance, tend to correlate with miles driven). Raw materials and energy supplies permitting, there should be no letup in output of material and components for power generation and transmission, equipment for oil and gas exploration, offshore and onshore.

While the crestover pattern may already have formed, the bulk of the slide in business will be centered in 1974. Consequently, the Federal Reserve Index of production may well average 5% below that of 1973, and the uniqueness of the existing climate suggests the drop could be a bit more, possibly 6%.

## FARM PROSPECTS

The economy should derive some support from the agricultural boom. With the low supply levels of most agricultural commodities in relation to expected domestic and foreign demand, the push is on to expand farm production. Acreage previously idled under the Soil Bank

plan of price stabilization is being put back to work. Considering the prices key farm commodities are commanding, the high allocation rating the Administration is asking on fuel supplies for farming purposes, and the present lush farm incomes, demand for agricultural machinery and implements is extremely brisk. With a little help from Mother Nature in important crop areas, the expansion of acreage put to seed assures a new record crop output in 1974. There should also be some increase in livestock and poultry supplies over the next twelve months. The picture as a whole promises more reasonable food prices, particularly after the 1974 growing season is well under way.

## "A PENNY SAVED IS... NOT GOOD FOR BUSINESS"

Although consumers have been a bulwark against recessions for nearly three decades, they may not be the stopper this time. Spending will be hurt by weakened consumer confidence, soaring living costs, and the burden of installment payments. Now, the high cost of both heating and transportation fuel along with gasoline shortages may limit shopping jaunts. Neighborhood mini-plazas and local retail outlets will benefit from this situation. Since neighborhood shopping tends to be less extravagant than that done in the impulse-buying supermarkets, we foresee a period during which consumers will channel more of their disposable income into savings and debt repayment. Long term, this is healthy and lays the groundwork for the next cyclical upbeat in the economy, but the short-run impact is negative. Less consumer spending will mean reduced inventory buying, with perhaps some backup of goods.

## EMPLOYMENT - PERSONAL INCOME

Aggregate personal income during 1974 will not show the vigor of the past two years. It will be up, but boosted more by transfer payments (social security, unemployment compensation, etc.) than by earned income. Salaries and wages and income of proprietorships and partnerships will average lower than in 1973 because of the slower business pace. Support will come, however, from wage hikes in multi-year union pacts, new agreements, and built-in cost-of-living adjustments. Employment faces reductions in 1974, and the jobless rate could average 6%, but may run as much as 7% at the topmost point. As in the early years of this decade, unemployment will be difficult to shrink because of the flood of new workers into the labor pool.

## BUILDING AND CONSTRUCTION

While the nation's housing needs are still enormous, tight and costly money has snuffed out the boom after the high rate of residential starts in 1972 and the first half of 1973. Government figures on building permits issued give no hint of early

improvement in this sector which utilizes so much manpower and materials. Resumption of vitality must await a longer spell of anti-recession credit policy than the past six weeks. By late spring of 1974 or sometime during the summer, residential building should bottom out, probably near the 1.1-million annual rate, and thereafter the economy can derive much-needed support from this source. For 1974 as a whole, new residential starts should approximate 1.3 million units. Industrial and commercial construction bolstered over all building activity for a good part of 1973. But high costs, supply shortages, and now the lack of clarity as to consumer spending plans and shopping patterns are likely to cause some hesitancy for nonresidential building during the coming year.

## CORPORATE PROFITS AND DIVIDENDS

The amazing 1973 gains in overall business profits after taxes were due to basic and uncomplicated business principles and not to profiteering on the part of cor-

porate enterprises, as claimed by some unthinking critics. Fact is, we saw what happens to profits when plant and equipment operate at full capacity and there is little simultaneous cut-throat price competition. For 1974, however, the outlook is less promising. In general, we cannot count on the strong demand of the past year, and costs will continue to move upward. The situation will be worsened if fuel allocations prevent profitable use of operating facilities. But, barring extremes, net corporate profits should dip about 14% overall, with the greatest year-to-year slippage in the first half of 1974. But some firms, notably those with food-related operations, may even stack up favorably vs. 1973 because of the afflictions they suffered at least part of last year.

As to dividend disbursements, if operational disruptions are not overly severe, corporate dividends can increase again in 1974. The reason for this is that anti-inflation rules permitted only a tiny slice of 1972 and 1973 profits to be paid out.

## POLITICS - DOMESTIC AND INTERNATIONAL

Politics caused a good deal of the uneasiness and uncertainty which marked 1973. The unending sequence of "shocks" in connection with the investigations on Capitol Hill make any reasonable forecast of political prospects for 1974 an exercise in futility. It is to be hoped that the biennial congressional and gubernatorial elections upcoming next fall will produce some semblance of reason to replace the chaotic circus. While those most eager to have the President impeached may have lessened their efforts just how much of a working relationship between the Administration and Congress will be restored is questionable. Past election years have usually brought forth some productive efforts on Capitol Hill; these will be most vitally needed in 1974. There should be no federal tax increases except on the Social Security impost in the year ahead.

While the staff of Babson's Reports is hopeful that there will be no resumption of fighting in the Mideast, negotiations leading to more stable conditions there will be arduous. Arabs will doubtless use their oil strategy as an overhanging threat for years to come in dealing with the industrialized nations of the world, although they may moderate their attitude some what. The emergence of underdeveloped nations is never smooth, and unrest will surface from time to time. We do not expect, however, actual military action between the great powers in 1974.

## INTEREST RATES AND THE BOND MARKET

Late in 1973 the monetary authorities at least temporarily relented their anti-inflation credit restriction in order to forestall a serious recession due to fuel shortages. Confronted with both inflation and recession, the Federal Reserve may be forced to vary its tactics. For now, the need to protect the economy prevails. So the peak in interest rates may have been seen for this go-round. With an economy-propping monetary policy and business needing less borrowed capital as activity eases, short-term money rates will likely back away from recent peaks; but long-term rates, which had risen

less than short-term in the past two years, will recede more slowly. This means healthier bond markets in 1974 than for the past two years. Investors requiring the best possible

yield on their investments should find, therefore, that bonds, preferred stocks, and even some common stocks generally regarded as "income issues" can now provide an (Continued On Page 12)



We join our friends and neighbors in a prayer for peace for the New Year in our community, country. Thank you.  
**FANGEN'S FLORAL**



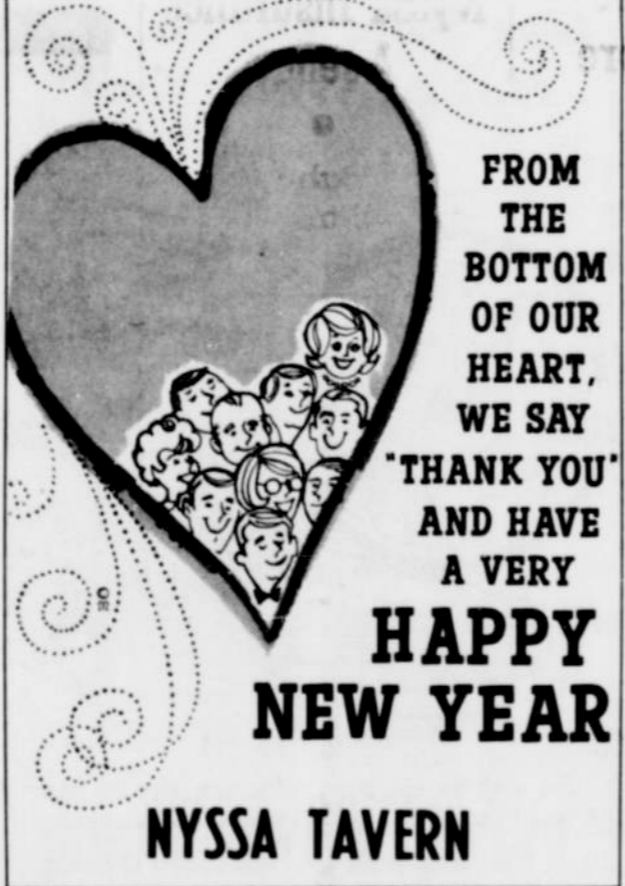
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**PRAY FOR PEACE**  
Our Sincerest Prayer is for a Peaceful New Year for all!  
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We're greeting the New Year with hope that it brings to all our wonderful friends and customers the best of everything... health, happiness and success. With many thanks for your good will and patronage, we sincerely wish you and your family a very joyous year. We look forward to serving you again, soon.  
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