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SAVING AND ITS CLAIMANTS

Remarks of C. Canby Balderston,  
Vice Chairman, Board of Governors of the Federal Reserve System,  
Before the Annual Western Mortgage Conference  
of the Mortgage Bankers Association of America,  
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April 22, 1960.

## SAVING AND ITS CLAIMANTS

Sir Walter Scott wrote 131 years ago in his Journal: "It is saving, not getting, that is the mother of riches." Now, as then, we individually need to save for protection; collectively, we need to save enough capital to undergird economic growth.

The ability to raise both our living standards and our growth rates will continue to depend heavily upon our saving habits. To accelerate our growth, investment must expand. This requires a parallel increase in our desire to save, if long-run growth is to occur without inflation. Success in the economic race between East and West will turn in part upon how effectively each side can increase its rate of saving and investment, and thereby realize its full growth potential.

### Saving by Groups and Nations

What is saving, the mother of riches? For consumers, businesses, and governments, it represents the extent to which current receipts after taxes are not spent on current consumption. Saving flows into investment in capital goods, like housing or plant and equipment, as well as into investment in financial claims, like savings deposits or new security issues. In this way, savers accumulate claims on future goods and services. As Adam Smith noted in his Wealth of Nations, "Parsimony, and not industry, is the immediate cause of the increase of capital."

For an entire nation, however, saving consists solely of increases in its stock of capital goods plus increases in net claims on foreigners. Unlike the saving done by particular groups like consumers, national saving excludes all financial claims except net claims on

foreigners. Whatever debt is owed by anyone as a liability is also owned by another as an asset; that is, financial assets and debt held within the economy balance out. Consumer saving in the form of bank deposits, for example, is offset by bank liabilities.

Consumers account for about three-fifths of our economy's gross saving. Collectively, they save enough to more than cover their own borrowing needs; thus they can help meet the net demand for saving by businesses and governments. Last year, in fact, consumers held interest-bearing assets amounting to nearly two-and-one-half times the amount of debt on which they had to pay interest. Preliminary estimates suggest, however, that in the 1950's consumers may have saved somewhat less in relation to their after-tax incomes than in the 1920's. Moreover, during the 1950's as compared with the 1920's, consumers may have increased what they borrowed in financial markets in comparison with what they saved by acquiring financial assets.

Businesses as a group finance themselves largely through internal saving. Nonetheless, businesses are usually net borrowers in financial markets, in contrast to consumers who are still major net lenders. Also in recent years Federal, State and local governments have generally been heavy net borrowers. Whenever a governmental net surplus occurs, of course, it adds to national saving.

#### Threats to Saving

The integrity of a nation's saving is always under threat from both external and internal forces. History is filled with examples in which the saving of a nation--its capital goods or treasuries--has been

confiscated by another through conquest. Indeed much of

. . . the glory that was Greece,  
And the grandeur that was Rome

was financed out of such appropriations from subjugated states.

Other dangers to national saving arise internally through natural hazards, like earthquake, fire, and flood, as well as through economic folly. Prolonged recourse to printing-press money or to deficit financing ultimately reduces the rate of saving. In periods of high level economic activity, these devices foster inflation. Eventually, as the value of accumulated saving depreciates, the propensity to save declines further. Inflation feeds on itself, and leads in the end to an economic crisis.

Modern civilization depends upon the accumulated saving of past generations; future generations in turn will depend upon ours. This saving is embodied in skyscrapers, homes, factories, highways, farms, and other facilities that enable us to enjoy the real benefits of Twentieth Century progress. This is why it is important to society that we save both wisely and well.

#### Saving and Interest Rates

The relationship between present saving and future command over resources is expressed by interest rates. As Benjamin Franklin wrote in Poor Richard's Almanac: "For £6 a year you may have the use of £100, if you are a man of known prudence and honesty." The 100 pounds borrowed in Franklin's example will be repaid as 106 pounds one year later. Meanwhile, the saver permits 100 pounds of his resources to be used for investment in such items as durable goods or plant and equipment. This

investment expands the economy's capacity to produce future goods and services. In so doing, it provides the additional real income that enables the borrower to pay the 6 pounds annual interest.

Thus interest is at once an earning to savers and a cost to investors. Over the long run, movements of interest rates tend to reflect the interaction of saving and investment at given levels of income and prices. Chart 1, which depicts the course since 1947 of long-term interest rates in six countries, shows that the general trend has been upward. Of these six nations, the United States has experienced the lowest long-term rates.

#### Interest Rates and Monetary Policy

Here let me comment on the Federal Reserve's monetary policy as it relates to interest rates. Monetary policy represents a vital means of keeping the nation's total money demand in balance with its capacity to produce. In doing so, however, monetary policy does not aim at specific objectives as to interest rates--even less, at abnormally high interest rates as some Federal Reserve critics allege.

Changes in the general level of interest rates reflect changes in the over-all balance between the supply of funds and the demand for them. Indeed, monetary policy permits these flows--and the expectations surrounding them--to operate in relatively free and competitive markets for money, credit, and capital. As Chairman Martin recently pointed out: "Monetary policy is effective only so long as it works in general consonance with the economic realities underlying the situation. . . Federal Reserve actions cannot for long enforce rates of interest on the market

that are either above or below the rates that maintain a balance between saving and investment."<sup>1/</sup>

### Saving and Its Claimants

Saving is needed to meet new investment demands resulting from changes in population size, composition, and preferences, along with concomitant job opportunities. For example, our economy should be ready by the middle of the decade to provide jobs for a sharply increased number of youngsters who will reach the age of 18 and be potential additions to the permanent labor force. Saving is also required to facilitate technological advances ranging from automation to rocketry. Technology intensifies the demand for saving both to apply the newest ways of doing things, and to offset the accelerated rate of obsolescence of older facilities.

Although consumers invest a large amount of equity saving in housing, much current housing is financed through mortgages. Charts 3 and 4 set forth the major types of long-term financing, classified by kind of indebtedness. Both charts show the prominent role that mortgages--both residential and non-residential--have played in the postwar period. Last year, total mortgage debt outstanding expanded by a record \$19 billion, or by one-sixth more than during the previous high in 1955. This spectacular growth occurred even though mortgage markets were under increasing pressure during much of the year.

### Saving and Housing Finance

It would be presumptuous of me to discuss the practical details of postwar mortgage financing before an audience so versed in these matters.

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<sup>1/</sup> Statement of William McChesney Martin, Jr., Chairman, Board of Governors of the Federal Reserve System, before the Joint Economic Committee, February 2, 1960, reprinted in the Federal Reserve Bulletin, February 1960.

Nor shall I speak about the soundness of postwar mortgage loans—a subject of especial interest to commercial bankers. Instead, I shall confine my remarks to long-term financial flows in mortgage markets, chiefly to home mortgages, and follow a pattern of analysis developed by Dr. Robert M. Fisher of the Board's staff.

The upward trend in the dollar volume of mortgage borrowing of all types, shown in Chart 3, and the large share of total long-term financing that mortgages have taken, shown in Chart 4, have been mentioned already. Chart 2 indicates that the increased volume of saving devoted to mortgage financing—at least to that on 1- to 4-family dwellings—has partly reflected a rise in the number of mortgage recordings. Chiefly, however, it has been caused by an upward trend in the average mortgage amount. Between 1947 and 1959, the number of recorded mortgages of \$20,000 or less rose by 47 per cent; the average mortgage amount, by 86 per cent.

As Charts 5 through 10 suggest, the larger average amount of credit extended per home mortgage reflects postwar trends toward relatively smaller average equity downpayments and toward higher home prices. Charts 5 and 6 depict the long-term decline in downpayment ratios on homes financed by newly-made mortgages. Between 1947 and 1959, average downpayment ratios on home purchases financed by conventional first mortgage loans from insured savings and loan associations decreased by one-fifth. On homes with FHA and VA mortgages extended by all types of lenders, average downpayment ratios tended to fall by more than one-half. Lessening downpayment ratios have naturally been accompanied by the greater use of borrowed funds.

Further pressure for increased financing has come from the upward postwar trend in home prices. From 1947 through 1959, as portrayed by Charts 7 and 8, the prices of homes financed with newly-made mortgages rose by more than four-fifths. Lower equity downpayments and higher home prices have accordingly given rise to an increase in the average amount of borrowed savings used per credit transaction. But at the same time, maturities on newly-made home mortgages have lengthened. Charts 9 and 10 indicate that from 1947 through 1959 average maturities on Federally-underwritten mortgages lengthened by about 40 per cent. (No comparable data exist for conventional loans.) Accordingly, the rate of saving through amortization has been reduced, and a comparable reduction has occurred in the rate at which funds so derived have become available for relending.

The impact of a change in maturities upon the accumulated volume of saving through amortization is depicted by Chart 11. This chart is based on a loan at 5 per cent--an interest rate on home mortgages which may be taken as more or less typical of the postwar period. Whereas a 20-year mortgage would, of course, be amortized completely if held to maturity, a 30-year mortgage would only be half paid off at the end of 20 years. Within the first five years, the lender of a 20-year loan is repaid about \$165 in principal per \$1,000 loaned; on a 30-year loan, he receives only \$82, or one-half as much. A shortening of average maturities from 30 to 20 years would thus double the amount of amortization received.

As my friend, Dr. Winfield W. Riefler, formerly Assistant to the Chairman of the Federal Reserve Board, pointed out to you two years ago,



lengthening maturities have reduced the rate of saving through mortgage amortization.

This reduction in amortization rates takes on added significance because it occurred during the period when interest rates rose as the demand for funds outran the supply of them. The chart is all the more illuminating when one recalls that some lenders-- due to uncertainties over saving inflows and withdrawals--have recently limited their new mortgage commitments to the volume of anticipated amortization payments.

Among many other factors that are relevant to a complete explanation of the postwar mortgage situation, I shall mention only two. One is an apparent upward trend in the frequency of credit as against all-cash transactions. Another is the apparent trend toward a longer average time period during which mortgages remain outstanding. Both developments have tended to increase the pressures in mortgage markets, in addition to those discussed previously that have stemmed from increased maturities and from larger average amounts of credit extended per home mortgage transaction.

#### Saving and Federal Reserve Policies

The Federal Reserve has closely followed these and similar developments in mortgages and other types of financing. But, of course, the Board's statutory responsibility for monetary policy focusses upon the overall stability and growth of the general economy. The Board's task is to serve the nation as a whole and all of its citizens by helping to foster an economic climate that encourages the highest rate of saving feasible under prevailing economic conditions.

This task can be accomplished only through general price stability. Inflationary developments rob both Peter and Paul. They tend to direct a growing proportion of financial saving into shorter-term rather than longer-term uses, and into existing rather than new equities. As Dr. Riefler recently said: "Inflation is the enemy of growth, particularly when there is public expectation that the purchasing power of money will continue to decline . . . because it increases instability . . . because it fosters the misallocation of capital and impairs the quality of the managerial and investment decisions on which growth is based . . . because it distorts the saving-investment process and encourages overspeculation; and because it undermines the country's position in international trade."

There are some indications that inflation may have hit housing harder than many other types of consumer goods. Chart 12 indicates what our outlays might have been for residential construction if prices had not increased during the postwar period. Last year over \$15 billion of new private nonfarm residential construction, as measured in 1947 dollars, actually cost more than \$22 billion. Inflation has probably accounted for a substantial portion of the area between the current dollar and the constant dollar curves on the chart. The cumulative difference between construction outlays in current and constant dollars since 1947 is equivalent to about one year's worth of current financing requirements. Here higher prices have increased demands for greater saving without necessarily providing offsetting incentives to save the required additional amounts.

Major Inferences from the Charts Covering the 13-year Period, 1947-1959

In conclusion, I shall summarize some major inferences to be drawn from the charts covering the postwar period. These trends have affected both the rate of saving through home ownership and the demand for mortgage credit. Beyond that, they have doubtless influenced the output, costs, and profits of the construction industry, as well as the incomes of savers and lenders, and the expenditure patterns of consumers.

(1) Mortgage credit demands were heavy. Total mortgage financing varied from 36 to 59 per cent of all major types of long-term financing.

(2) Demands for greater home mortgage credit stemmed mainly from an increase in the average amount of credit used per mortgage.

Although the number of recorded home mortgages rose by 47 per cent, the average mortgage amount rose by 86 per cent, or by nearly twice as much.

(3) An increase in the average amount of credit used per home mortgage transaction reflected a decline in downpayment ratios and a rise in prices. Average downpayment ratios decreased by one-fifth on homes financed by conventional loans, and by more than one-half on most homes financed by FHA and VA loans. Average prices of mortgaged homes rose by more than four-fifths.

(4) While demands for home mortgage credit increased, the rate of saving through amortization decreased. Average maturities of FHA and VA home loans lengthened by nearly two-fifths. As a result, home mortgages closed in recent years are being amortized more slowly than before.

Let me add a final word. If society's ultimate goal is the well-being of its individual citizens, saving must be kept in tune with consumption. Consumption does not mean bread alone. It also includes housing, schools, hospitals, libraries and other attributes of a good life. What our country needs is to maintain a balance between consumption, and saving and investing. Only thus can we achieve a growing and healthy economy that can provide expanding employment opportunities and a rising scale of living. The perennial problem is to keep consuming, saving and investing in balance so that saving may truly be the mother of riches.

Chart 1

### LONG - TERM INTEREST RATES

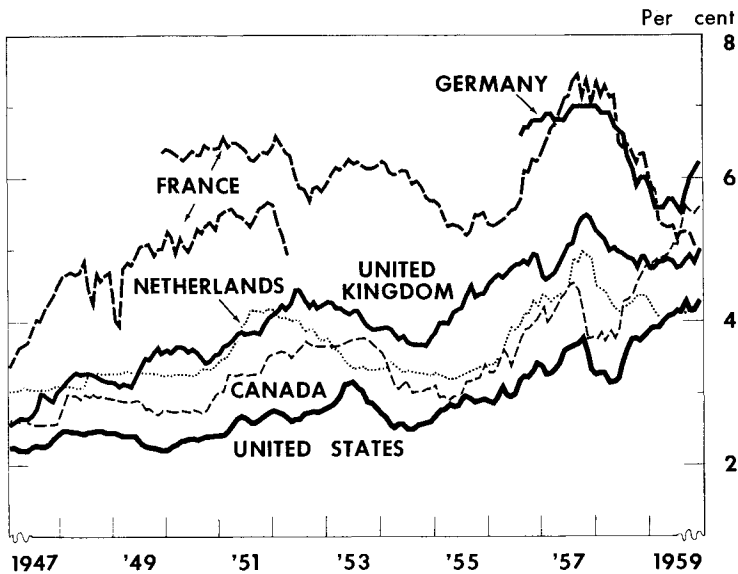


Chart 2

### MORTGAGE LOANS RECORDED

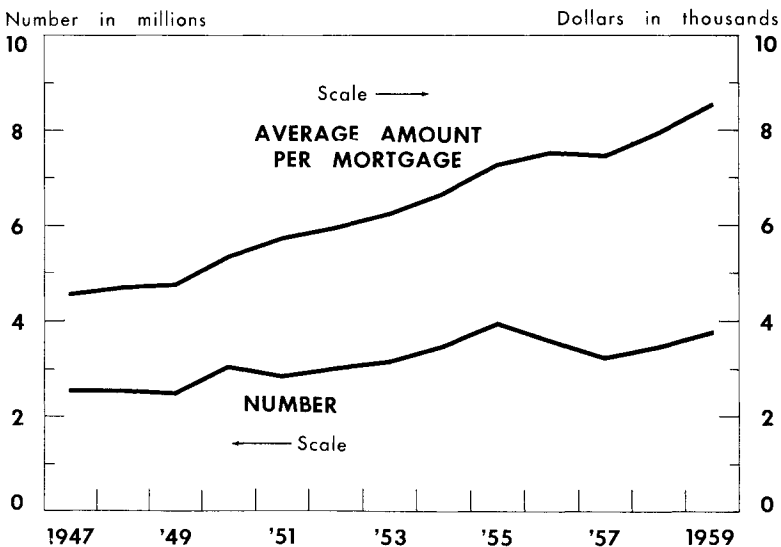


Chart 3

### MAJOR TYPES OF LONG-TERM FINANCING

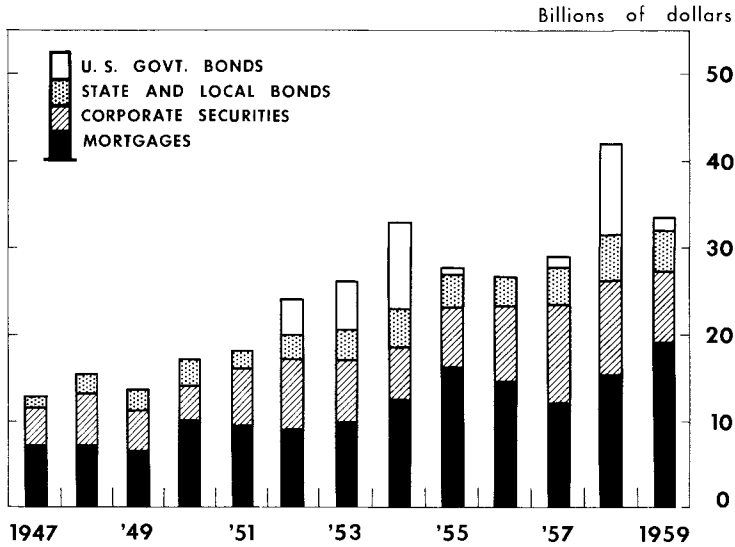


Chart 4

### MORTGAGES AS PER CENT OF LONG-TERM FINANCING

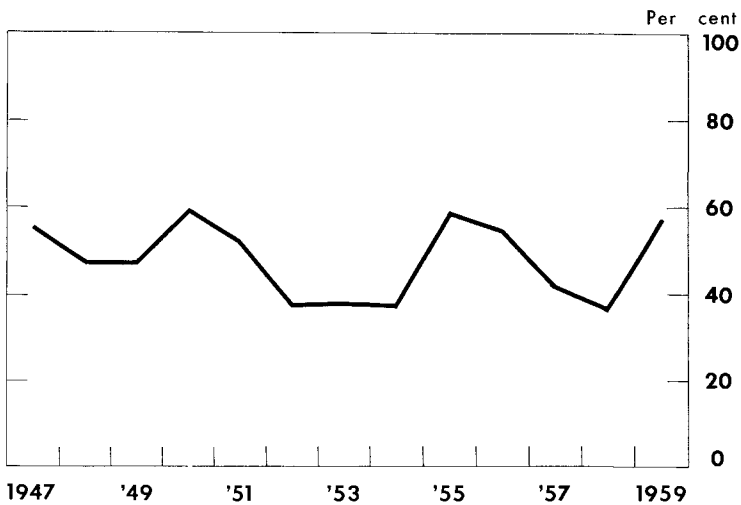


Chart 5

### AVERAGE DOWNPAYMENT RATIOS ON HOME MORTGAGES

Per cent of purchase price

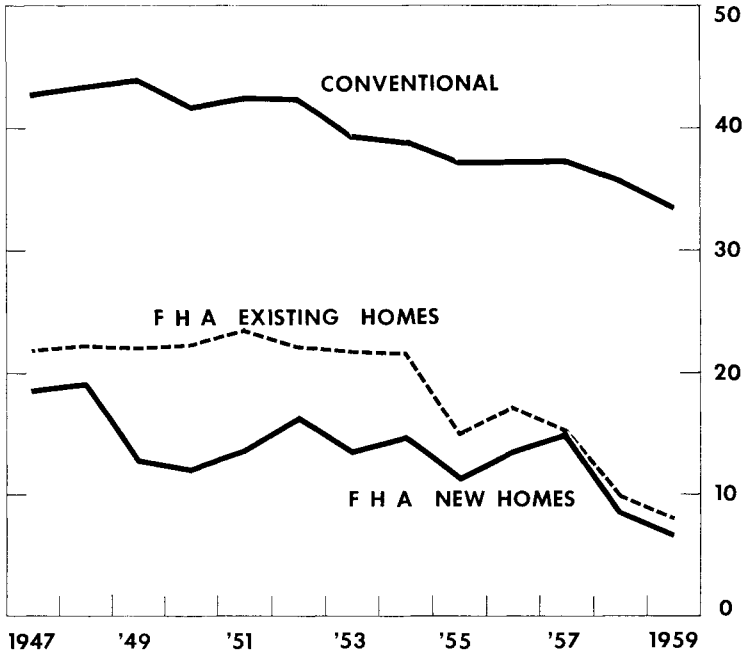


Chart 6

### AVERAGE DOWNPAYMENT RATIOS ON HOME MORTGAGES

Per cent of purchase price

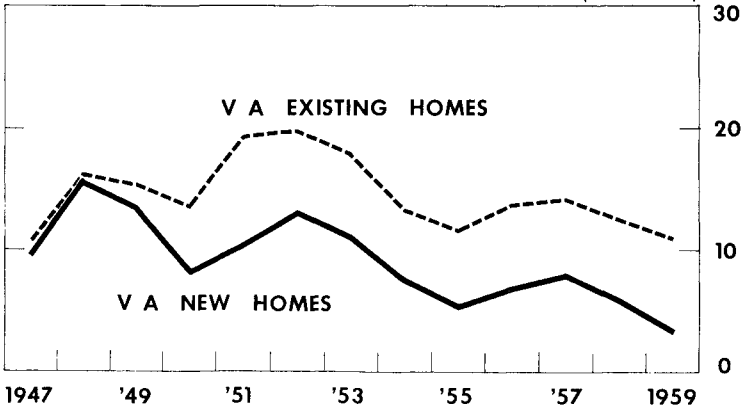


Chart 7

### AVERAGE PRICES OF MORTGAGED HOMES

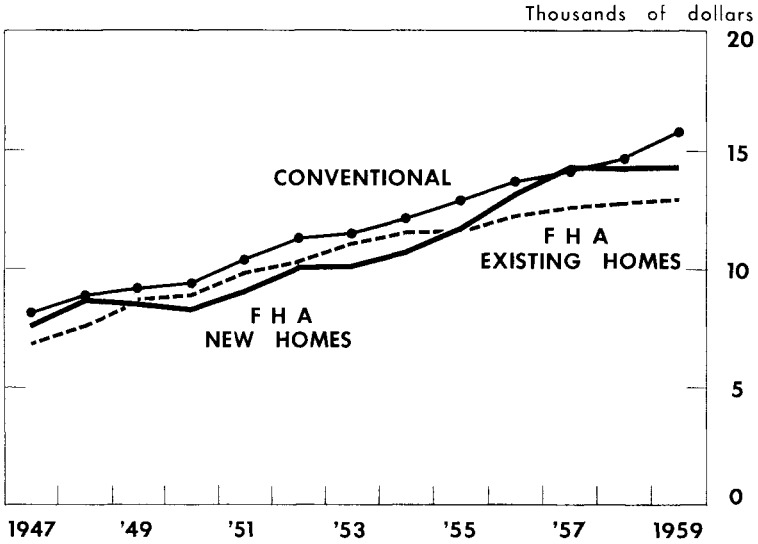


Chart 8

### AVERAGE PRICES OF MORTGAGED HOMES

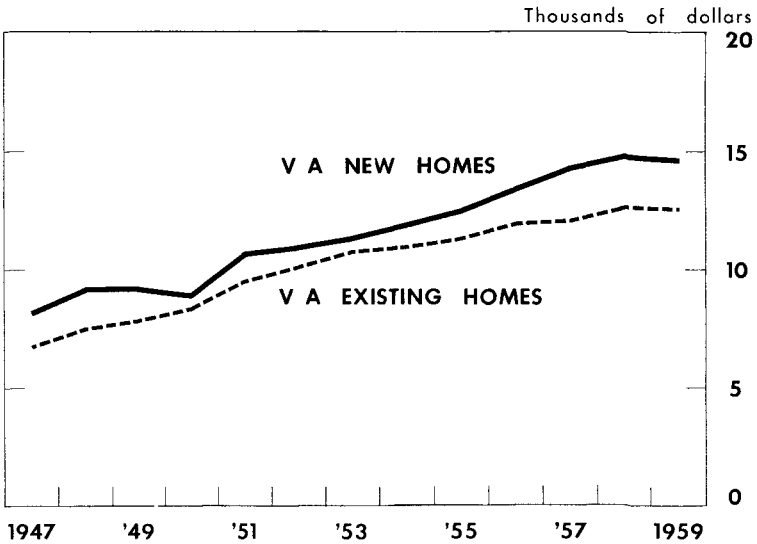




Chart 9

### AVERAGE MATURITIES OF HOME MORTGAGES

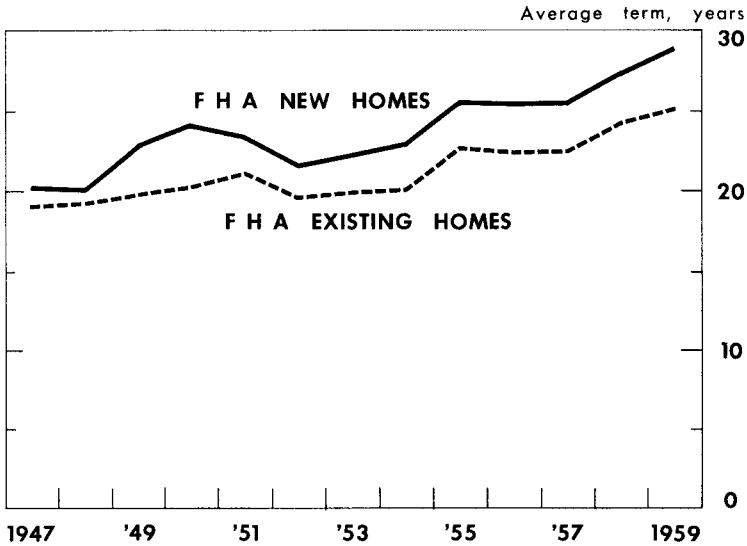


Chart 10

### AVERAGE MATURITIES OF HOME MORTGAGES

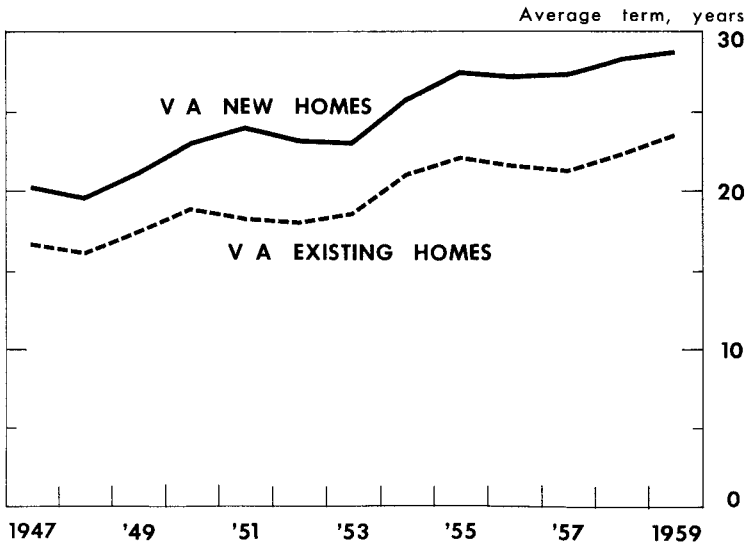


Chart 11

### CUMULATIVE AMORTIZATION FOR 5% LOAN

Dollars per \$1,000 loaned

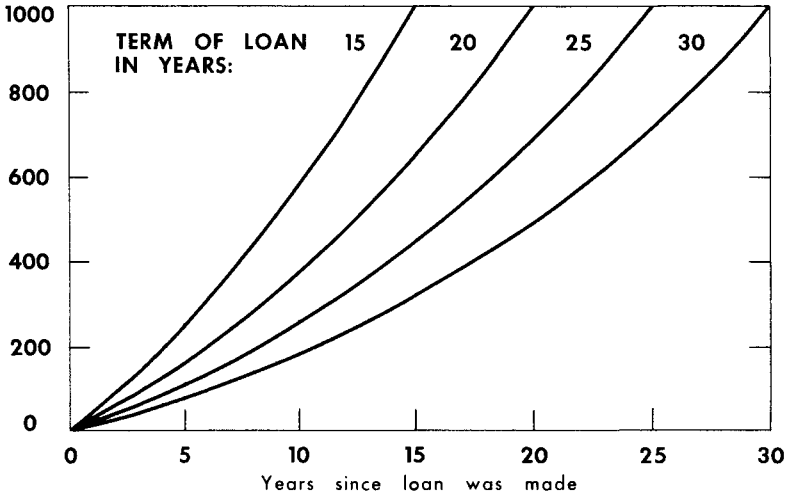
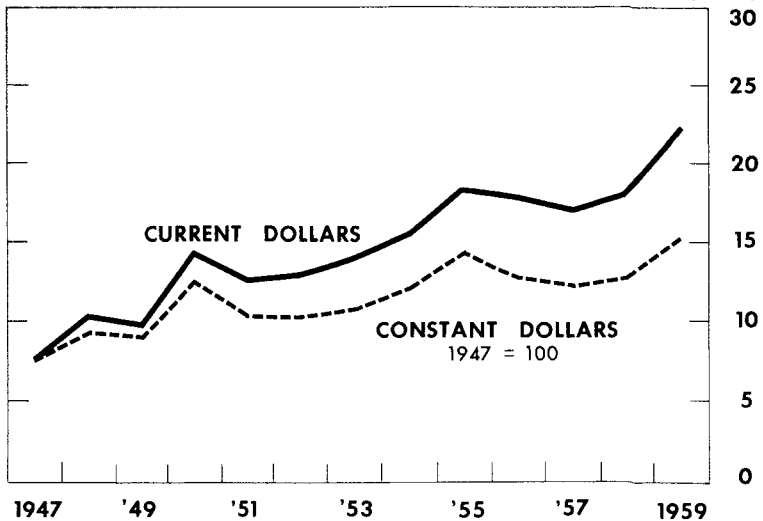


Chart 12

### PRIVATE RESIDENTIAL CONSTRUCTION PUT IN PLACE

Billions of dollars



April 22, 1960.

SOURCES OF CHART DATA

Chart 1: Long-term Interest Rates—Monthly data relate to average annual yields on long-term government bonds for all countries except Germany. For Germany, data are for yields on issues of public authorities and are not available prior to August 1956. Data from Federal Reserve Bulletin, International Financial Statistics, and monthly reports of the Deutsche Bundesbank.

Chart 2: Mortgage Loans Recorded—Annual data are Federal Home Loan Bank Board estimates for mortgages (or deeds of trust) of \$20,000 or less secured by nonfarm real estate, primarily 1- to 4-family properties.

Chart 3: Major Types of Long-term Financing—For U. S. Government bonds, data are from Treasury Bulletin and are for issues with original maturities of over five years, sold for cash or in exchange for obligations with original maturities of five years or less. Annual data for securities and mortgages represent net increases in amounts outstanding. For state and local bonds, data are for issues with original maturities exceeding one year. Corporate securities include, in addition to the increase in outstanding securities of domestic corporations, estimates of net foreign government and corporate securities sold in the United States. Data are Federal Reserve estimates based on flow of funds accounts published in Federal Reserve Bulletin, August 1959 and April 1960.

Chart 4: Mortgages as Per Cent of Long-term Financing—Calculated from same data as Chart 3.

Chart 5: Average Downpayment Ratios on Home Mortgages: Conventional and FHA-Insured—Conventional mortgage data, from Federal Home Loan Bank Board annual examination reports, relate to average downpayment-to-price ratios on first mortgage loans granted by FSLIC-insured institutions to finance purchases of 1-family houses (whether new or existing) during the 90-day period preceeding the date of examination. FHA data, from annual reports, relate to median ratios of downpayment-to-FHA-estimated-value for samples of mortgage transactions insured under Sec. 203(b) for new and for existing 1-family houses.

Chart 6: Average Downpayment Ratios on Home Mortgages: VA-Guaranteed—Annual average downpayment-to-price ratios on primary mortgage loans closed under Sec. 501 for purchases of new and of existing houses (nearly all in 1-family structures). Source is Veterans' Administration.

Charts 7 and 8: Average Prices of Mortgaged Homes—Conventional and VA data are for average purchase prices; FHA data, for median FHA estimates of property values (see notes for Charts 5 and 6).

Charts 9 and 10: Average Maturities of Home Mortgages--Sources same as for Charts 5 and 6.

Chart 11: Cumulative Amortization for 5% Loan--Curves depict amortization of direct reduction mortgage loans, with 5 per cent interest rates, calling for equal monthly payments over 15, 20, 25, and 30 year terms, respectively.

Chart 12: Private Residential Construction Put in Place--Estimates of the dollar amount of new private nonfarm residential construction put in place. Source is Bureau of the Census.

Charts and source explanation prepared by the Staff of the Board of Governors of the Federal Reserve System, Washington 25, D. C.