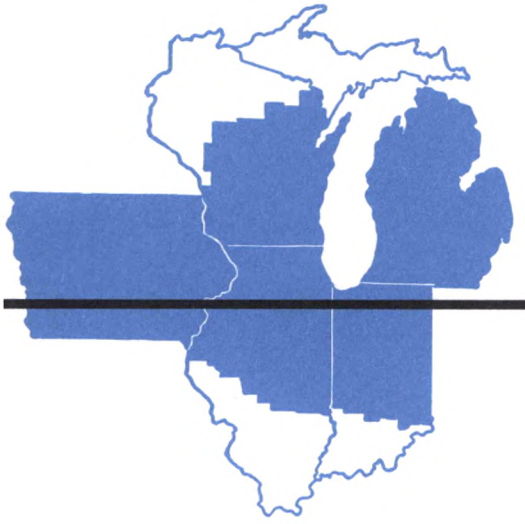
A review by the **Federal Reserve Bank of Chicago**

Business Conditions



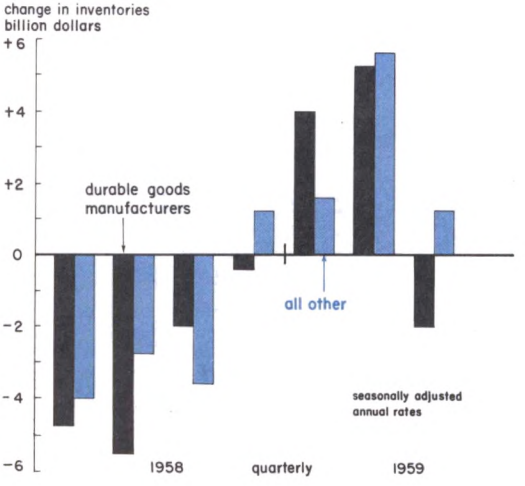
1959 December

Contents

THE Trend OF BUSINESS

Employment and production in most durable goods lines appears poised for a strong rise in the months ahead now that steel output has returned to near-capacity levels. The short-term outlook has brightened because of the speed with which the steel industry has re-achieved the rates of operation of the pre-strike months. Also, the problems involved in allocation of the first supplies and in obtaining sufficient rail and truck transport seem to have been somewhat less troublesome than had been anticipated. Nevertheless, it will take another month—even longer in the case of some users—for the flow of steel to proceed "normally." These prospects for the months ahead assume a settlement of the dispute during the 80-day injunction period.

Substantial inventory liquidation by durable goods producers since midyear



Earlier expectations in some quarters that the upswing, which began in the spring of 1958 and continued through mid-1959, would have lost momentum early in 1960 have been largely dissipated. The advance in activity had been propelled in the main by developments in three major sectors: a rise in residential housing activity, an increase in Federal Government expenditures and a shift from inventory liquidation to inventory accumulation, mainly in durable goods lines. At midyear, further increases in general activity were expected to depend more upon consumer spending and business outlays on plant and equipment which were giving promise of providing additional push.

Since midyear, spending by the Federal Government has leveled off, reflecting the stabilization of military spending and declines in recession-induced outlays for unemployment compensation and mortgage purchases. The surge in housing expenditures came to a halt at about the same time, in part because of reduced availability of credit. Even had there been no steel strike, the rise in business inventories probably would have slowed markedly.

Spending by the Federal Government in 1960 is indicated to continue at about the recent rate. Residential construction activity has declined from the levels of last spring and may decline further next year. The big

change since midyear is in the inventory sector. Here, the clock has been turned back by the steel strike.

In the first seven months of 1959, total business inventories, seasonally adjusted, had risen by 4.7 billion dollars—about 5.5 per cent. The lion's share, 3.9 billion, was accounted for by durable goods firms. In August and September, durable goods inventories dropped by 1.2 billion dollars. The decline probably continued in October and November, and possibly in December as well. By year end, a large portion of the inventory rise of the first seven months will have been wiped out. In many individual lines, both materials and finished goods will be at levels lower than those reached in the 1957-58 recession. Rebuilding will be necessary and this will strengthen demand.

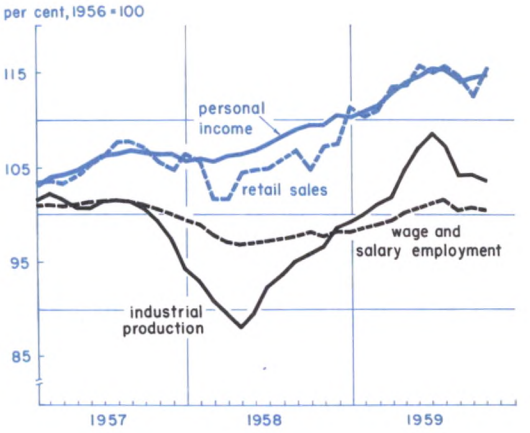
Autos the main loser

The major casualty among the steel users has been the automobile industry. It now appears that fourth-quarter production will total less than two-thirds as many cars as the 1.9 million originally scheduled. Truck production in November was less than 50,000 compared with 92,000 in October. Sales of cars and trucks had continued at a high level through October. It was obvious that production curtailments would soon be translated into lost or deferred sales.

Interestingly, the auto industry was thought to be one major steel user having "adequate" inventories to weather almost any length of strike which was likely to occur. This would have been true if the strike had not lasted more than two months—the longest previous work stoppage. However, a strike of three and one-half months has meant layoffs for over 200,000 auto workers.

Heavy construction, too, has been adversely affected by the steel strike. But in

Steel strike temporarily reverses uptrend in activity measures



this case, the impact on activity still lies largely in the future. Construction contract awards, tabulated by the F. W. Dodge Corporation, in the first seven months of 1959, exceeded the same months of 1958 by 11 per cent nationally. In August, September and October, there was a decline of 7 per cent. In part, this was because awards were especially high in these months last year, but the comparison is influenced strongly by awards for heavy engineering construction which were 30 per cent below last year in the August-October period. The Midwest experience has been very similar to the national totals. Contractors are reluctant to bid on jobs requiring definite prices and completion dates when the availability and cost of steel are highly uncertain.

Inflationary or deflationary?

Any strike has both inflationary and deflationary effects. The reduction in the supply of goods tends to force prices up. At the same time, the loss of income to the firms and individuals involved would, other things

being equal, tend to reduce demand and prices. In the present case, the dominant effect of the strike appears to be somewhat inflationary, on balance, even aside from the terms of any settlement which may result.

Exhaustion of user inventories of steel often results in costly substitutions in an attempt to maintain production. Manufacturing costs are increased also by the curtailed volume. But the most important impact comes through the reduction in the supply of goods available for sale. Although particular types of goods cease to be available, the effect is more subtle for the most part. As inventories decline, dealers are able to move merchandise at higher net markups, often in the form of lesser "discounts from list." It does not follow, of course, that dealers' total profits rise since total sales may be affected adversely. These results would be expected when strikes occur during a period characterized by rising demand and bouyant expectations.

Employment and unemployment

Through the month of October there was surprisingly little rise in unemployment compensation claims in Midwest centers. For the five states combined, the number of new claims was less than last year despite the fact that employment was rising in the fall of 1958. Moreover, many of the persons filing initial claims recently did not report back a second time to receive checks, indicating that they were able to obtain employment. As a result, there was little increase in the number of persons receiving unemployment compensation through October.

Seasonal influences have helped to mitigate the impact of the steel slowdown. October is typically the low month in the year for unemployment. But the major effects of the secondary layoffs were far more important in November than had been the case up to that time.

Abstracting from strike effects, the employment situation of Midwest cities as a group currently is stronger than that of the rest of the nation taken as a whole. In the early fall, the Department of Labor classified ten District cities as having less than 3 per cent unemployed, eleven as having between 3 and 6 per cent and only three as having more than 6 per cent. The latter group included Detroit, Flint and Terre Haute. In the spring of 1958, sixteen District centers had more than 6 per cent unemployed.

Business expands abroad

Economic activity in the major industrial nations abroad has shown a strong advance in 1959, following a slowing pace during late 1957 and 1958. This gain in activity has tended to boost demand for United States exports in recent months and, if it continues, could help to strengthen this country's trade balance. During the first nine months of 1959, United States merchandise exports, adjusted for seasonal movements, totaled 12 billion dollars, 600 million more than imports. About 400 million of that ex-

port surplus resulted from trade in the third quarter of the year.

Industrial production throughout Western Europe is now at a record high. During the second quarter of 1959, the latest period for which comprehensive data are available, output of factories and mines in Western Europe was 7 per cent above the low of the spring and summer of 1958. A recent report of the European Economic Community forecast that industrial production during the final three months of the year in its six member nations—France, West Germany, Italy, the Netherlands, Belgium and Luxemburg—will continue to register gains averaging about 7 per cent from the closing quarter of last year.

Britain has experienced a strong surge in activity in 1959. After rising gradually in the first quarter of the year, business picked up at an increasing pace. By midsummer, industrial production was 7 per cent above the corresponding period in 1958. In August, employment moved ahead of the year-ago level, and, by the end of the summer, the number of unfilled vacancies—a commonly used indicator of the employment situation in Great Britain—was 40 per cent greater than in the summer of 1958.

The rise in activity in Great Britain is largely the result of increased domestic spending by consumers and government, and higher exports. Consumer instalment credit controls were relaxed in 1958, and commercial banks have greatly increased loans to individuals for the purchase of consumer durables.

The experience in 1959 is in contrast to the 1955-57 boom. During the earlier period, business investment was a key factor in the rise in activity. Capital outlays by business firms in Great Britain during 1957 were 60 per cent above the 1954 level. Since 1957, the rate of increase of investment in plant and equipment has slowed, and capital spending this year is indicated to be only slightly above 1958. A Board of Trade survey of manufacturers' intentions had indicated a decline in such expenditures was in prospect for 1960. But the expansion in activity has brought an upward revision in plans by at least some firms.

Great Britain's holdings of gold and dollars in 1959 continued an increase which had been under way for almost two years. At the end of December 1957, British-owned gold and United States securities totaled 3.1 billion dollars. In June of this year, the aggregate had increased by a billion dollars.

In view of the improvement in gold and dollar holdings, Great Britain chose to make an advance repayment this fall of 250 million dollars in outstanding borrowing from the Export-Import Bank. The loan was originally scheduled to be repaid over a five-year period.

That country, in addition, has further relaxed restrictions on currency convertibility and controls on imports. In recent months, discriminatory import quotas were lifted on most United States industrial exports, including autos, trucks, machinery and industrial equipment, textiles and clothing, sports equipment and jewelry. However, imports of some of these items had been below amounts permitted by the quotas. Applicable tariffs have not been changed.

Western Germany is now in the midst of a full-scale boom, although the current rise in activity has been under way less than a year. In January, industrial output was about equal to early 1958. By August, however, output of factories and mines in Western Germany was 8 per cent above the year-earlier level.

In contrast to Great Britain, the steam behind the current rise is generated largely by construction, business outlays for new plants and equipment and additions to business inventories. The rise in investment reflects both a strong demand for new housing and the need to add new capacity and to modernize existing manufacturing facilities. The shortage of labor has become increasingly severe, intensified in part by the shortening of the normal work week to 45 hours.

With output approaching capacity in many lines, the German central bank, in early September, raised the discount rate from 2¾ to 3 per cent, the first increase in more than three years. Then, in late October, the rate was raised again, this time to 4 per cent. In addition, reserve requirements on commercial banks have been increased and the maximum amount that the commercial banks can borrow from the central bank has been reduced.

Prices in Western Germany have remained stable from early 1958 to August 1959, with the cost of living index showing a variation of less than 1 per cent. Rising prices for agricultural commodities caused the index to rise in September. Wage rates as measured by hourly earnings are about 5 per cent above the year-earlier level.

In *France,* the current expansion in business did not get under way until early 1959. Nevertheless, industrial output by midyear was setting new records. The increase in activity has been reflected in higher employment and reduced unemployment. The auto, steel and chemical industries have shown strong gains in output. Construction also has been proceeding at a vigorous pace.

Prices in France have increased somewhat over the past year. As of midsummer, consumer prices were about 4 per cent above the corresponding 1958 period. The rise, however, is less than might have been anticipated in view of the devaluation of the franc in December 1958. The effect of the 15 per cent devaluation, of course, was to reduce imports by making foreign products more expensive and, at the same time, to increase the foreign demand for French products by reducing prices to buyers in other countries. The devaluation, together with the modestness of the rise of domestic prices, has resulted in a dramatic shift in France's balance of trade. In October, exports exceeded imports by 97 million dollars, the ninth consecutive month showing an export surplus.

The improvement in France's trade balance has led to a rapid rise in gold and foreign exchange holdings. At the end of September, combined holdings totaled 1.9 billion dollars, compared with 1.0 billion 12 months earlier. As a result, France has taken steps to relax controls on foreign trade.

The Government deficit was substantially reduced in 1958 and 1959 and was financed without borrowing from the central bank. The budget presented to the legislature in October anticipates a deficit of less than 600 billion francs (1.2 billion dollars) and will be the third successive budget to be financed by a noninflationary means.

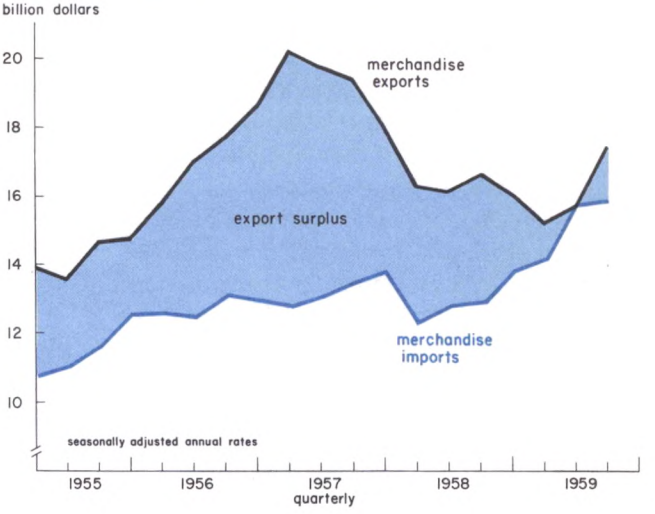
These recent developments in both foreign trade and domestic fiscal policy have helped promote increased confidence in France's future economic stability. The fact that, for the first time in ten years, a corporate bond issue was floated bearing a coupon rate as low as 5 per cent and with no clause tying the value of the obligation to changes in prices is one indication of this improved confidence.

Japan, an industrial nation on the other side of the world, is also experiencing an expansion in business activity. Industrial

production this summer was more than 25 per cent higher than the year-earlier level, and gross national product for the year ending March 1960 is officially estimated to show an 11 per cent rise. Employment this fall was 8 per cent above year earlier. Manufacturing output was at 80 per cent of capacity, compared with 68 per cent a year ago.

As in Great Britain, the expansion in output is largely the result of increased consumer demand and exports. This has been supplemented recently by increasing outlays for new plants and equipment, now estimated to show a rise of at least 7 per cent for the current fiscal year.

In the merchandise sector, export surplus reappears in third quarter, after imports matched exports in second quarter



The Japanese monetary authorities have recently taken action to restrain credit expansion and price increases. The Bank of Japan has been selling securities under re-purchase agreements to absorb liquidity in the economy. Stock margin requirements were raised and reserve requirements on commercial banks were increased somewhat.

Canada experienced a milder recession in 1957-58 than did the United States. Their recession seems to have had a "double bottom," however, with the seasonal and sustained pickup in industrial production not getting under way until September 1958. In December 1958, industrial production in Canada was 5 per cent above the low reached in December 1957 and rose another 5 per cent in the first half of this year.

The limited extent of the decline in activity has been attributed to extensive governmental assistance to residential construction. Housing starts in 1958 totaled 165 thousand, 35 per cent above the previous year and a record. In 1959, home construction has declined but personal consumption expenditures have increased. Expenditures by individuals in the first half of 1959 were 10 per cent above consumer expenditures in the first half of 1958.

In the third quarter, the pace of business growth in Canada slackened somewhat, due mainly to strikes and early auto changeovers. Thus, industrial production in July was almost 2 per cent below the April level. Production began to rise again in August, however, and it is generally believed that the third quarter easing represents only a pause in Canada's cyclical upswing. A recent survey indicates that winter unemployment will be smaller than usual this year. Recent optimistic forecasts of exports to Europe and the United States and indications of a pickup in private capital expenditures add to the

favorable outlook in Canada for 1960.

Since August and September, Canada's credit markets have taken on an easier tone. Rates on three-month Treasury bills dropped to 4.8 per cent in early November, a decline of 1.4 percentage points within three months. Yields on long-term Canadian Government obligations have also eased slightly. Bill rates in Canada are now only about one-half of 1 percentage point above those in the United States compared with a 3 percentage point gap in mid-August. The chartered banks have recently been important purchasers of Treasury bills in an attempt to build up their liquidity, and this has been a factor in the decline in yields in short-term securities.

United States exports stimulated?

Many observers had expected the rise in business activity abroad to provide some stimulus to United States exports. During the first half of the year, however, exports averaged 4 per cent below the first half of 1958 and more than 20 per cent under the peak rate in the first half of 1957 when a surge in overseas shipments was precipitated following the Suez crisis in late 1956.

This summer, total United States exports increased significantly for the first time since 1957. In the third quarter, exports were about 10 per cent above the second quarter, seasonally adjusted. Exports to Canada had been increasing since mid-1958, and this summer exports to Europe began to pick up. There were large increases in chemicals, textiles and automotive products. Also, machinery and aircraft exports began to rise this past summer, followed by a sharp increase in cotton in the fall. Orders for machine tools have increased sharply and in September were within 10 per cent of the four-year high set in July.

Experience in a brief period, of course, does not provide conclusive evidence that the long awaited rise in exports has begun. Yet, a continued surge in activity in the major industrial countries would almost certainly be accompanied by increased purchases of both raw materials and manufactured commodities from the United States. Recent evidence on this score is encouraging.

Further decline in farm income

Income in the agricultural sector of the economy has fluctuated in opposite directions from the rest of the economy the past two years. In 1958, net farm income *climbed* 19 per cent while national income showed a small decline. So far in 1959, net farm income has *declined* 15 per cent from last year, in contrast to vigorous growth in most other sectors and a rise of around 7 per cent in national income. The experience of the past two years should not lead to the conclusion that agriculture is inherently a contracyclical sector of the United States economy. The large increase in net farm income in 1958 resulted from a number of essentially fortuitous factors largely unrelated to the general business picture. Thus, in a sense, the decline in farm income in the

current year represents merely a return to the pre-1958 situation. But that doesn't explain the further decline now believed to be in prospect for 1960.

Most of the annual gyrations in net farm income in the past ten years or so can be traced to changes in production of farm commodities and the related effects on prices. Governmental price supports, of course, have played an important role, especially for a few commodities, in blunting these price effects.

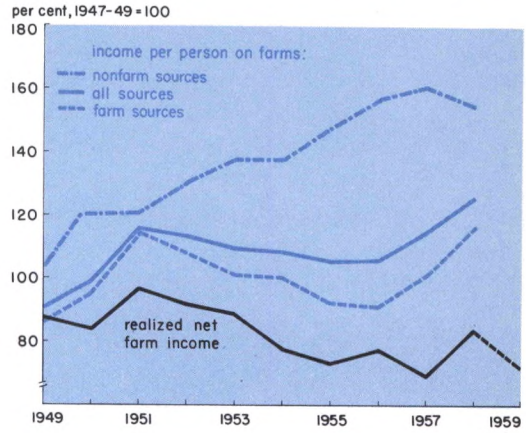
Demand and supply are always important in price changes, for both agricultural and nonagricultural commodities. But demand, taken by itself, for farm commodities has been strong most of the time since 1940. Consumer incomes have been generally high and rising. Population has increased rapidly. Except for short periods of mild recession, employment has been high. And exports of farm commodities since World War II have been at a high level, albeit with liberal Government assistance.

But much of the time since World War II, supplies of agricultural commodities have been so burdensome that prices have not responded to the very favorable basic demand situation. Farm output has grown faster than the market for farm commodities. The result has been a downward drift in agricultural prices and farm income, indicating that too many resources are engaged in agriculture. It is within this general setting that the experience in 1959 and the prospects for 1960 must be assessed.

1959 in review

Prices received by farmers in 1959 have averaged 3½ per cent below a year earlier, as the physical volume of farm marketings slightly exceeded last year's record. Substantially lower prices for hogs, poultry and eggs

Declining farm population, rising income from nonfarm sources maintain income per person on farms



have been largely responsible. Lower farm prices, combined with higher production costs and a substantial reduction in soil bank payments following elimination of the acreage reserve program, have been the major cause of the decline in net farm income in the current year.

Income from livestock has been in the forefront of the decline. Hog production expanded cyclically through the year, and prices were more than one-fourth below last year's levels. Production of eggs and poultry increased further in 1959 from the high levels of the previous year. As a result, prices of these commodities declined in the spring to the lowest figures since prewar.

Prices received for all livestock and products through September averaged 5 per cent lower than in the corresponding period in 1958; the volume of marketings showed a small increase and cash receipts from these commodities were off about 4 per cent.

Income from sales of crops also shows some decline. Crop production in 1959

matched last year's record and would have been higher except for a substantial reduction in wheat production due to unfavorable weather and the wheat mosaic disease. The decline in wheat production in the Great Plains regions was largely offset by increases in cotton production in the South and Southwest. Declines in production of oats, barley and grain sorghums in the Corn Belt were more than offset by increased production of corn. Winter fruit and vegetable production was above the reduced supply last year when severe weather in the winter damaged these crops.

The large production of crops in 1959 has been due primarily to more acres under cultivation. The index of crop yields per acre is about 6 per cent below last year's record. But this has been offset by an increase in total acreage of crops, with the end of the acreage reserve program and shifts to high-yielding crops such as corn. Farmers' cash receipts from crop marketings and CCC loans on crops in the first nine months of 1959 were the same as in the corresponding period in 1958. However, Government payments to farmers declined about 500 million dollars—largely the result of termination of the acreage reserve program in the soil bank—and cash receipts from marketings of livestock and products declined more than 500 million dollars.

In the Seventh Federal Reserve District, cash receipts from farm marketings for the first nine months have declined in all states. Receipts were down 1 per cent from last year in Michigan and 4 per cent in Wisconsin. Farm prices of milk and butterfat have risen slightly, while production in these states has shown a small decline. Cash receipts from farm marketings in Iowa and Indiana have been 6 per cent below last year and in Illinois 2 per cent below. The large volume of hog marketings has partially offset price declines on hogs. Larger numbers of cattle being fattened on Corn Belt farms and higher average prices for fat cattle have boosted cash receipts from that source and maintained total cash receipts from livestock close to last year's level in these states. However, net income from livestock has been cut because of low hog prices and higher prices paid last fall for feeder cattle which were marketed as fat cattle in 1959.

Prospects: 1960

The outlook next year, as appraised by the United States Department of Agriculture, is for farm prices and income to hold about at the levels of the third quarter and to average somewhat lower than 1959 as a whole. With prices of both livestock and crops expected to average somewhat lower and with some increase in costs of production, net farm income would decline perhaps 7 to 8 per cent. This decline would be half as much as this year and would reduce farm income to its lowest level since 1942.

Hog marketings are expected to continue their cyclical increase through the first half of 1960, though the second half may mark the end to the current uptrend. Hog prices would be expected to remain fairly close to the level in recent months and to average below 1959.

Larger marketings of cattle are expected as a result of the increased number placed on feed and anticipated larger marketings of cattle and calves off farms and ranches. However, at this stage of the cattle cycle, any changes in marketings and prices would be moderate, barring severe drought in the important grazing areas. Prices of dairy products may be somewhat higher during 1960, and poultry and egg prices are expected to improve the first half of next year

from the depressed 1959 levels.

Slightly lower prices for crops are expected in the coming year in response to small downward adjustments in price supports authorized under the present legislation. Thus, income from crops would depend largely on the influence of weather and technology on yields per acre and, hence, on total output. With "normal" weather, some declines in yields and production would be expected.

For the Midwest, a decline in farm income similar to that projected for the nation as a whole is indicated. However, the decline in the dairy areas may be somewhat smaller, and the decline in the livestock areas somewhat larger, than the average for the United States as a whole. In view of the large feed supplies on hand and in prospect, livestock production and, therefore, prices and income, may be under pressure for some time to come.

Farmers' purchases

Farmers' purchases of farm machinery and equipment, building materials, fertilizer and farm supplies increased during 1959 both in response to the rise in farm income in 1958 and to the increase in acreage planted this year.

In the postwar period, purchases of farm equipment and supplies have typically responded to farm income levels of the preceding year, so declines in sales to farmers would be expected in the coming year. However, there are several factors which may keep the reduction smaller than would be indicated by the size of the income drop this year: first, the continuing shift of agricultural output to the larger and more specialized farms will tend to create demand for additional machinery, equipment and other production inputs; second, the larger current stock of machinery and equipment on farms may create greater replacement demand; and, third, depreciation charges, which are deducted in arriving at estimates of net farm income but which represent funds available for machinery purchases or other uses will be higher. Nevertheless, purchases of farm machinery and supplies in the coming year appear to be headed for a contracyclical decline similar to farm income.

Government financial aid plays big role in private housing

The silver anniversary of the Federal Housing Administration which occurred earlier this year and passage of the same milestone two years before by the Federal Home Loan Bank System were reminders that financial participation by the Government in the construction and sale of private housing is by no means a new feature of the economic landscape. Government's role, moreover, has assumed major dimensions.

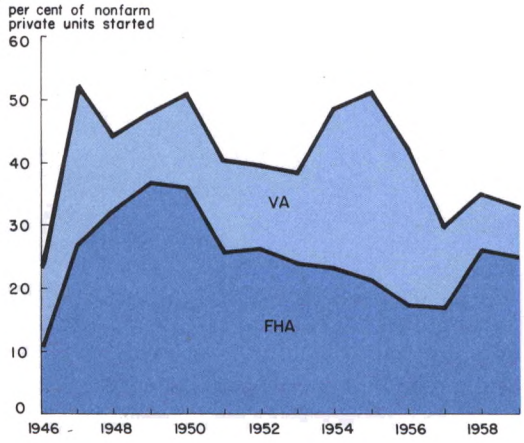
Of the 15 million or so new, privately owned, nonfarm dwelling units built since the war, more than 6 million, or 40 per cent, have been financed by mortgage loans underwritten by Federal agencies.

The past three decades have seen the emergence of a sizable number of new Federal institutions and programs directly concerned with housing. Some of these, born during the collapse of the Thirties or in the course of the war, have since disappeared from the scene. The Home Owners' Loan Corporation was organized in 1933 to refinance delinquent home mortgages. HOLC's lending authority, 4.75 billion dollars at its peak, expired in 1936, but it was not until 1951 that the agency was liquidated. Limitation of housing rentals, launched in wartime as part of the program of price control administered by OPA, lasted until about a decade ago, or well beyond the end of hostilities, but the scope of regulation had been progressively restricted during the postwar stages. Surviving to the present, and by now well-established participants in the financing of private housing, are a series of programs which fall into two broad categories:

—two institutions (the Federal Home Loan Bank System and the Federal National Mortgage Association or "Fanny May") which are designed to facilitate the flow of credit into private housing and, in the case of Fanny May, in some instances to provide the funds directly;

—Federally sponsored insurance (provided by the Federal Housing Administration and the Veterans Administration) of mortgage loans on residential real estate.

FHA-VA financing a major but widely varying factor in postwar home building; VA starts decline sharply since 1955 peak



Credit for home lenders

The *Home Loan Bank System* was established in 1932, well after the onset of the great depression and the demoralization of the real estate market that was an important feature of that period. Support for the creation of such an institution had been gathering strength during the decade of the Twenties. Thus, while the date of the system's establishment suggests that the objective was to extend emergency aid to home financing, it is possible that the depression simply brought to a head a growing realization that institutions in the field of home lending had need for a means of providing additional liquidity to individual institutions.

The Home Loan Bank System, patterned somewhat after the older Federal Reserve System, was designed to provide pools of credit which could be drawn upon by institutions engaged in mortgage lending. In practice, savings and loan associations have made up almost the entire membership of the system, although certain other classes of savings institutions also are eligible to be-

long to it. Any member association confronted by unexpectedly large withdrawals of share account balances may borrow from its Home Loan Bank as an alternative to curtailing mortgage loans or disposing of other assets. The system has at its disposal the balances that member associations keep on deposit with the eleven regional Home Loan Banks, plus the proceeds of stock sales to the member associations, and these sources of funds are augmented as needed by borrowing in the open market. At the end of last year, total resources of the Home Loan Bank System were about 3 billion dollars. Member association borrowings stood at 1.3 billion dollars. The active demand for mortgage funds during the past season has been reflected in a substantial rise in loans to members. The total was more than 1.8 billion dollars at the end of September.

More than half the home mortgage holdings of mutual savings banks and life insurance companies underwritten by FHA and VA

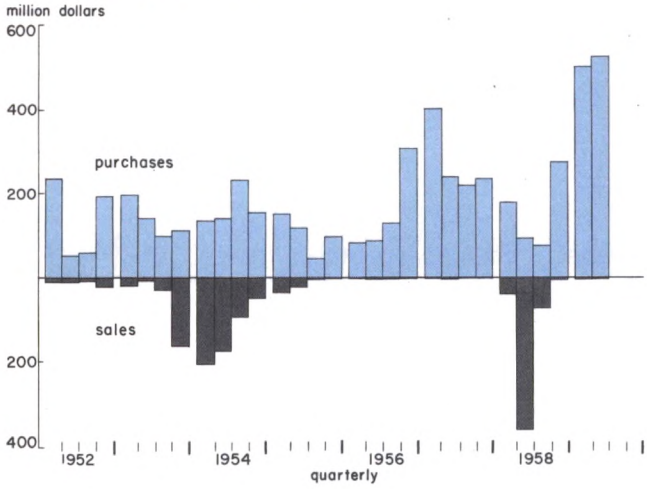
	Total Dec. 31, 1958 (billion dollars)	Government-underwritten: Total (per cent)	Government-underwritten: FHA (per cent)	Government-underwritten: VA (per cent)	Conventional (per cent)
Total outstanding	**130.7**	**40**	**17**	**23**	**60**
Financial institutions	**108.2**	**42**	**18**	**24**	**58**
Savings and loan associations	42.6	21	5	16	79
Life insurance companies	26.1	52	24	28	48
Commercial banks	18.6	47	29	18	53
Mutual savings banks	20.9	66	26	40	34
All other	**22.5**	**29**	**11**	**18**	**71**
Government agencies	4.8	96	29	67	4
Individuals and other	17.7	12	6	6	88

Underwriting private credit

Under the Federal Housing Administration and Veterans Administration plans, borrowers meeting certain standards as to income, veteran status and the like may secure insurance or guarantee of their mortgage borrowings, provided the contracts and collateral comply with prescribed standards. FHA charges insured borrowers a premium of ½ of 1 per cent of principal outstanding. No such charge is made by VA, and the cost of its guarantee program is met out of general tax funds. Both plans provide means of pooling risks and shifting some of the contingent liability involved in mortgage lending from private investors to Government instrumentalities. The pooling of risk has tended to lessen the cost to eligible borrowers of obtaining mortgage loans of given amounts and maturities, to broaden the market for mortgage loans and to stimulate the flow of funds into private housing (see accompanying chart and table).

Total liability of the Federal Government under the FHA and VA home loan insurance and guarantee plans currently is in excess of 50 billion dollars. This is the amount of insurance in force and represents a contingent liability. It is not a measure of the "cost" of the two programs. Costs—defrayed out of premiums in the case of FHA

FNMA in recent years a big supplier of mortgage money . . .

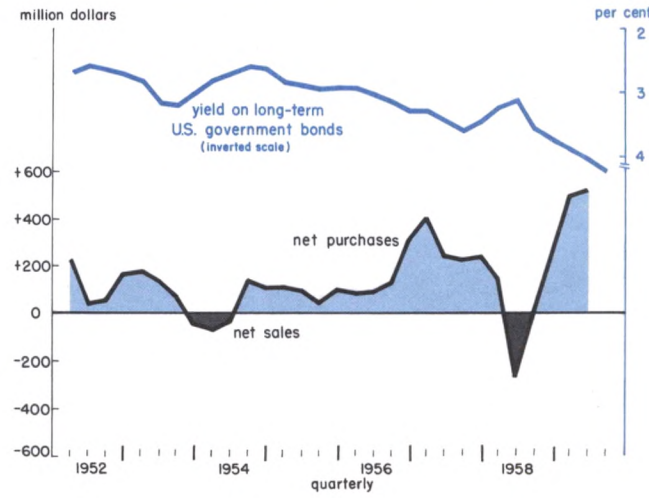


—consist of administrative expense plus claims paid, after allowance for recoveries.

The two Federal programs have been important contributors to the rise of a national market for mortgages. Inherently, lending to home builders and buyers is a highly individualized process, owing to the wide variations in both borrowers' creditworthiness and their loan collateral. A lender has a strong incentive to make his own estimate of the borrower's qualifications and his own appraisal of the property securing the loan. Often he will feel obliged to maintain close contact with the borrower and the property during the term of the loan. Home lenders' activities in earlier years tended to be confined within a limited geographic area. But with Government backing, mortgage loans have assumed a measure of uniformity or homogeneity, reflecting the minimum standards prerequisite to acceptance for insurance or guarantee. With reduced risk of capital loss, moreover, lenders increasingly place funds in loans secured by property and negotiated by borrowers far beyond their direct purview. Large mutual savings banks located principally in New England and the Atlantic Seaboard states have come to be important investors in FHA and VA mortgage funds throughout the country. Similarly, the major life insurance companies with headquarters in the East are active in mortgage markets as far removed from the home office as Southern California.

The life insurance companies, moreover, are generally free to invest in out-of-state

. . . net buying heaviest at times of declining prices of long-term investments



conventional mortgages as well as the Government-underwritten varieties and do so on a substantial scale. Local and regional mortgage company correspondents and, in some cases, field offices of the companies themselves originate and service these loans, as they do the FHA's and VA's. The vigorous postwar growth of mortgage companies, therefore, has also helped to create a national market in mortgages. These firms provide a service which makes it possible for investors to deal with borrowers over great distances. The tendency towards standardization of lending practices and terms in conventional lending has also broadened the market for the nonguaranteed and noninsured home mortgages.

The reduction of barriers to the flow of mortgage funds has opened the way to sizable, continuing shifts of funds from savings "surplus" areas, like New England, into "deficit" communities on the West Coast and in parts of the South and appears to have lessened regional differentials in the cost of housing credit. Differences in mortgage rates still remain substantial, however, and there appears to be some tendency for them to widen in times of especially vigorous demand for long-term funds. During the week ended September 11, for example, prevailing rates on conventional home loans were reported by *House and Home* magazine as 5¼ per cent in the Boston market, 5¾ to 6 per cent in the Chicago area and 6 to 7.2 per cent in San Francisco. Minimum down payment, 30-year, FHA, 5¼ per cent loans were quoted at par to 1 point above in Boston, at 4 to 4½ points below par in Chicago and 6½ points under par on the West Coast.

In areas undergoing rapid development, the demand for funds for investment in mortgages characteristically exceeds the supply of savings provided locally. Importation of capital becomes an indispensable requisite to sustained development. The ability to export capital to deficit areas may be advantageous from the standpoint of lenders as well, inasmuch as it permits them to seek out higher yields than those obtainable in local markets.

FNMA—a wholesale market

The *Federal National Mortgage Association,* newly chartered in 1954 but initially established by a transfer of funds from the Reconstruction Finance Corporation in 1938, performs a trio of functions. One of these is the gradual liquidation of a portfolio of home mortgages on hand at the time of rechartering. Liquidation is effected by sale in the market and, of course, the gradual repayment of outstanding loans. Fanny May's other two duties fall under the headings of its special assistance and secondary market programs.

The special assistance program is designed to provide funds for investment in Government-underwritten mortgage loans on particular types of property, e.g., urban renewal projects, housing for elderly persons, disaster area housing and low- and moderate-priced veterans' homes, which otherwise might not attract the desired amounts of funds.

The secondary market operation was established to enhance the liquidity of FHA and VA mortgage loans in the hands of private investors. Under this program, the agency buys and sells Government-underwritten loans at prices which are intended to permit operation on a self-sustaining basis. Capital was provided initially by the Treasury, which to date has purchased 143 million dollars in preferred stock in the association. This capital, together with any ad-

ditional funds that may be furnished by the Treasury under an outstanding authorization to purchase a further 65 million dollars in preferred, is slated to be repaid out of the proceeds of interest earnings and pro rata sales of common stock to those firms from which mortgages are acquired. In the meantime, the Treasury is paid a service fee on its investment in the form of dividends on the preferred. Additional capital has been provided by the sale of debentures in the open market; at mid-1959, liability of the secondary market program on this account came to roughly 1.3 billion dollars.

Transactions are confined to FHA and VA loans. Purchases and sales prices are tailored to prevailing market conditions in order to keep within the Congressional ceiling on its portfolio holdings, to prevent excessive use of the association's facilities and to make the operations self-supporting. Mortgage holdings of FNMA under all three of its programs came to 4.8 billion dollars on June 30, 1959, with a third of the total accounted for by the secondary market program.

Federal policy objectives varied

The immensely involved network of Federal programs and agencies dealing with housing finance—and the present account necessarily refers to only the major ones—has taken shape gradually and often experimentally. The motivations to Federal action have been numerous and have reflected widely varying shades of opinion.

Historically, popular sentiment and public policy have favored wide diffusion of property ownership. In the housing field, this often has meant a bias in favor of home ownership as against tenancy and a concern for the ability of low- and moderate-income families to own their homes. The FHA and VA mortgage programs give expression to this point of view in their primary focus on single-family home financing and, within this category, on units of moderate value. Still, both programs, and particularly FHA, are broad enough to provide Federal participation in the financing of rental dwellings. This public policy recognizes that to some families owner-occupancy of housing is an expensive and inconvenient alternative to tenancy.

The Home Loan Bank System and Fanny May's secondary market operations function essentially as lubricants of the private home lending market. Although both agencies were set up initially by the Federal Government and remain Federal instrumentalities, and Fanny May continues to utilize Government capital, both are designed to be self-supporting adjuncts to the private lending institutions serving the housing market.

FNMA's special assistance program, of course, is something else. This is a direct source of financing tailored to needs in specific segments of the market. The funds applied are repayable loans, but the presumption is that the borrowers accommodated would not otherwise be served, at least on terms comparable to those on which the Federal National Mortgage Association makes its credit available.

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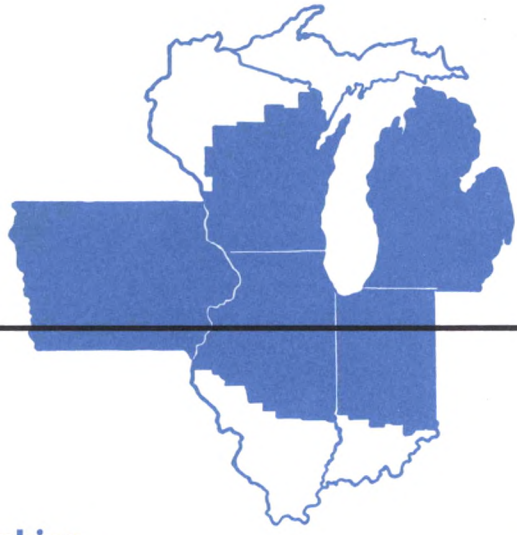

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