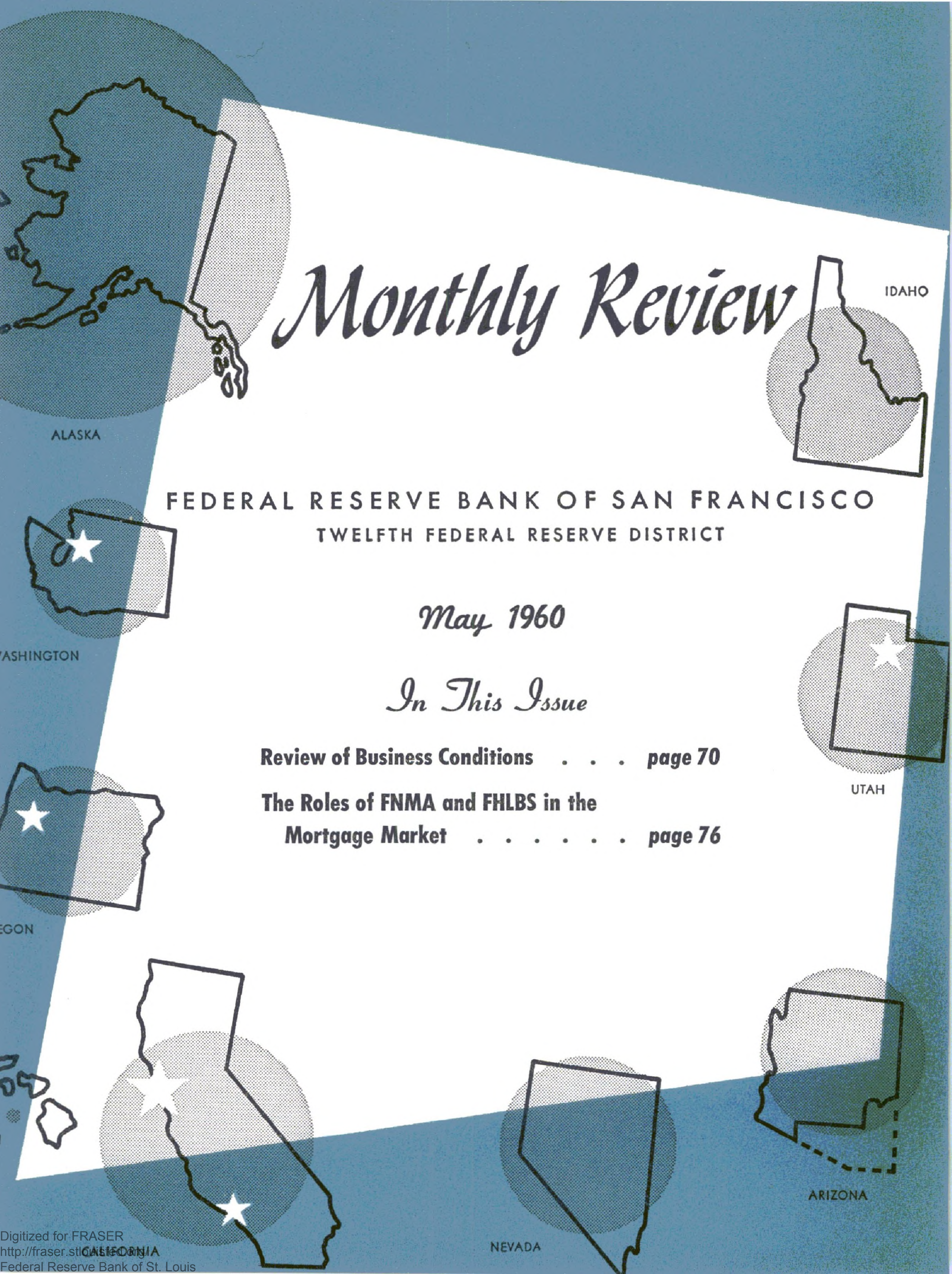


Monthly Review

FEDERAL RESERVE BANK OF SAN FRANCISCO
TWELFTH FEDERAL RESERVE DISTRICT

May 1960

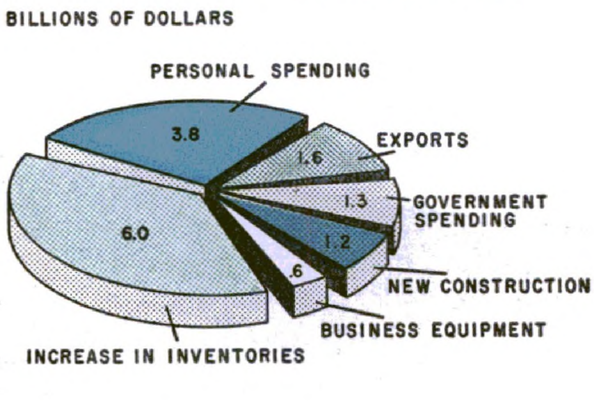
In This Issue

Review of Business Conditions

In March and early April, discussions of the business situation inevitably led to discussion of the "unusual" weather. The mood of uncertainty as to the underlying strength of business was intensified by the fact that production was down and unemployment had risen and that some of the decline in activity could be laid directly to adverse weather conditions. Some of the exuberant optimism generated in the contemplation of the new decade variously christened the "Soaring Sixties" or the "Golden Sixties" was dampened by factors of both meteorological and economic origin. From the incomplete data available for April, it appears that some but not all of the decrease in the level of activity was indeed due to abnormally severe winter weather in March. Although preliminary data indicate that the Gross National Product rose $14.5 billion (on an annual adjusted basis) in the first quarter of the year, the peak month being January, production and employment were down in February and March. The rise in inventory accumulation, which accounted for nearly half the increase in total spending during the first quarter, was largely concentrated in January and February and had fallen off markedly in March. (Chart 1 illustrates the components of the first quarter increase in Gross National Product.) In March, with the exceptions of nonelectrical machinery and printing and publishing, most industries were operating at levels below 1959 or 1960 highs. Retail sales for March showed only slight gains over a year ago. Personal income has risen slowly but steadily this year, reaching $395.8 billion in March. The growth in personal income was not matched by a proportional rise in consumer spending. Most of the gain in personal income in March arose out of government payments, as private payrolls fell off somewhat.

CHART 1

INCREASE IN GROSS NATIONAL PRODUCT COMPONENTS, FIRST QUARTER 1960



The business outlook at the end of April did not, however, present a picture of unmixed decline. With the exception of construction (particularly home-building), average activity was at the highest levels attained in the postwar period. Recent developments in the mortgage market indicate that more funds are being made available for residential construction. The McGraw-Hill survey of business capital spending plans, which was conducted in late March and early April, confirmed the earlier estimates of the Commerce Department and Securities and Exchange Commission, which had forecast business outlays of over $37 billion in 1960. This latest survey indicated that projected capital spending will be up 16 percent from 1959 and hit a record rate of $37.9 billion, exceeding the 1957 high. United States commercial exports were up sharply in March, rising 9 percent from February and standing 19 percent above March 1959. Retail trade was brisk in April; and, after adjustment for the late Easter, preliminary estimates indicate that the index of department store sales touched 150, an increase of 10 percent from the March level and equal to the record month of July 1959. Automobile deliveries in April reached a rate of 22,269 units per working day, the strongest April showing since 1955 and 4 percent above March levels.

Over these bright spots in the economy there are darker areas that must also be considered if our picture is to be a balanced one. Although the sharp jump in unemployment in

March was apparently reversed in April, current levels of unemployment cannot be counted among the expansive forces in the economy. Steel output fell from 92 percent of capacity in March to just below 80 percent in April. Manufacturers' new orders slipped down by 1.6 percent in March from February, with declines in both durable and nondurable lines of goods. At the same time, manufacturers' inventories in March were equal to the high point set in August 1957. Industrial production declined by an additional point in March, standing at 109 percent of the 1957 average. Most of the decline was confined to consumer lines, as business equipment industries registered gains. The continued decline in steel production and scattered declines in other industries during April were offset by some improvement in consumer goods output, and the overall production index was unchanged from March.

Unemployment declines in nation

The most troublesome aspect of the present expansion has been the persistence of unemployment. Preliminary data for April indicate that state unemployment compensation claims fell more than seasonally between mid-March and mid-April, although they were still much higher than in April 1959, when employment was rising rapidly. Offsetting the decline in unemployment to a certain extent were the prospects of further layoffs or shorter workweeks in the durable goods industries. Although claims were up from a year ago in many states, it is unemployment in the durable goods industries in the Midwest that has shown the largest increases over last year. The disturbing rise of unemployment in March, from 4.8 to 5.4 percent of the labor force, can be blamed in some measure upon the weather. The mid-month census of unemployment was taken in a week when severe storms in the East and Midwest curtailed outdoor activity and production in the durable goods industries. Factory hiring declined from 29 per 1,000 employees to 27 during March, while the rate of layoffs rose sharply, from 15 per 1,000 employees in February to 21 per 1,000 in March. Normally, hirings show gains in March and layoffs show little change. The quit rate was unchanged at 10 per 1,000 employees. This rate, generally regarded as a gauge of the availability of other employment, usually shows a small increase in March. In view of the reduced demand for labor in steel, appliances, autos, and related industries, it is apparent that by no means all of the March rise in unemployment can be attributed to the weather.

In the Twelfth District, nonfarm employment rose by 0.3 percent (about 20,000 workers) on a seasonally adjusted basis in March, bringing the total gain in jobs for the first quarter of 1960 to about 1.4 percent from the end of last year. All major industries except manufacturing recorded net increases in employment, though late winter storms hampered the expansion of outdoor activity, particularly so in lumbering and construction. Defense-related manufacturing payrolls were reduced by more than 5,000 workers, as aircraft plants released 5,300 workers and electrical machinery firms cut employment by 900 workers; partially offsetting these losses were small gains in ordnance and other defense manufacturing in the District. Recovery from the steel strike appears to have been largely completed by February, since small net cutbacks at primary metals, fabricated metals, and automobile assembly plants were reported in March. Nondurable goods manufacturing employment increased moderately, with most of the gain occurring in food processing.

Despite the recent inclement weather and the rather poor showing of construction contract awards since mid-1959, employment in District construction increased moderately in March. Mining firms moved closer to their mid-1959 employment levels following settlement of the copper strike, but there were indications that copper demand might not be sufficient to result in a complete return to the pre-strike level. Other major industry divisions also showed employment increases in March.

Unemployment in the 3 Pacific Coast States reached 4.5 percent of the labor force (seasonally adjusted) in March, compared with 4.3 percent in February. Most of the rise occurred in California, and some of this can be traced to adverse weather conditions limiting the seasonal expansion in outdoor employment and to cutbacks in defense industries. On the more favorable side, electronics plants in San Jose, San Francisco, San Diego, and possibly in Los Angeles are expected to resume hiring in the near future. It should be kept in mind, however, that further cutbacks at aircraft plants are also anticipated, which will serve to offset some of the gains in employment in other lines.

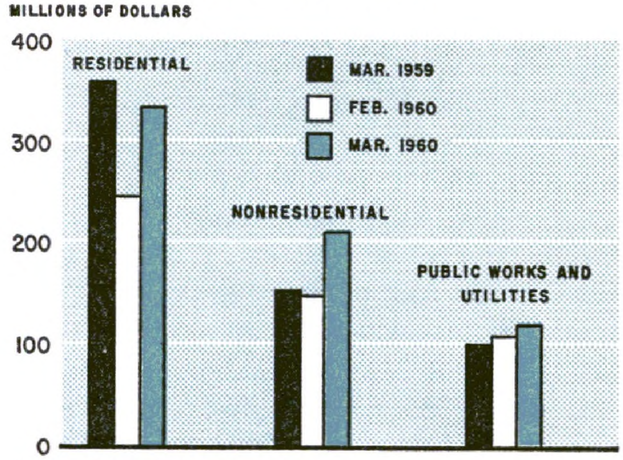
Construction activity up seasonally; home-building lags

Total construction activity in the District, as measured by the value of construction contracts, was up seasonally during March and 8 percent above the corresponding month of a year ago. Most of this increase is attributable to the larger volume of nonresidential construction contracts, which rose 35 percent over the total for March 1959. This, in turn, was chiefly the result of increased contracts for commercial, industrial, and educational and science buildings. Public works and utilities contracts also rose, standing 14 percent above March of last year. At the same time, March residential contracts fell 6 percent below the same month last year (Chart 2).

The outlook for home-building in the District reflects much the same uncertainty that is evident in the nation. During March there were additional signs of ease in the District mortgage market. FHA estimates of the price of FHA-insured (section 203), 5¾ percent, new-home mortgages in the West rose slightly, from $96.1 per $100 on March 1 to $96.2 on

CHART 2

VALUE OF CONSTRUCTION CONTRACTS
TWELFTH DISTRICT



Source: F. W. Dodge Corporation.

April 1. The flow of savings into District savings and loan associations has been heavy, the first quarter increase in savings accounts running above the first quarter of 1959, but there is apparently a strong demand for these funds as these associations have begun to increase their loan commitments. They have added to their commitments, which are primarily for conventional mortgages, at a rate exceeding that of the same period last year. The increasing demand for mortgage credit also appears to be reflected in estimates of the average interest rate on conventional mortgages in the West. This rate is reported by FHA to have risen very slightly during the first 3 months of the year.

A disturbing note is the report of the Census Bureau that rental vacancy rates in the West jumped from 8.3 percent in the fourth quarter of 1959 to 9.7 percent in the first quarter of 1960. If the rate continues at this higher level in the second quarter, this could be interpreted as indicative of an oversupply of rental units, a factor which could be expected to exert a depressing influence on future levels of construction.

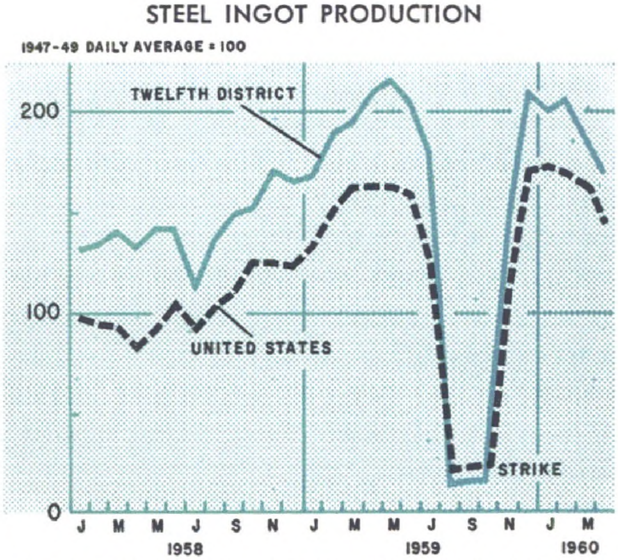
Slight quickening in lumber markets

New orders received by District lumber mills ran hot and cold in April, but some overall improvement was evident. Prices moved up slightly, although since early March they have been below the corresponding weeks in 1959 and the gap has been widening in succeeding weeks. Though production increased little in April, it still exceeded shipments, and mill inventories continued to grow from an unusually high level for early spring. In the fir region, lumber stocks were up more than one-fourth from last year, and the pine area reported stocks up more than one-tenth. Dealers are apparently content to let the mills and transit shippers carry their inventories this year. The plywood market strengthened moderately in April, with the ¼ inch sanded variety bringing roughly $66 per thousand square feet, compared with $64 a few weeks earlier. The industry anticipates that a price of $68 will prevail in the first part of May.

Domestic demand for metals quiet

Steel production declined in both the nation and in the District in April. In the nation, production fell from 92 percent of capacity in March to just below 80 percent in April. The decline was more noticeable in the District, where April operating schedules averaged about 72 per cent of capacity compared to 80 percent in March (Chart 3). A principal cause of the decrease in capacity utilization was the decline in inventory accumulation. Steel plants returned to full capacity production much more rapidly than was expected and order backlogs have been worked down to the point where the needs of consumers may be met with a relatively short lead time. In addition, activity in lines such as appliances and autos, which are heavy steel users, has slackened, and there is less inclination to build inventories among competing users of steel.

CHART 3
STEEL INGOT PRODUCTION



Sources: United States, American Iron and Steel Institute; Twelfth District, United States Department of Commerce.

During April, foreign demand for copper continued to prop the United States custom smelter price at 33 cents a pound, demand remaining weak here. Spot copper in London touched 35 cents a pound in the last week of April, responding to fears of the possible spread of South African political disorders to copper producing areas of Northern Rhodesia and the Belgian Congo. Foreign prices also reacted to strikes at copper mines and smelters in Chile as workers left their jobs May 1 when their union contract expired. There is concern in London over the low level of copper stocks in warehouses there.

American makers of brass mill copper and alloy mill products, concerned over the inroads foreign copper and copper alloy goods have been making in the United States market, are dropping prices on some copper sheets to correspond with prices for foreign imports. In 1959, total imports of all mill products aggregated a record 200 million pounds, up almost 30 percent from the previous record of 154 million in 1958. New orders in March by brass mills, wire mills, and foundries called for only 73,327 tons of new refined copper, 2,436 tons less than February orders and down 55 percent from new orders for March 1959. Fabricator stocks rose to 441,026 tons, the highest since October 1959, as copper shipments by foreign producers reached an all-time high in March and were the best for United States producers since June 1959.

The production of refined slab zinc by American smelters in March was the highest in 27 months at 86,038 tons. Total shipments were slightly above production and stocks declined, for the sixth consecutive month, to 136,566 tons, one-third below March 1959. Demand for zinc remained quiet at 13 cents a pound, East St. Louis, while the demand for lead was reported "pretty good" at 12 cents, New York.

District farm income prospects bright

Cash receipts in the second quarter may be expected to be bolstered by heavy marketings of cattle from District feed lots. Although beef prices are now slightly below a year ago, second quarter marketings are expected to be up almost 40 percent from last year in California and nearly 30 percent in Arizona. An additional increase in acreage that may be devoted to sugar beet production also served to heighten District farm income prospects. On April 20 the allotment was raised by 6,125 acres, following an earlier increase of 24,525 acres above that allotted for 1959. District states account for about half the nation's production of sugar beets and the acreage added in 1960 represents about $80 million in gross returns to District farmers. The additional acreage is welcome by District farmers not only because sugar beets is a high value crop but also because of the price assurance for this crop. Relaxation of production controls involves domestically produced sugar cane as well as sugar beets. Acreage controls on cane production have been extended to the 1961 crop, assuming the Sugar Act will be continued in its present form, as well as for the current crop.

California auto sales set record

New passenger car registrations in California (the only District state for which March data are available) set a record in March. Sales were 32 percent above the same month a year earlier and exceeded the previous monthly record established in September 1955. This faster pace was maintained in the first half of April. For all Twelfth District states, data are available only through February. In January, new passenger car registrations in District states lagged behind the year-ago level by 10 percent. Conversely, February sales were up 10 percent, so that for the first 2 months of 1960 approximately the same number of cars were sold as in 1959.

April department store sales in the District were up 5 percent over April 1959, but with adjustments for the later date of Easter this year they were probably slightly below last year's level. From January 1 through April 30, District department store sales were 2 percent above the first 4 months of 1959. This compares with a 3 percent increase in the nation as a whole. Sales at District apparel stores were down 4 percent in the first 3 months of the year.

Loans, investments, and deposits rise in April

The expansion of bank credit at District reporting banks which began in the last week of March continued during April. Total loans adjusted and investments were up $491 million from March 30, with an increase of $235 million in loans and $256 million in investments. Commercial and industrial loans accounted for almost one-half of the loan increase. Public utilities and transportation firms stepped up their borrowing by $32 million. Wholesale trade firms were the only other classified group of borrowers in the commercial and industrial loan category to increase their bank borrowings by a sizable amount: $13 million. Metal and metal products manufacturers, who had been particularly heavy borrowers during the first quarter of the year, did not add to their total bank indebtedness during April. Commodity dealers made repayments of $11 million during the month, following the seasonal pattern at this time of year. Food processors also continued

CHANGES IN SELECTED BALANCE SHEET ITEMS OF WEEKLY REPORTING MEMBER BANKS IN LEADING CITIES

(dollar amounts in millions)

	Twelfth District				United States			
	From March 30, 1960 to April 27, 1960		From April 29, 1959 to April 27, 1960		From March 30, 1960 to April 27, 1960		From April 29, 1959 to April 27, 1960	
ASSETS:	Dollars	Percent	Dollars	Percent	Dollars	Percent	Dollars	Percent
Total loans and investments	+486	+ 2.25	— 28	— 0.13	+1,737	+ 2.15	+ 365	+ 0.44
Loans and investments adjusted[1]	+491	+ 2.30	n.a.	n.a.	+1,525	+ 1.91	n.a.	n.a.
Loans adjusted[1]	+235	+ 1.61	n.a.	n.a.	+ 367	+ 0.70	n.a.	n.a.
Commercial and industrial loans	+103	+ 2.02	n.a.	n.a.	— 189	— 0.73	n.a.	n.a.
Real estate loans	— 12	— 0.23	+ 246	+ 4.90	+ 7	+ 0.10	+ 515	+ 7.57
Agricultural loans	— 1	— 0.18	+ 38	+ 7.24	— 2	— 0.59	+ 2	+ 0.60
Loans for purchasing and carrying securities	+ 73	+75.26	+ 21	+14.09	+ 245	+ 9.25	— 602	—17.22
Loans to nonbank financial institutions	+ 49	+ 6.70	n.a.	n.a.	+ 71	+ 1.41	n.a.	n.a.
Loans to domestic commercial banks	— 5	— 0.18	— 106	—28.49	+ 213	+18.77	— 112	— 7.67
Loans to foreign banks	0	0			+ 8	+ 1.52		
Other loans	+ 88	+ 3.14	n.a.	n.a.	+ 157	+ 1.33	n.a.	n.a.
U. S. Government securities	+271	+ 5.67	—1,654	—24.67	+1,225	+ 6.21	—4,232	—16.81
Other securities	— 15	— 0.77	— 238	—10.99	— 68	— 0.88	— 635	— 7.67
LIABILITIES:								
Demand deposits adjusted	+211	+ 1.94	— 34	— 0.31	+1,419	+ 2.94	—1,280	— 2.51
Time deposits	+ 52	+ 0.49	— 312	— 2.85	+ 176	+ 0.84	— 407	— 1.89
Savings accounts	— 35	— 0.39	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.

N.A. Not available.
[1]Exclusive of loans to domestic commercial banks and after deduction of valuation reserves; individual loan items are shown gross.
Sources: Board of Governors of the Federal Reserve System and Federal Reserve Bank of San Francisco.

their repayments, but at a slower rate than in the preceding months.

Consumer loans at District banks increased in April as the "all other" loan category, which consists largely of loans to finance consumer expenditures, rose $88 million. Sales and personal finance companies also had greater recourse to bank credit during April. Real estate was the one major loan category which did not follow the seasonal pattern. The amount of real estate loans outstanding at District reporting banks remained at the March level, $31 million below December 30, 1959. This reflects the slower pace of residential construction and the relative unavailability of mortgage money earlier this year.

April was the first month this year in which District reporting banks made net additions to their holdings of United States Government securities. The increase of $271 million in April was about the same amount as the average monthly decline in the first quarter. Total deposits at weekly reporting member banks also rose during April. Demand deposits adjusted, however, were still $510 million lower than on December 30, 1959, and time deposits, $384 million below the year-end. Although there was a small increase in total time deposits during April, savings deposits continued to decline and were $35 million less than on March 30 and $414 million below December 30, 1959. As a result of the drop in bank deposits since the first of the year, the loan/deposit ratio of all Twelfth District member banks rose from 60.1 on December 30, 1959 to 63.1 at the end of March 1960, high above the 54.9 ratio at the end of March 1959.

Strong tone in municipal bond market

New issues totaling $77 million (in lots of $5 million or larger) came to market in the Twelfth District in April. Reception was fair to outstanding depending on the issue. Overall, the tone of the market appears to have been strong. The State of California initiated its "flexible" policy of selling smaller issues at more frequent intervals with a $25 million flotation of School Building Aid bonds on April 19. The issue was completely sold out the first day of marketing and has since been trading in the secondary market at the original price. Net interest cost to the State was 3.835 percent, compared with 3.95 percent and 4.01 percent rates on two $100 million issues sold earlier this year. This issue received two bids; the rejected bid would have set the net interest cost at 3.875 percent.

Los Angeles School District bonds amounting to $16 million were issued on April 26, and reception varied according to maturity. All bonds in the first 11 years and last 3 years of the 1961-85 maturity schedule were quickly sold out. Net interest was 3.87 percent, a shade below the 3.89 percent paid for a similar issue last December. Sacramento Municipal Utility District issued $30 million in revenue bonds on the 28th for its Upper American River hydroelectric project. This issue consisted of $18.75 million of term bonds, which sold out completely the day of issue, while the remainder, consisting of serial bonds, moved more slowly, $5 million remaining in syndicate hands late on the day of issue.

As of April 28 there were no issues exceeding $5 million which were definitely scheduled to be offered. No date has yet been set for the $62 million of Wyandotte-Oroville electric power bonds expected this spring. Staat's index of California municipal bond yields remained stationary at 3.70 throughout the month until the week ending April 29, when it rose slightly to 3.74.

The Roles of FNMA and FHLBS in the Mortgage Market

For well over two decades, one of the aims of the housing policy of the Federal Government has been to stimulate the flow of funds into residential mortgages. This policy has had its major impact through devices which have influenced the flow of private funds into these mortgages. The more important devices are the mortgage insuring and guaranteeing operations of the Federal Housing Administration and the Veterans Administration, the insurance of savings and loan shares, and the liquidity improvement associated with the secondary market operations of the Federal National Mortgage Association. However, the operations of the Association coupled with those of the Federal Home Loan Bank System have also influenced these financial flows more directly, and it is this aspect of policy that has been growing in importance in recent years. The concern of this article is with the activities of these two agencies, i.e., FNMA and FHLBS. The objectives are to bring into focus the "direct" impact of their operations on the flow of investment funds into home mortgages and to show how this influence has been increasing recently.

TABLE 1

FNMA MORTGAGE LOANS, COMBINED OPERATIONS

(millions of dollars)

	Purchases	Sales	Net Purchases	Repayments and Other Credits	Net Changes in Mortgage Holdings
1948	197.9	—	+ 197.9	3.0	+ 194.9
1949	672.2	19.8	+ 652.4	23.4	+ 629.0
1950	1,044.3	469.4	+ 574.9	56.6	+ 518.3
1951	677.3	111.1	+ 566.2	63.4	+ 502.8
1952	537.9	55.9	+ 481.9	89.8	+ 392.2
1953	542.5	221.1	+ 321.4	101.4	+ 220.0
1954	658.1	525.2	+ 132.9	117.1	+ 15.8
1955	411.4	61.7	+ 349.7	168.4	+ 181.3
1956	608.7	5.0	+ 603.7	171.7	+ 432.0
1957	1,096.0	2.9	+1,093.1	166.1	+ 927.0
1958	621.0	478.9	+ 142.9	214.9	— 72.9
1959	1,907.0	5.0	+1,902.0	272.0	+1,630.0

Source: *Housing Statistics,* Housing and Home Finance Agency.

The Federal National Mortgage Association

The Federal National Mortgage Association was created by Congress in 1938 primarily for the purpose of encouraging investors to participate in the Federal Housing Administration program set up several years earlier. Specifically, FNMA, through its buying and selling activities, was to provide a broader secondary market for FHA-insured mortgages. This support was intended to improve the marketability of these mortgages, and, thereby, encourage the flow of private investment funds into residential mortgages. In providing this support, however, the Association affects directly the flow of funds into home mortgages since its purchases add to these flows, whereas its sales constitute a drain.[1] The importance of this "direct" influence is apparent in the $9 billion of Government-insured mortgages purchased since its inception. It is necessary, however, to distinguish between three separate and distinct periods in FNMA's history to interpret the significance of these activities.

During the first phase of its operations, from February 1938 through July 1948, FNMA's activities were carried out on a modest scale, as its total purchases amounted to $318 million and sales to $166 million. This was largely the result of a $220 million limit imposed on its mortgage holdings and the restriction of home-building during World War II.

The second phase began with the reorganization of FNMA in July of 1948. Among the more important changes were an increase in its lending capacity, the expansion of its purchasing authority to include mortgages guaranteed by the Veterans Administration, and the development of the advance commitment procedure. This was followed by a rapid expansion of its buying and selling activities, chiefly the result of a strong demand for mortgage funds coupled with the fact that the Association was willing to issue advance commitments to purchase no-down-payment, VA, new-home construction mortgages at par. Its operations expanded to the extent that Congress increased its lending authority 3 times within a period of 4 years after the date of the reorganization. In the Housing Act of 1950, however, Congress modified the activities of the Association in several important respects, which, in turn, resulted in a gradual restriction of them. As a consequence, its net pur-

[1] Customarily, net purchases (the difference between purchases and sales) are used to measure the extent of this influence. There is, in addition to these, the matter of repayments. Since practically all of the holdings of the Association are amortized mortgages, there is a continuous flow of funds back into FNMA. If these are not reinvested, they also constitute a drain. Thus, it can be argued that net changes in mortgage holdings are a more complete measure of this influence. On the other hand, net purchases are better indicators of the extent to which the Association is actively trying to influence these flows. Both of these measures will be used in the discussion to follow.

chases reached a post-1948 low point immediately preceding its second reorganization in 1954.

In summary, FNMA added substantially to the flow of funds into home mortgages during this period, especially during the years of 1949 and 1950. The nature of this influence was largely a function of legislative action in that it was heavily dependent on the activity authorized by Congress in its housing legislation. The operations were not, strictly speaking, general support in the secondary market. The Association not only functioned as a primary source of funds during this period, but as a result of its policy of purchases at par, also provided special support for certain classes of mortgages.

The third and most recent phase began with the second reorganization included in the Housing Act of 1954. In part, this reorganization represented an attempt to establish separate accountability for different types of operations and by doing so altered to some extent the nature of FNMA's influence. This separate accountability was to be accomplished by reorganizing its structure into three separate and distinct functions which were to provide for: (1) a secondary market for Federally-underwritten residential mortgages; (2) special assistance for financing of selected types of mortgages originating under special housing programs; and (3) the management and liquidation of mortgages held or acquired pursuant to contracts entered into under its previous charter.

Secondary market operations

Theoretically, the most important area of current activity of FNMA is its secondary market operations. The objective of this activity is "to make Government-insured mortgage investment more liquid so as to improve the distribution of investment capital available for these home mortgages." This is to be accomplished through the purchase and sale of FHA and VA home mortgages, buying

TABLE 2

FNMA SECONDARY MORTGAGE MARKET OPERATIONS

(millions of dollars)

	Purchases	Sales	Net Purchases	Repayments and Other Credits	Net Changes in Mortgage Holdings
1955	86	—	+ 86	—	+ 86
1956	575	5	+ 570	6	+564
1957	1,021	3	+1,018	31	+987
1958	259	466	— 207	49	—256
1959	735	3	+ 732	62	+670

Source: *Housing Statistics,* Housing and Home Finance Agency.

when and where mortgage funds are scarce and selling when and where there is a demand for mortgage investments. However, FNMA has not been given a carte blanche with respect to these operations. There are certain important constraints imposed by the legislative framework within which it operates. For example, the Association is restricted to the purchase and sale of FHA and VA mortgages whose principal amount does not exceed $20,000. More important is the restriction imposed upon its ability to borrow. Although there is no longer a direct limit on its secondary market operation mortgage holdings, the same purpose is accomplished by limiting the amount of funds the Association can borrow. This is because its secondary market operations are based primarily on the use of borrowed funds.[1]

The limit on total borrowing was set forth in the 1954 reorganizing legislation as an amount equal to 10 times the amount of the Association's total capitalization and surplus. With its initial capitalization, this limit would have greatly restricted its ability to borrow; yet, this problem turned out to be more apparent than real, since Congress has increased the authorized capitalization when it threat-

[1] A part of its purchases are made with the funds received from repayments made on the mortgages included in its portfolio. Nevertheless, if the Association wishes to expand its mortgage holdings, it does so primarily by the use of borrowed funds. It does have funds that were made available by the sale of preferred stock to the Treasury. It also has funds from the sale of stock in its secondary market operations. The combined total of these latter two sources, however, is substantially less than the funds that it derives from its borrowing, i.e., $195 million as compared with $1,800 million on December 31, 1959.

ened to interfere with the purchasing activity of the Association. Currently, the Association has a total borrowing authority of close to $3 billion. With obligations outstanding at the end of 1959 in the amount of approximately $1.8 billion, its secondary market portfolio can still be expanded by over $1 billion.

The impact of these secondary market operations on the home mortgage market since 1955 can be observed in Table 2. One important aspect of this influence has been that it has "offset" in some degree the consequences of the alternating periods of tightness and ease that have characterized this market in the recent past. For example, during the last half of 1955, pressures, associated to a large extent with increased demands for funds from other sectors of the economy, began to develop. These pressures were intensified during the following year and reached a peak during 1957. The secondary market activities of the Association appear as offsets in that its net purchases increased during each of these years, reaching a peak during 1957. In 1958, the market eased somewhat as a result of the declining demands for funds from the other sectors in the economy. Correspondingly, FNMA became a net seller of mortgages in the secondary market. Then, in the last half of 1959, pressures again began to develop. FNMA responded by increasing its net purchases to the extent of adding over $700 million to the flow of funds into home mortgages during the year.

These activities moderated the pressure of the heavy demand for credit on the home mortgage market. For example, FNMA, through its secondary market operations, accounted for approximately 12 percent of the funds that flowed into 1- to 4-family home mortgages throughout 1957. Moreover, the offsetting aspects of these operations appear to be increasing in significance. This is evident in the comparison of net purchases during 1955 and 1959, years in which pressures started to develop in the mortgage market. The fact that net purchases were approximately 9 times as great in 1959 as in 1955 suggests that the Association is making more of an effort to smooth out the fluctuations in the flow of funds into this market. This is not to say that its net purchases during 1960 will be 9 times as large as those in 1956 or 1957. However, the Association does have the borrowing authority which makes possible a large volume of net purchases in the future. Furthermore, if the past provides us with any sort of a guide as to what to expect in the future, Congress may increase the limit of this authority if it threatens to interfere with future purchases of the Association.

The special assistance function

The Housing Act of 1954 established a special assistance function so as to eliminate all aspects of special support from the operations of the Association unless expressly authorized by Congress. Essentially, this function provides the basis for two types of activity. First, it enables the Association to give assistance for financing selected types of home mortgages for which established financial facilities are deemed "inadequate." Since this function was established in 1954, the President has authorized urban renewal, disaster, military and defense, elderly persons, Guam, and Alaska as qualified for special assistance, while Congress has authorized certain types of cooperatives and the armed services. The funds required for financing are obtained principally by borrowing from the Treasury. However, the Association is limited in the amount of special assistance mortgage holdings permitted. Currently, the limitation on the dollar amount of mortgages outstanding which may be authorized by the President is $950 million, whereas the amount authorized for programs approved by Congress is $725 million. By the end of 1959 the Association had accumulated a portfolio of $232 million for the programs of the President and $536 million for Congress.

Secondly, this function provides the basis for FNMA assistance "when needed to retard or stop a decline in mortgage lending and home-building activities which threaten the stability of high levels of production and income." This provision was used for the first time in the Emergency Housing Act of 1958, which appropriated to the Association $1 billion to be used to purchase FHA and VA mortgages on low- and moderate-priced housing, i.e., under $13,500.

TABLE 3

SPECIAL ASSISTANCE FUNCTION

(millions of dollars)

	Purchases	Sales	Net Purchases	Repayments and Other Credits	Net Changes in Mortgage Holdings
1955	—	—	—	—	—
1956	6	—	+ 6	—	+ 6
1957	67	—	+ 67	—	+ 67
1958	363	13	+ 350	4	+ 346
1959	1,172	—	+1,172	23	+1,149

Source: *Housing Statistics*, Housing and Home Finance Agency.

The impact of these operations on the flow of funds into mortgages is summarized in Table 3. In contrast to its secondary market operations, these activities were of minor importance during 1956 and 1957. The increased level of net purchases in the latter part of 1958 and throughout 1959 is, to a large extent, the result of the emergency legislation passed in 1958. This, of course, was a measure primarily designed to stimulate the overall economy, whose implementation in this case resulted in adding to the flow of funds into home mortgages when the market was easing somewhat.

Although the $1 billion emergency fund created by the 1958 legislation has been exhausted, purchases in those special assistance areas designated above will continue to add to the flow of funds into mortgages. These net purchases have been growing in importance and are likely to continue to do so in the future, since the mortgage holdings of the Association are still below the maximum authorized. Furthermore, this is another area in which Congress has seen fit to increase the authorization limit in recent years.

The management and liquidation function

The management and liquidation function concerns the mortgage portfolio acquired under contracts entered into before November 1, 1954. This function requires the Association to manage and liquidate this portfolio of mortgages "in an orderly manner with a minimum of adverse effect upon the home mortgage market and a minimum loss to the Federal Government." The management of this portfolio before the latter part of 1959 consisted primarily of servicing the portfolio and using the repayments as a means of retiring the debt incurred to finance the purchases.[1] The sale of these mortgages has been minimal partly because of the tightness that developed in the mortgage market not long after the function was set up.

In the latter part of 1959, the Association, in cooperation with the administration, adopted a new technique for liquidating this portfolio which, essentially, involves an exchange of FNMA mortgages for United States Treasury bonds. In December, suitable prices were arranged so as to permit an exchange of $191

[1] Almost all of this portfolio was acquired initially on the basis of funds borrowed from the Treasury. In recent years, however, the Association has attempted to replace this with private debt through the issuance of debentures and the use of these funds to retire its debt with the Treasury. At the end of 1959, the portfolio was financed to the extent of 41 percent with private capital.

TABLE 4

MANAGEMENT AND LIQUIDATION FUNCTION

(millions of dollars)

	Purchases	Sales	Repayments and Other Credits	Net Changes in Mortgage Holdings
1955	325	62	170	+ 93
1956	27	—	166	—139
1957	8	—	136	—128
1958	—	3	162	—165
1959	—	1	187	—188

Source: *Housing Statistics*, Housing and Home Finance Agency.

million of 2¾ percent Treasury bonds from the public for $188 million of 4 percent VA mortgages held in FNMA's management and liquidation portfolio. In March of 1960, the Association offered to trade an additional $200 million of these VA mortgages but was able to swap only $130 million. The bonds received in these exchanges will be turned over to the Treasury and the Association will receive a corresponding reduction in its debt. These exchanges mean a reduction in budget expenditures during the fiscal year in which they are made.

The liquidation of this portfolio by means of repayments and the concomitant retirement of its debts represent a reduction in the funds invested in mortgages. On the other hand, the effects of sales and exchanges are somewhat less certain. To the extent that they involve persons or institutions who would have invested these funds into mortgages in any event, the effects are the same as with repayments. However, the effect is neutral if these "buyers" would not have otherwise done so. It is the view of the Association that the recent exchanges have not resulted in a decline in mortgage investment, since the majority of the institutions involved indicated that they made additional funds available for these mortgages and that they intend to keep these funds in mortgage investment.

The Federal Home Loan Banking System

The Federal Home Loan Banking System was created in 1932 primarily for the purpose of rescuing distressed home financing institutions by providing a central reservoir of credit. As it has evolved, however, the FHLBS has become an institution which tries to facilitate the flow of funds into home mortgages under more normal economic circumstances by making credit advances to its members under certain sets of conditions. Its current membership is composed almost exclusively of savings and loan associations.

In contrast to FNMA, the FHLBS does not buy or sell mortgages. However, by extending credit advances to members whose funds are invested primarily in home mortgages, the Federal Home Loan Banks permit them to invest correspondingly more in mortgages. The reverse holds true when these Banks are contracting their credit advances. Consequently, the lending activities of the Federal Home Loan Banks are a part of the total mechanism which affects the extent of the flow of funds into the home mortgage market.

Credit advances are granted to qualified members for a number of reasons. The most important of these are for needs which arise from heavy seasonal or unusual demands for mortgages that cannot be satisfied out of the current inflow of savings capital and mortgage repayments and needs which arise from unusual withdrawals of savings capital. Member institutions are limited by statute to an amount of borrowing which is not to exceed 12 times their capital stockholdings in their regional Bank. The Federal Home Loan Bank Board further restricts them by limiting all borrowing to one-half of the member's net assets or 50 percent of a member's liability for shares and deposits, whichever is the lower. Finally, some of the regional Banks impose still further conditions which vary substantially as between these Banks. In spite of these restrictions, however, member institutions, in the aggregate, can still borrow large amounts.

The Federal Home Loan Banks use funds acquired from both internal and external sources to finance these credit advances. The internal funds are those which become available as a result of stock subscriptions and member deposits.[1] These internal funds pro-

[1] Each Federal Home Loan Bank is authorized to accept deposits made by members. A maximum interest rate of 3 percent has been authorized. Currently, the rate for the 11 regional banks averages a little over 2 percent. Not all of the funds derived from these deposits are available for the purpose of making credit advances. The FHLB Board requires each regional bank to have cash and United States Treasury obligations maturing in 13 months equivalent to 75 percent of member deposits on each financing date. The remaining 25 percent may be invested in advances with maturities of 1 year or less.

TABLE 5

ADVANCES AND CONSOLIDATED OBLIGATIONS OF THE FEDERAL HOME LOAN BANKS

(millions of dollars)

	Advances Outstanding	Net Changes in Outstandings	Consolidated Obligations Outstanding	Net Change in Outstandings
1941	219	+ 18	90	—
1942	129	— 90	69	— 21
1943	110	— 19	64	— 5
1944	131	+ 21	66	+ 2
1945	195	+ 64	68	+ 2
1946	293	+ 98	169	+ 101
1947	436	+143	262	+ 93
1948	515	+ 79	416	+ 154
1949	433	— 82	206	— 210
1950	816	+383	561	+ 355
1951	806	— 10	529	— 31
1952	864	+ 58	449	— 80
1953	952	+ 88	413	— 36
1954	867	— 84	273	— 140
1955	1,417	+550	975	+ 702
1956	1,228	—189	963	— 12
1957	1,265	+ 37	825	— 138
1958	1,298	+ 33	714	— 111
1959	2,134	+836	1,774	+1,060

Source: Federal Home Loan Bank Board.

vide the Banks with the basis of providing for demands that are seasonal in nature. In the case of the more protracted increases in demand, the Banks generally resort to borrowing in the money and capital markets through the sale of consolidated obligations.[1] This is clearly evident in the strong correlation apparent between annual changes in credit advances and outstanding consolidated obligations in Table 5. By financing their credit advances this way, the Federal Home Loan Banks attract funds into home mortgages. Thus, it is these two balance sheet items that are most important to our discussion.

Table 5 indicates that the growth in the level of advances and consolidated obligations has been substantial, albeit uneven. In fact, most of this growth has taken place recently during the years of 1955 and 1959. In each of these years, the increase was associated with a liquidity squeeze experienced by many of its members. Savings and loan associations had rapidly expanded their loan commitments during the earlier part of the year and subsequently found they were unable to fulfill these commitments on the basis of the net increase in savings capital. In providing funds, the Federal Home Loan Banking System, in effect, brought about an increase in mortgage investment during periods in which pressures were beginning to develop in the home mortgage market. In contrast to the secondary market operations of FNMA, however, the offsetting aspects of this activity were of a much shorter duration, as steps were successfully taken towards the latter part of the year to restrain member borrowing.

It is not possible to measure precisely the impact of these lending and borrowing operations on the flow of funds into mortgages. Nevertheless, net changes in advances and consolidated obligations holdings do provide a guide. Although the impact is modest when related to total mortgage investment, close to $1 billion was put into mortgages during 1959 as a result of the activities of the Banks. This activity appears to be growing in importance. This is not only apparent in terms of absolute importance, i.e., the comparison of net changes in advances and consolidated obliga-

TABLE 6

Net Increase in FHLBS Advances and Consolidated Obligations as a Percentage of the Net Increase in 1- to 4-Family Nonfarm Residential Mortgage Debt for Selected Years

	Credit Advances	Consolidated Obligations
1950	5.0	4.7
1955	4.4	5.6
1959	6.1	7.8

Source: Federal Home Loan Bank Board and *Federal Reserve Bulletin.*

[1] These obligations are joint obligations of the 11 Federal Home Loan Banks issued by the Federal Home Loan Bank Board. From 1946 through 1957 they were issued with a term of 1 year or less. Since then, the Board has issued longer-term securities, although the largest portion of this debt still consists of these short-term notes.

tions during the years of 1950, 1955, and 1959, but also in terms of relative importance, i.e., the net changes in both advances and consolidated obligations in 1959 were a larger percentage of the net increase in 1- to 4-family nonfarm residential mortgage debt than during 1950 (Table 6). Furthermore, the FHLBS is in a position to expand these operations even further in the future, since the total volume of consolidated obligations outstanding at the end of 1959 was still substantially below the maximum permitted by statute.[1]

Conclusions

It is clear that as a consequence of the activities of these two agencies, funds that otherwise would have been put to other uses have been diverted into home mortgages. Although some of this diversion has been accomplished by the use of funds acquired from the Treasury, i.e., the earlier operations of FNMA coupled with the financing of its current special assistance function, much of it has come about as the result of the fact that these agencies have been successful in marketing their obligations in the money and capital markets. Although the total amount of these funds is small in relation to the total supply of funds made available to home mortgages during the period in which these agencies have been operating, during any given year the amount can be significant. In 1959, for example, these two agencies were responsible for close to $2.5 billion, or approximately 20 percent of the net increase in nonfarm, 1- to 4-family, residential mortgage debt. It is also apparent that in recent years the activities of these agencies have provided the mortgage market with some degree of insulation from the consequences of changing conditions in the money and capital markets.

Another conclusion is that the influence exerted through these agencies is growing in importance. This is apparent in a comparison of their combined activities in the first half of the 1950's with that of the last half. From 1955 through 1959, these agencies, on the average, added approximately $900 million annually, as compared with a little over $400 million during the first half. Furthermore, when they have acted to augment these flows of funds into home mortgages, they have been providing an increasingly larger share of the total.

What lies ahead depends in part on the extent to which Congress will continue to use FNMA as a means of aiding low and middle income families in getting mortgage credit. It also depends upon the ability of these two agencies to borrow from the money and capital markets. Currently, they both have the authority to borrow substantially more. This is less true of FNMA, although when its borrowing limit was approached in the past, Congress showed willingness to expand its authority. There is also the fact that they have demonstrated themselves as an effective means of making funds available to the mortgage market that would have been invested elsewhere. Among the more important sources of these funds are personal trusts and retirement and pension fund trusts. The managers of these funds have been hesitant to invest into mortgages as a consequence of the substantial operating and management burden involved in servicing them. However, they have shown an inclination to invest in the obligations of FNMA and FHLBS, which, in turn, means that these agencies are in a good position to add large amounts of funds to home mortgages if they choose to do so.

[1] The maximum is 12 times the total paid-in capital stock and legal reserves of the banks. By applying this formula, the maximum would be well over $9 billion at the end of 1959.

BANKING AND CREDIT STATISTICS AND BUSINESS INDEXES—TWELFTH DISTRICT[1]

(Indexes: 1947-1949 = 100. Dollar amounts in millions of dollars)

Year and Month	Condition items of all member banks[2]: Loans and discounts	U.S. Gov't securities	Demand deposits adjusted[3]	Total time deposits	Bank debits index 31 cities[4, 5]	Bank rates on short-term business loans[6]	Total nonagricultural employment	Total mf'g employment	Car-loadings (number)[5]	Dep't store sales (value)[5]	Retail food prices[7, 8]
1929	2,239	495	1,234	1,790	42	....	...	...	102	30	64
1933	1,486	720	951	1,609	18	....	...	...	52	18	42
1939	1,967	1,450	1,983	2,267	30	....	60	57	77	31	47
1950	......	......	......	......	...	....	103	105	98	107	100
1951	7,866	6,463	9,937	6,777	132	3.66	112	121	100	112	113
1952	8,839	6,619	10,520	7,502	140	3.95	118	130	100	120	115
1953	9,220	6,639	10,515	7,997	150	4.14	121	137	100	122	113
1954	9,418	7,942	11,196	8,699	154	4.09	120	134	96	122	113
1955	11,124	7,239	11,864	9,120	172	4.10	127	143	104	132	112
1956	12,613	6,452	12,169	9,424	189	4.50	134	152	104	141	114
1957	13,178	6,619	11,870	10,679	203	4.97	138	156	96	140	118
1958	13,812	8,003	12,729	12,077	209	4.88	138	154	89	143	123
1959	16,537	6,673	13,375	12,452	237	5.36	143	163	93	156	123
1959											
April	14,768	7,739	12,874	12,301	241	....	143	164	94	153	123
May	15,000	7,511	12,520	12,399	231	....	143	163	101	154	123
June	15,328	7,329	12,589	12,517	235	5.21	143	164	95	161	123
July	15,617	7,096	12,945	12,390	242	....	144	166	88	161	123
August	15,924	6,932	12,797	12,378	241	....	144	164	105	162	123
September	15,978	6,717	12,850	12,365	238	5.54	144	163	87	154	123
October	16,010	6,702	12,963	12,316	232	....	144	161	71	153	123
November	16,252	6,651	13,133	12,138	251	....	145	164	91	156	123
December	16,537	6,673	13,375	12,452	236	5.71	145	165	98	158	123
1960											
January	16,354	6,304	12,971	12,111	239	....	146	167	92	153	124
February	16,388	5,976	12,493	12,017	244	....	147	167	92r	158	123
March	16,660	5,707	12,553	11,986	249	5.72	147	167	95	161	123
April	16,933	5,999	12,810	12,042	251	....	...	...	..	...	...

Year and month	Industrial production (physical volume)[5]: Lumber	Petroleum[7]: Crude	Petroleum[7]: Refined	Cement	Steel[7]	Copper[7]	Electric power	Waterborne Foreign Trade Index[9, 10] Exports: Total	Exports: Dry Cargo	Exports: Tanker	Imports: Total	Imports: Dry Cargo	Imports: Tanker
1929	95	87	78	55	...	103	29	190	150	247	124	128	7
1933	40	52	50	27	...	17	26	110	...	...	72	...	...
1939	71	67	63	56	24	80	40	163	107	243	95	97	57
1950	114	98	103	112	125	115	120	91	80	108	142	145	103
1951	113	106	112	128	146	116	136	186	194	175	163	140	733
1952	115	107	116	124	139	115	145	172	200	129	206	142	1,836
1953	116	109	122	131	158	113	162	141	138	146	314	163	4,239
1954	115	106	119	133	128	103	172	133	141	123	268	166	2,912
1955	122	106	124	145	154	120	192	165	178	149	313	187	3,614
1956	120	105	129	156	163	131	209	201	261	117	459	219	7,180
1957	106	101	132	149	172	130	224	231	308	123	582	216	10,109
1958	107	94	124	158	142	116	229	176	212	123	552	218	9,096
1959	116	92	130	174	138	100	253	186	221	135	682	283	11,083
1959													
March	114	92	128	171	192	140	250	212	210	217	657	383	7,810
April	114	92	130	178	213	144	250	170	191	139	605	279	9,101
May	118	92	128	188	216	148	254	161	181	133	587	283	8,516
June	111	93	128	186	205	138	269	170	192	139	813	307	13,990
July	118	92	136	192	79	118	267	166	215	96	612	284	9,168
August	111	92	136	191	11	76	256	196	265	97	654	254	11,074
September	113	92	132	176	13	36	248	171	217	107	678	269	11,344
October	115	91	132	186	15	40	249	231	289	150	702	261	12,206
November	117	91	133	154	148	43	257	148	202	71	807	290	14,284
December	129	91	131	152	212	40	257	209	266	128	858	302	15,333
1960													
January	127r	90	130	141	197r	67r	263	...	...	...	958	277	18,687
February	127r	90	127	140	209p	116	...	...	...	...	...	...	...
March	120	91	131	153	185p	...	...	...	...	...	...	...	...

[1] Adjusted for seasonal variation, except where indicated. Except for department store statistics, all indexes are based upon data from outside sources, as follows: lumber, California Redwood Association and U.S. Bureau of the Census; petroleum, cement, and copper, U.S. Bureau of Mines; steel, U.S. Department of Commerce and American Iron and Steel Institute; electric power, Federal Power Commission; nonagricultural and manufacturing employment, U.S. Bureau of Labor Statistics and cooperating state agencies; retail food prices, U.S. Bureau of Labor Statistics; carloadings, various railroads and railroad associations; and foreign trade, U.S. Bureau of the Census. [2] Annual figures are as of end of year, monthly figures as of last Wednesday in month. [3] Demand deposits, excluding interbank and U.S. Government deposits, less cash items in process of collection. Monthly data partly estimated. [4] Debits to total deposits except interbank prior to 1942. Debits to demand deposits except U.S. Government and interbank deposits from 1942. [5] Daily average. [6] Average rates on loans made in five major cities, weighted by loan size category. [7] Not adjusted for seasonal variation. [8] Los Angeles, San Francisco, and Seattle indexes combined. [9] Commercial cargo only, in physical volume, for the Pacific Coast customs districts plus Alaska and Hawaii; starting with July 1950, "special category" exports are excluded because of security reasons. [10] Alaska and Hawaii are included in indexes beginning in 1950. p—Preliminary. r—Revised.