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Statement of

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Board of Governors of the Federal Reserve System

before the

Subcommittee on Housing and Urban Affairs

of the

Committee on Banking and Currency

of the

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Mr. Chairman:

On behalf of the Board of Governors of the Federal Reserve System, let me express our appreciation for the excellent compendium your Committee has prepared in the Study of Mortgage Credit. As the largest single user of credit, the mortgage market is the subject of continuing analysis by the Federal Reserve, and its efficient functioning is a matter of deep concern to us. Your volume makes an extremely useful contribution to knowledge in this field. It shows a wide area of agreement regarding the basic problems of the mortgage market, as well as the reasons they exist. It also indicates a rather broad consensus as to the lines along which future progress appears possible.

Because time is limited, let me summarize briefly under four headings the areas in which the Board believes progress may be made in easing the difficulties of the housing market. These suggestions are primarily evolutionary, recognizing that the nature of the product and the structure of the market will nevertheless continue to make housing somewhat more vulnerable in periods of excess demand for credit than most other types of spending. Still they hold promise of significant gains. Improvement in the areas discussed can help the mortgage market come closer toward obtaining the credit it requires to meet our national housing goals.

1. Most important is the more active use of a flexible fiscal policy. Because of its particular structure, the mortgage market has severe difficulties when the demand for credit substantially exceeds the amount that can be supplied at non-inflationary levels. The type of fiscal policy adopted both in the short and long run plays a major role along with other government policies in determining whether the total savings of the economy in comparison to the demand for credit are adequate to provide financing at rates house purchasers can afford.

2. An improvement in the relationship between the mortgage market and the general capital market, as well as in the marketability of mortgages, is highly desirable. Some possible steps along this line, which should be examined more completely, include:

   a) Removal of geographic and other legal impediments to the efficient distribution of mortgage credit.

   b) Providing greater flexibility in the setting of the maximum contract interest rates on FHA-insured and VA-guaranteed mortgages.

   c) Creation within FNMA of a true trading operation in mortgages under its secondary market functions.

   d) FHA guarantee of marketable bonds backed by portfolios of FHA-VA mortgages.

   e) Issuance by FNMA of participation certificates based on the mortgages held under their secondary market operations.

Each of these steps is a possible method of attracting additional investors such as individuals, pension funds, small insurance companies, and commercial banks into the residential mortgage market as well as of lessening the burden of credit restraint on this market. These potential investors need a simpler, less complicated, more marketable, and safer investment instrument than is now found in the typical mortgage. A broader spectrum of available investors should not only lower interest costs, but also make it easier for mortgages to compete for available funds.

3. The experience of the past decade indicates that more consideration ought to be given to portfolio management by thrift institutions. Improvements appear possible on both the asset and liability sides. We have suggested the possibility of:

   a) The adoption of a wider variety of liability instruments by more thrift institutions. Longer term certificates and special time accounts paying higher rates, but with a larger penalty on withdrawal, were very useful this past year.

   b) The use of more flexible liquidity or secondary reserve requirements.

   c) The introduction of more investment options should be carefully analyzed as should the federal chartering of mutual savings banks.

   d) The Federal Home Loan Bank System should consider the use of longer term bonds based on similar length advances, as well as the possibility of furnishing more flexible short-term credit.

There are major risks when institutions borrow most of their money in the short-term market and lend long. The dangers of these policies increase when investment funds are attracted from other markets since such funds flow among outlets primarily on a basis of relative returns alone. A structure of differing rates on varied types and maturities of liabilities can reduce the average cost of funds while helping to insure their availability in times of need. Similarly a variety of assets can increase flexibility.

4. More thought is required of the logic and procedures to be used when public measures are adopted in an attempt to ease directly the impact of tightening general credit conditions on the availability or price of residential mortgage credit. Care must be taken to insure that such measures do not have undesired results opposite to those intended through increasing prices and inflationary pressures. Furthermore, we believe that the extent and form of the subsidy element involved in such proposals should be carefully considered and revealed. Many schemes which involve subsidized credit may work to penalize those most in need of housing while subsidizing those with more than adequate funds to cover their own requirements.

Mr. Chairman, I am very pleased to be here this afternoon. I welcome any questions either on the paper submitted by the Board of Governors or in my individual capacity on any of the many interesting questions raised by your compendium.