

Research Department Federal Reserve Bank of San Francisco

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Housing Fears

According to most of the forecasts made last fall, housing starts in 1974 were expected to reach about 1.7 million units—roughly 15 percent below the 1973 figure and 25 percent below the 1972 peak. Most scenarios envisioned a trough in the first half of the year, followed by a second-half pickup in response to an improved flow of savings into mortgage-lending institutions. Along with autos, housing was expected to contribute substantially to a general business recovery as the year progressed.

But today, even this relatively modest forecast seems less certain than before. Money again appears to be flowing out of, rather than into, the mortgage institutions, because of the attractiveness to savers of the high rates now available on money-market instruments. This development could cause problems to the housing industry several quarters from now, given the usual lag between flows of funds at thrift institutions and new construction activity.

Prospective homebuyers thus may face a renewed shortage of mortgage funds, at the same time that they are forced to contend with the soaring cost of new housing. (Mortgage borrowing costs, which had dipped to 8 percent or so earlier in the year, topped 9 percent in late April and approached the highs reached in last summer's upsurge.) Supporting the market, however, is a fairly strong level of basic demand,

as well as a buy-now pay-later attitude generated by present inflationary expectations.

Early hopes

First-quarter statistics seemed to bear out the earlier forecast. Housing starts were on target (or better) at about a 1.6-million unit annual rate, thanks mostly to February's high level of activity, which reflected a combination of unusually mild construction weather and inadequate seasonal adjustment factors. Meanwhile, residential spending in the GNP accounts fell off by about 8 percent from the preceding quarter.

Hopes for an upturn later in 1974 were buoyed by an improved flow of savings funds into mortgage-lending institutions during the early months of the year, which would normally be translated into a rise in housing starts during the summer and fall. Thrift institutions and large commercial banks pulled in some \$14 billion in consumer savings during the January-March period—substantially more than in the preceding quarter. The renewed flow of savings contributed to some reduction in mortgage borrowing costs and a modest gain in home sales and permit activity, while the amount of work in the construction pipeline remained relatively high.

Present fears

But then the sharp turnaround in financial markets darkened the hopes for an early housing recovery.

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The upsurge in interest rates triggered renewed outflows of funds from depository institutions in April, as many savers placed their funds in higher-yielding instruments such as Treasury bills. To help stem the outflow, the thrifts raised their offering rates to savers, in many cases returning to the 7½ per cent ceiling rate on longer-term certificates. But even this rate was considerably below the 8¾-percent interest coupon which the Treasury offered in early May on \$3.7 billion of new notes.

The outlook for further disintermediation will depend in part on the spending and saving habits of the American consumer. The saving rate dropped from 7.3 percent to 6.5 percent of disposable income between fourth-quarter 1973 and first-quarter 1974, as consumers adjusted their budgets to cope with the sharply rising prices of necessities (food and fuel) and sharply rising social-security tax deductions. Perhaps more significantly, the saving rate early this year was close to the relatively low level maintained throughout most of heavy-spending 1972-73, but far below the level reached during the sluggish, heavy-saving period of 1970-71.

It's anybody's guess how spending and saving decisions will be influenced by rising prices, rising debt burdens, and lowered real incomes. But even if consumers should turn cautious and raise their level of saving, they may still tend in this

inflationary atmosphere to channel their funds into high-yielding market instruments (such as Treasury bills) rather than into relatively low-yielding deposit instruments at thrift institutions—which is just what recent statistics indicate. Such a decision, if adhered to throughout the year, would sharply reduce the availability of new mortgage money.

Rising costs

The impact of inflation can also be seen in housing costs. The median price of new single-family housing reached \$34,500 during the first quarter—some 14 percent above the year-ago level—in response to rising costs of land, labor and materials. Lumber prices have moved back toward their earlier peaks following a late-1973 decline, and the long-term trend is upward because of lagging reforestation programs and other factors. Land costs seem bound to rise because of continued population growth, while large wage increases are likely to occur in the construction industry following the termination of the controls program. (These increases would only continue an earlier uptrend; both land and labor costs have risen more than 50 percent over the past six years.) Rising home-ownership costs are also a problem; costs of taxes, insurance, utilities and other such items have risen 13 percent over the past year, or twice as fast as rental costs.

Somewhat paradoxically, these figures could support the case for a relatively high level of housing

activity this year, since the arithmetic might persuade househunters to buy now rather than later. In addition, demographics provide an important underpinning for housing demand. The marriage rate has been strong recently because of the increase in the marriageable-age population, and "single" households have increased because of the rising proportion of both young and older people who maintain separate households.

More intervention?

Nonetheless, the inflation-generated turnaround in the money and capital markets now threatens to upset the projected turnaround in the housing industry. In this situation, we may witness renewed intervention on the part of the housing agencies—although if last year is any criterion, this could have the side effect of increased pressure on securities markets. In 1973, the Federal National Mortgage Association, the Federal Home Loan Banks and other agencies raised a record \$12 billion in those markets to finance their secondary-market and other mortgage-support operations.

The original scenario for 1974 envisioned a sharply reduced intervention; in fact, the agencies made net repayments of about \$800 million on their outstanding debt during the first quarter of this year. In addition, the Home Loan Bank Board raised S&L liquidity requirements in response to improved savings inflows—but it was then forced to rescind this move in April when the thrifts

began to experience outflows of funds. The same agency went to market this week to raise \$2 billion with which to replenish the coffers of mortgage-lending institutions.

In the same changed atmosphere, Housing Secretary Lynn raised the ceiling rate of FHA and VA loans to 8½ percent to forestall deepening discounts, which could otherwise raise sale prices as sellers forced buyers to cover the amount of the discount. In another support move, the Government National Mortgage Association reaffirmed its intention to purchase mortgages on as many as 200,000 newly constructed homes at the below-market rate of 7¾ percent.

Meanwhile, the housing legislation introduced into Congress last fall remains bogged down, partly due to disputes over the Administration's moratorium on certain subsidized housing programs. If enacted, the legislation would raise the ceiling on FHA mortgages and reduce downpayment requirements for such loans, would raise the single-loan limit for Federally-chartered S&L's, and would sharply increase deposit insurance coverage. These measures would afford some relief to homebuilders and lenders, but they are purely compensatory; they are designed to offset some of the inflation which has already taken place, but they are not directed at the fundamental problem of inflation itself.

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BANKING DATA—TWELFTH FEDERAL RESERVE DISTRICT

(Dollar amounts in millions)

Selected Assets and Liabilities Large Commercial Banks	Amount Outstanding 4/24/74	Change from 4/17/74	Change from year ago	
			Dollar	Percent
Loan gross adjusted and investments*	82,405	-115	+8,539	+ 11.56
Loans gross adjusted—	63,533	+ 79	+7,588	+ 13.56
Securities loans	1,046	- 28	- 958	- 47.80
Commercial and industrial	23,155	+ 58	+3,000	+ 14.88
Real estate	18,896	+ 18	+3,015	+ 18.98
Consumer instalment	9,189	+ 18	+ 959	+ 11.65
U.S. Treasury securities	5,766	-200	- 612	- 9.60
Other Securities	13,106	+ 6	+1,563	+ 13.54
Deposits (less cash items)—total*	78,263	-328	+7,382	+ 10.41
Demand deposits adjusted	22,002	-853	+1,503	+ 7.33
U.S. Government deposits	664	- 18	- 591	- 47.09
Time deposits—total*	54,446	+836	+6,493	+ 13.54
Savings	17,916	- 38	- 176	- 0.97
Other time I.P.C.	26,391	+689	+6,913	+ 35.49
State and political subdivisions (Large negotiable CD's)	7,423 13,535	+149 +636	- 419 +4,889	- 5.34 + 56.55
Weekly Averages of Daily Figures	Week ended 4/24/74	Week ended 4/17/74	Comparable year-ago period	
Member Bank Reserve Position				
Excess Reserves	45	70		158
Borrowings	379	49		46
Net free (+) / Net borrowed (-)	- 334	+ 21		+ 112
Federal Funds—Seven Large Banks				
Interbank Federal funds transactions				
Net purchases (+) / Net sales (-)	+2,152	+2,243		+1,229
Transactions: U.S. securities dealers				
Net loans (+) / Net borrowings (-)	+ 125	+ 117		+ 379

*Includes items not shown separately.

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