Research Department
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End of the Tunnel?

More and more analysts are finding favorable portents this bleak December in the economy's most depressed sector, the housing industry. Various Administration officials have seen light at the end of the tunnel, and some have argued that we will reach the exit as soon as early 1975. The light at that point may not be dazzling in its radiance; nonetheless, somewhat brighter days for homebuilders and homebuyers appear to lie ahead.

It should quickly be added that the immediate prospects are still gloomy, even on the heels of the sharpest downturn of the postwar era. Housing starts declined 55 percent from the early 1973 peak to an annual rate of 1.1 million units in August-October 1974, which compared with a 38-percent drop in 1966 and a 25-percent drop in the 1970 slump. (Single-family starts fell substantially in the past year and a half, and multiples fell by a precipitous 70 percent.) A continued slide recently in both new permit activity and the backlog of unused permits implies a possible further dip in starts in the months immediately ahead.

Hopeful signs

The hopeful signs are the usual recession symptoms of easier and cheaper financing. Market interest rates have fallen substantially since last summer, with three-month Treasury bills, for example, now yielding 7½ percent as against the earlier peak of 9 percent or more. (The latter is illustrative of the type of rate movement which pulled such substantial sums out of the thrift institutions last summer, crippling the home-financing sector in the process.) With rates on competitive instruments declining, savings-and-loan associations recorded a $400-million net savings inflow in October, and the improvement apparently continued into November. This easier situation has been accompanied by a slight drop in mortgage rates from their record highs.

Looking ahead, many observers have concluded that the combination of a weakening economy and an easier monetary-policy stance means decreased market pressures and a further decline in rates, to the advantage of the thrift institutions and the housing market. A slackening in business investment and in consumer purchases of autos and appliances would ease borrowing pressures, while a drop in market rates meanwhile would entice savers to put their funds again into thrift institutions, and thus indirectly into housing. Heavy government borrowing may continue, partly because of locked-in Federal spending increases and partly because of a recession-caused shortfall in revenue, and these pressures may limit the expected decline in interest rates, but overall, the state of the market should permit some easing

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of the mortgage market. (But the easing movement could be limited if corporations continue to turn to the bond market for funds, as they have done in recent weeks.) The following illustrative example shows what could happen in an easier mortgage market.

A Treasury-bill rate averaging, say, 7 percent in 1975 might be consistent with a $20-billion net savings inflow into the S&L's—one-third higher than this year's likely gain. This amount, supplemented by $23 billion or so in loan repayments, would make about $43 billion in funds available to the S&L's for mortgage lending. However, that amount would still be somewhat below the record $51 billion of both 1972 and 1973. Besides, at today's home prices, $43 billion in mortgage money would finance only 1.2 million homes, compared with the 1.8 million homes that could have been financed with the funds available just two years ago.

Rising prices

Indeed, home prices have already reached $36,500—twice the average figure of a decade ago—and they are continuing to increase. Lumber prices have eased in recent months, but prices of other materials (such as asphalt, concrete and plumbing fixtures) are now 15 to 55 percent above their 1973 levels, while land and labor costs have continued their inexorable rise. In addition, the overall costs of home ownership (including taxes, insurance and utilities) have increased by 13 percent over the past year.

Yet these very considerations—the "today is the best time to buy" syndrome—may lure growing numbers of potential homebuyers back into the market as mortgage credit becomes more available. The homebuying public appears increasingly reconciled to the fact that higher costs (including mortgage costs) are here to stay. Rates on conventional new-home loans could drop from the recent level of 9.80 percent to about 9.00 percent in 1975, but they are unlikely to drop to the 7.75-percent level of two years ago, be-

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cause of continued inflationary expectations on the part of market participants as well as the still-high cost of funds to mortgage-lending institutions.

Despite the improving financing situation, the projected housing recovery may again require substantial agency intervention, although not as much as this year, when the various housing agencies through October raised $10 billion in the credit markets. Still, borrowers apparently have drawn down only about one-sixth of the $20 billion involved in various government support programs this year. In terms of housing units, about 475,000 of the original potential 537,000 units remain to be financed, thus providing a measure of support to the present housing market.

Another questionmark is a potential oversupply of units, despite the severe slump in building of the past two years. The unsold inventory of single-family housing now totals about 415,000 units, the equivalent of a ten-month supply at current sales rates. Houses under construction now total about 1.4 million, half again as many as the number in the pipeline at the beginning of the last housing recovery in early 1970. Also, vacancy rates still exceed year-ago levels despite the depressed level of building, although they are not excessive by the standards of the middle and late 1960's.

Industry sources suggest that, with an easing financial situation, housing starts could average about 1.45 million units in 1975—moderately above the 1974 average but well below the 2-million-plus rates of the 1972-73 period. However, such a level would imply a 1.7-million rate by late 1975, or half again as much as the recent level of activity. This would represent a hefty pickup, and would require a substantial volume of financing, especially in view of the 33-percent increase in home prices over the past two years. But if the hoped-for turnaround does not occur, we may witness intensified Congressional pressure to "do something" for housing.

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BANKING DATA—TWELFTH FEDERAL RESERVE DISTRICT

(Dollar amounts in millions)

Selected Assets and Liabilities Large Commercial Banks	Amount Outstanding 11/20/74	Change from 11/13/74	Change from year ago Dollar	Percent
Loans (gross, adjusted) and investments*	83,786	− 769	+7,195	+ 9.39
Loans (gross, adjusted)—total	66,345	− 768	+8,284	+ 14.27
Security loans	1,239	− 786	− 24	− 1.90
Commercial and industrial	24,036	+ 6	+3,700	+ 18.19
Real estate	19,969	+ 36	+1,842	+ 10.16
Consumer instalment	9,768	+ 6	+ 788	+ 8.78
U.S. Treasury securities	4,758	+ 131	−1,439	− 23.22
Other securities	12,683	− 132	+ 350	+ 2.84
Deposits (less cash items)—total*	80,411	− 403	+7,798	+ 10.74
Demand deposits (adjusted)	22,788	− 462	+ 967	+ 4.43
U.S. Government deposits	431	+ 85	− 95	− 18.06
Time deposits—total*	55,601	− 63	+6,555	+ 13.36
States and political subdivisions	5,648	+ 10	− 99	− 1.72
Savings deposits	18,021	+ 57	+ 321	+ 1.81
Other time deposits‡	28,530	− 49	+6,035	+ 26.83
Large negotiable CD's	15,253	+ 6	+4,481	+ 41.60

Weekly Averages of Daily Figures	Week ended 11/20/74	Week ended 11/30/74	Comparable year-ago period
Member Bank Reserve Position			
Excess Reserves	13	94	100
Borrowings	174	172	88
Net free (+) / Net borrowed (−)	−161	− 78	+ 12
Federal Funds—Seven Large Banks			
Interbank Federal fund transactions Net purchases (+) / Net sales (−)	+987	+646	+686
Transactions of U.S. security dealers Net loans (+) / Net borrowings (−)	+462	+665	−219

*Includes items not shown separately. ‡Individuals, partnerships and corporations.

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