

BABSON'S

BUSINESS REVIEW & OUTLOOK

BY — ROGER BABSON

American's Leading Authority On Business & Finance

By Babson's Report Inc., Wellesley Hills, Mass., December 30, 1971. A year ago our Forecast for 1971 looked hopefully toward a better business year than had prevailed in 1970. Unfortunately, the trouble spots we cited combined to frustrate the possibilities offered by the favorable forces. For example, the vexing problems of high unemployment, underutilization of industrial productive capacity, dangerous inflationary pressures, the huge federal budget deficit, and labor problems did indeed raise barriers to economic progress in 1971.

1971 — ANOTHER CRISIS YEAR

As we look back upon 1971, therefore, we can justly label it another "crisis year", just as 1969 and 1970 had been. However, the crisis of the previous two years were largely of a domestic economic nature, albeit the burden of the Vietnam war was a contributing influence to the dislocations. In 1969 the main villain was the grinding credit crunch; in 1970 it was the harrowing corporate liquidity squeeze, plus two major strikes and the surprise of the foray into Cambodia.

In 1971 the focal point was more the "flight from the American dollar" in the leading foreign exchange markets of the free world. This crisis had been building for many years, and it also had been inexorably linked with a complex of other problems. These included cost-push inflation, a steady weakening of the U. S. foreign trade position, and the long succession of federal budget deficits and imbalances in our international payments position — which resulted from our foreign aid and military programs plus sizable private spending and investments abroad. There was also the aggravation of the long and costly strikes during 1971; but in the final analysis, the real havoc was wrought by the dollar's troubles.

STABILIZATION OR TRAUMA?

In a counteroffensive to combat the dollar's woes, to bridle the inflationary spiral, and to revitalize the nation's economy, the Nixon Administration took everyone by surprise by dramatically reversing its economic approach. In the first phase of the new program, President Nixon imposed a 90-day emergency freeze upon prices, wages, and rents. In addition, he asked Congress to move to an earlier date the planned revision of the federal income tax structure so as to increase consumer disposable income, and to grant a tax credit for certain business capital expenditures. He also imposed a 10% surcharge on certain imports of foreign goods.

Initially, public reaction was favorable. The program was regarded as a positive step in coming to grips with the vital problems afflicting the economy. However, the piecemeal fashion in which the second phase of the program was unveiled left consumers, businessmen, and investors in an uncertain frame of mind. Doubts mounted as early lukewarm labor acceptance of the program turned to antagonism, and as industrial activity, consumer spending, and unemployment failed to respond as quickly as had been anticipated.

VESTIGES OF HOPE

On the surface, the disappointing economic results of 1971 would seem to point to a year of inept failures. A deeper analysis reveals grounds for a contrary view. Even though business and employment did not respond as the Nixon Administration had anticipated, there were extenuating circumstances which critics of the new economic game plan have been remiss in considering.

For example, there was the protracted tie-up of West Coast ports and subsequently a virtual paralysis of East Coast and many Gulf Coast ports, which exacted a toll of the economy. In addition, there were the coal and copper miners' strikes, and the inescapable liquidation of strike-hedge steel inventory stockpiles. These retardant factors would have exerted adverse influences even if the Administration had not opted for "controls".

Furthermore, the fainthearted miracle seekers and the opportunistic politicians may be premature in labeling the Nixon economic game plan an exercise in futility. There has not been enough time to gauge the results of this program. After all, Congress has been agonizingly slow in acting on those facets of the program which are beyond the jurisdiction of the President.

1972 — YEAR OF SOLID PROGRESS

AT THIS OUTSET OF THE NEW YEAR, THEREFORE, THE STAFF OF BABSON'S

REPORTS VIEWS CONSTRUCTIVELY THE PROSPECT OF WHAT LIES IN STORE FOR THE ECONOMY. We are hopeful that the Administration's economic game plan will jell sufficiently to encourage businessmen and consumers to sluff off their cocoons of cautiousness and assume a more optimistic perspective. Such an improvement in public confidence, after the long siege of uncertainty of the past three years, should produce a definite pattern of business improvement.

It would be well not to expect an immediate return of boom conditions for the economy as a whole. The fight against inflation will require continuing vigilance and therapy, and with the large reservoir of idle productive capacity in American industry the task of paring unemployment will require patience. The Nixon Administration's economic program was not set forth as one which would produce deflation, but rather one which would restrain inflationary pressures sufficiently to create productivity gains and make for solid progress in the economy, as opposed to the illusory gains of recent years when price inflation accounted for much of the advance. So, to the extent that inflation is curtailed, Babson's Reports forecasts that 1972 will emerge as a period of genuine achievement.

It would be well not to expect an immediate return of boom conditions for the economy as a whole. The fight against inflation will require continuing vigilance and therapy, and with the large reservoir of idle productive capacity in American industry the task of paring unemployment will require patience. The Nixon Administration's economic program was not set forth as one which would produce deflation, but rather one which would restrain inflationary pressures sufficiently to create productivity gains and make for solid progress in the economy, as opposed to the illusory gains of recent years when price inflation accounted for much of the advance. So, to the extent that inflation is curtailed, Babson's Reports forecasts that 1972 will emerge as a period of genuine achievement.

LESS WORRISOME CLIMATE

The primary characteristic which the staff of Babson's Reports expects will mark 1972 and enable the economy to regain its forward thrust in the next twelve months is an anticipated easing in certain troublesome areas. The major labor groups are tied to multi-year contracts, and the next "go around" is not scheduled until 1973. Hence, on the labor front, it will be a year of relative quiet on the part of the major unions, whose walk-outs can be quite debilitating to the economy. To further brighten the background picture for the coming year, we anticipate no real money and credit worries for the better part of 1972.

Even as demand for money and credit increases in pace with the projected improvement in economic activity, the monetary authorities are well situated to pump in additional credit to meet legitimate business needs, thus obviating the likelihood of another restrictive credit crunch. Corporate liquidity in general has been bolstered quite significantly during the past two years; thus, except for the marginal companies which have trouble securing credit under most circumstances, the threat no longer looms of businesses being pushed to the wall.

We must also remember that even though the tax incentives have been extremely slow in gaining congressional approval, it is very likely that initial benefits to the economy will be seen by the end of the first quarter of 1972. Moreover, the Administration will strive to impart more zip to the economy because of the national elections coming up in the fall of 1972. Probably one method will be to increase attempts to stimulate trade with hitherto restricted Communist countries. One thing is true, however — that the Nixon Administration is girding for 1972's elections does not have the latitude to stimulate the economy which other incumbent Administrations have had in the past, due to the grave budget deficit problem. Nevertheless, the healthier background climate prevailing should produce a greater willingness to spend on the part of consumers. Some pickup in retail trade surfaced in the latter part of 1971, albeit on a spotty basis. Improved consumer demand, higher inventory requirements as a result of a more buoyant level of general business, and the incentive of the investment tax credit should bring management thinking around toward policies emphasizing the expansion of inventories and increases in capital spending.

THE IFFY FEATURES

At this juncture, there are some important iffy aspects to the 1972 outlook. As 1971 drew to a close, however, some of these vital issues did take a turn for the better. But until they are actually resolved, these adverse factors will exert some dampening influence on public sentiment. The most important change for the better was the monetary situation. The leading free world nations achieved a meeting of the minds and realigned their currency parities. The American dollar was devalued 8.57% via an increase in the official price of gold, while stronger foreign currencies were revalued

upward formally. On the other hand, it will require a little time to hammer out new trade agreements providing for a more equitable climate for American goods in foreign markets. Until the trade agreements are revised, foreign commerce will remain a tenuous area.

Another iffy area concerns the machinery of Phase Two. Will it be successful in keeping inflation in check, or do the generous concessions to labor in the initial rulings of the Pay Board portend an inevitable loss of effectiveness in the fight against inflation? Also, will labor groups revolt against the game plan and provoke widespread general strikes? For the record, we are hopeful that union leaders will bend enough to give Phase Two some latitude to operate.

A third area of uncertainty is of a military nature. We refer to the threat that one of the world trouble spots will suddenly lose its limited scope overnight and become the "cause celebre" in the jockeying for supremacy of the three major powers. There is adequate precedent in each of the now known tinder boxes, namely the Middle East, Southeast Asia, and India and Pakistan. Indeed, the list could well grow even longer if the rest of the Arab world should gang up on Jordan and if Northern Ireland becomes Britain's Vietnam. Let us hope the attempts of the Nixon Administration to establish rapport with Russia and Red China, the winding down of American participation in the Vietnam conflict, and our thus far resolute stance against being drawn into the Arab-Israeli "brink of war" problem will provide a calming influence and keep these trouble spots from becoming the breeding grounds for World War III.

INFLATION VERSUS DEFLATION

The shift in Nixon's economic strategy last summer never did include a goal of deflating the economy. Rather, the object was to restrain the dangerous pace of inflation, which had been accelerating during 1969, 1970, and the first half of 1971. Therefore, once again the staff of Babson's Reports rules out deflation in the coming year. However, we no longer regard inflation as "Public enemy No. 1", as we did in our forecasts for 1970 and 1971.

But it would be unrealistic to expect an equilibrium between inflationary and deflationary forces. Instead, what we look for is a moderate degree of inflation on both price and cost fronts. Buffers against a return to hyperinflation are expected to be the monitoring on the part of the Federal Government and, for the better part of the year, the carryover of 1971's record farm production, plus the large reservoir of unused industrial productive capacity. One must remember also that despite the generous wage concessions to the coal miners, the railroad signalmen, and others, the major labor union contracts are going into either their second or third years. In multi-year contracts, the labor cost increase is usually "front-end loaded," which means that almost half the total increment of the contract is granted in the first year, so that each of the succeeding two years has substantially smaller labor cost increases by comparison.

The most difficult area of inflationary potential which faces the country in 1972 is that of public finance. The Federal Government in the fiscal year which ends June 30, 1972 will find it hard to improve on the horrendous deficit of \$23.2 billion for the fiscal year ended June 30, 1971. Indeed, unless Congress shows greater spending restraint, the federal budget is in jeopardy of "falling into the red" by well over \$30 billion in this fiscal year. As the next fiscal year unfolds, President Nixon's inability to hold overhanging to a tolerable level might haunt him and the Republican Party in the elections of 1972.

DOLLAR DEVALUATION

The devaluation of the American dollar near the end of 1971 took place pretty much in line with the expectations of the Babson's Reports staff, at 8.57% in terms of the official price of gold. Moreover, the multi-national currency realignment process was pretty much what the Babson staff had anticipated, and the elimination of the 10% surcharge on imports as a part of the effort to revitalize international commerce took place as expected.

The term "devaluation" implies the probability of a loss of public confidence, along with chaotic business and investment conditions. However, the American public has been conditioned to the prospect of devaluation in recent years, and more particularly over the past year or so. Therefore, since devaluation does not affect the value of consumer purchasing power here at home for domestically produced goods (the loss will be evident in higher prices for foreign goods (the loss will be evident in higher prices for foreign goods shipped into this country, and less buying power for Americans traveling abroad), no traumatic or protracted turbulence greeted the devaluation. It is likely that more equitable trade agreements will be consummated which, with the beneficial aspects of the total currency realignment program should be a net plus factor for the American economy over the next few years. That is,

THE PENNSYLVANIA TIMES DEC. 30, 1971 PAGE TWELVE

the U. S. should gain a more equitable position in the world trade, and also, since our burden of military assistance to the now well-to-do NATO nations is likely to be shared — albeit grudgingly — by those countries over which we have held a protective umbrella, the adverse trade and payments balances should post some improvement in 1972.

BUILDING AND CONSTRUCTION

The residential building picture "saved the bacon" for 1971. Strength was centered largely in housing and in heavy construction related to the generation of electric power. For all practical purposes, however, home building was the main show in the building field, with an average annual rate equivalent to 2 million units for 1971 compared with 1.4 million units started in 1970. Looking ahead, Babson's Reports forecasts that residential building will remain in the forefront of a high level of total building and construction activity. The chief ingredients for sustaining the building boom in housing should again be present during the year ahead: Money and credit for mortgage demand are ample; the cost of long-term credit has backed away somewhat from peak levels; and the rate of new family formations is definitely on the upswing. Indeed, the latter could be accentuated in 1972 if the improvement in business, employment, and personal income picks up as expected.

With the high level of home building expected to persist throughout 1972, the building materials, home furnishings and accessories, and appliance industries should enjoy brisk business in the year ahead. The housing sector of the economy packs a powerful wallop in terms of materials and manpower utilization, and in contributing flow-through strength to related industries. All in all, this will make for a stronger real estate market in the year ahead.

We look for non-residential construction to start slowly but gather steam as 1972 progresses. Because of the delay by Congress in implementing the 7% investment tax credit, many businesses have had to "sit on their hands" when it came to large-scale capital expenditures. Furthermore, industrial activity will have to make quite a bit of headway before enough excess productive capacity is absorbed to make businessmen more expansion-minded.

CONSUMER SPENDING

The Babson staff forecasts a good increase in consumer spending for 1972. A beginning of the long-awaited revival in consumer spending was evident during the past year even though, for the most part, retail trade was sporadic and periods of promising gains could not be sustained. In addition, an inordinately high percentage of personal income went into savings in 1971, further fattening the backlog of buying power. With fewer major danger points in the offing, consumers should be much more willing to loosen their purse strings in 1972.

Increases over the past two years in personal consumption expenditures and private domestic investments in residential building have figured very prominently in lifting the American economy above the trillion-dollar gross national product mark. And, in 1972, the GNP should show a net gain approximately 8% over 1971's figure in current dollar value, and about 5% on a deflated basis.

PERSONAL INCOME AND EMPLOYMENT

The emergency freeze and the subsequent controlled economy slowed the upward trend of personal income. Not only were wages frozen, but the rent freeze restrained rental income of individuals and non-corporate entities, while investment income from dividends and interest likewise leveled off. In view of the generous awards approved by the Pay Board, we forecast a resumption of the upward trend in total personal income in the year ahead. Babson's forecast calls for gross personal income in 1972 to average about 8% above that of 1971.

This will not all be the result of higher wage rates. Since the second quarter of 1971, total employment has had an upward bias. Unemployment followed a more or less sideways trend during the months of 1971. As economic activity gains strength, we look for employment to show more distinct betterment in 1972. There will be some progress along the line of reducing unemployment, but it will be difficult to shrink the jobless ranks below the 5% unemployment rate by year-end 1972, according to estimates of Babson's Reports. Because the labor force is now in a period of accelerated growth, and the military is expected to reduce its manpower requirements further, the task of

—Turn to Page Thirteen