Research Department
Federal Reserve
Bank of
San Francisco

April 11, 1980

FRBSF Weekly Letter

Budgets and Borrowing

In an unprecedented step, the Administration has now unveiled a new budget, less than two months after Wall Street had given such a tepid response to the initial budget figures. According to the new document, the fiscal year ending this September will show a $36.5-billion deficit rather than the $39.8-billion deficit originally anticipated. More dramatically, fiscal 1981 should show an actual surplus, of $16.5 billion, rather than a $15.8-billion deficit.

These steps should help ease the pressures on financial markets created by heavy deficit financing. But the Federal presence in the markets goes beyond the figures shown in the "unified" budget, which itself includes both the major budget categories (Federal funds) and social-security and other trust-fund transactions. Also operating in the market are off-budget agencies, government-sponsored enterprises, and mortgage-pool agencies. Net borrowing of all types amounted to $89.9 billion in calendar 1979, and might approach $95.0 billion in calendar 1980. Since the unified budget accounts for only a portion of the total, it is worthwhile examining what falls under the other borrowing headings.

Off-budget agencies

First to be considered is a group of off-budget entities whose outlays (disbursements of borrowed money) amounted to $12.4 billion in fiscal 1979, as compared to the $27.7 billion unified-budget deficit. These off-budget entities are Federally owned and controlled, but by law their transactions are excluded from the budget totals. Their appropriation requests are not included in budget-authority totals, and their outlays are not subject to the ceilings set by Congressional budget resolutions. When off-budget outlays are financed by Treasury borrowing, the additional debt is subject to the statutory debt limit; when financed by the entities' own borrowing, it is not. But in either case, the additional debt is part of the gross Federal debt.

By far the most important off-budget agency is the Federal Financing Bank (FFB), a Treasury Department entity which acts as a source of capital for some Federal programs, and which also makes or finances most of the Federal government's direct loans. The FFB does not operate programs itself, but rather assists other programs by purchasing their debt securities or their guaranteed obligations. Most FFB outlays support rural-housing and rural-electrification programs, but some assistance also goes to the student-loan program and foreign military-sales credits.

Government-sponsored enterprises

Seven privately owned but government-sponsored enterprises also play an important role in the credit markets, with borrowings which totalled $32.7 billion in fiscal 1979. These entities were established and chartered by the Federal government to perform specialized credit functions in the areas of housing credit, rural finance and student loans. The three agencies operating under the aegis of the Farm Credit Administration frequently are heavy borrowers, but even more important are the three housing agencies—the Federal Home Loan Bank system, the Federal National Mortgage Association (Fannie Mae), and the Federal Home Loan Mortgage Corporation (Freddie Mac).

These enterprises essentially are financial intermediaries, borrowing in the securities market and lending their borrowed funds in support of various specified activities. Their borrowing programs are subject to Federal supervision—and in addition, they consult the Treasury Department, either by law or by custom, in planning their market offerings. All of these enterprises have a history of successful financial performance. Hence, despite the absence of Federal guarantees, their obligations sell at interest rates only

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moderately above the rates on comparable Treasury issues.

Substantial cyclical fluctuations have marked the borrowing activities of government-sponsored enterprises over the past decade. These fluctuations can be traced to the operations of the three housing agencies, which help stabilize housing activity during those money crunches when private mortgage lenders encounter great difficulty in obtaining financing. Such borrowing doubled between 1970 and 1974, and reached a new high in fiscal 1979, at $32.7 billion. According to the January budget document, government-sponsored enterprises expect borrowing requirements to fall substantially below that figure in fiscal years 1980 and 1981, but these figures may have to be revised in view of the current weakened state of the housing market.

Mortgage-pool activity

Further support to the housing market is provided by three Federally sponsored mortgage pools which support various segments of the housing market—the Government National Mortgage Association (Ginnie Mae), the Federal Loan Mortgage Corporation (Freddie Mac), and the Farmers Home Administration (FmHA). Borrowing for guaranteed mortgage pools has trended sharply upward over the past decade, reaching $28.0 billion in calendar 1979. This differs somewhat from the direct borrowing activities of government-sponsored enterprises (including Freddie Mac), which have moved up and down with the housing cycle.

Ginnie Mae, with its "tandem plan," purchases mortgages to support housing for low-income families which have difficulty finding private financing. Secondly, Ginnie Mae operates the program of "pass-through mortgages"—the mortgage-backed securities program. Under this program, the Federal government guarantees payment of principal and interest on securities issued by private mortgage institutions and backed by pools of FHA-insured or VA-guaranteed mortgages. These pass-through securities are designed to appeal to pension funds and other institutional investors which don't wish to originate and service mortgage loans themselves.

As a major counterpart, Freddie Mac's mortgage-backed securities are used to finance conventional loans, which account for four-fifths of all home mortgages. The FHLMC, which is wholly owned by the Federal Home Loan Banks, was created by Congress to develop a national secondary market in conventional mortgage loans originated by thrift institutions and other mortgage-lending institutions. Similarly, in the rural area, Congress created the FmHA to provide direct and guaranteed loans for low- and moderate-income families in communities of less than 20,000 population.

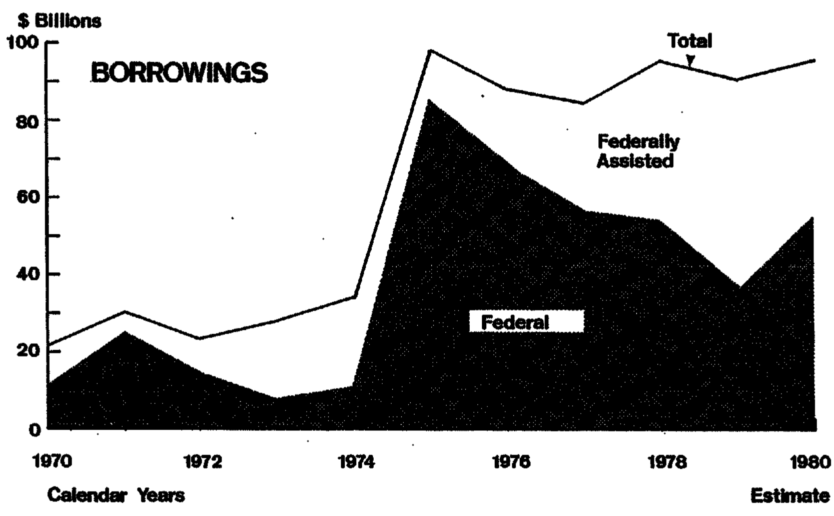
Impact on credit markets

To measure the overall impact of Federal and federally-assisted borrowing on credit markets, we can add the net borrowing from the public needed to finance the unified deficit ($28.2 billion in calendar 1979) and the off-budget deficit ($13.2 billion), plus the net borrowing by government-sponsored enterprises ($24.6 billion) and the net borrowing by government-guaranteed mortgage pools ($27.8 billion). Federal and federally-assisted transactions in 1979 thus were financed by $89.9 billion in net borrowing and a $3.9-billion reduction in Treasury cash. "Borrowing" here is a net concept signifying a flow of funds, i.e., a change in outstanding stocks. Thus, net borrowing from the public represents the change in the total outstanding publicly-held debt.

Federal and federally-assisted borrowing has increased substantially in the second half of the 1970's (see chart). From $34.3 billion in 1974, total borrowing surged to $98.2 billion in 1975 as heavy deficit financing helped to combat the recession of that year. Direct Federal borrowing declined substantially during the ensuing business expansion, but total borrowing remained high as government-sponsored enterprises borrowed heavily to support the mortgage financing boom of the late 1970's. In 1979, total borrowing amounted to $89.9 billion, but it could rise to about $95.0 billion or more this year because of a higher deficit plus continued heavy borrowing by mortgage-financing agencies.

Because of these developments, the Federal presence in the credit markets may be the dominant element in the credit markets this year. Total Federal and federally-assisted borrowing could account for perhaps 23 percent of all funds raised in credit markets in 1980, compared with the 15-percent average of the 1970-74 expansion and the 20-percent average of the 1977-79 expansion. That figure, although considerably lower than the Federal share in the 1975 recession year, could give some substance to the argument that Federal borrowers are "crowding out" private borrowers from the market.

Rose McElhattan



Source: Various Flow of Funds issues, Board of Governors of the Federal Reserve System. 1980 estimate: Federal Reserve Bank of San Francisco.

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BANKING DATA—TWELFTH FEDERAL RESERVE DISTRICT

(Dollar amounts in millions)

Selected Assets and Liabilities Large Commercial Banks	Amount Outstanding 3/26/80	Change from 3/19/80	Change from year ago Dollar	Change from year ago Percent
Loans (gross, adjusted) and investments*	138,716	+ 176	+ 16,299	+ 13.3
Loans (gross, adjusted) — total#	116,586	+ 172	+ 16,582	+ 16.6
Commercial and industrial	33,901	+ 103	+ 4,295	+ 14.5
Real estate	45,393	+ 191	+ 9,014	+ 24.8
Loans to individuals	24,477	− 29	+ 3,325	+ 15.7
Securities loans	1,281	− 59	− 199	− 13.4
U.S. Treasury securities*	6,742	+ 17	− 1,064	− 13.6
Other securities*	15,388	− 13	+ 781	+ 5.3
Demand deposits — total#	41,714	−1,761	+ 2,458	+ 6.3
Demand deposits — adjusted	30,376	− 322	+ 1,331	+ 4.6
Savings deposits — total	27,280	− 41	− 2,730	− 9.1
Time deposits — total#	61,472	+ 392	+ 11,095	+ 22.0
Individuals, part. & corp.	52,745	+ 283	+ 11,909	+ 29.2
(Large negotiable CD's)	21,865	+ 264	+ 3,984	+ 22.3

Weekly Averages of Daily Figures	Week ended 3/26/80	Week ended 3/19/80	Comparable year-ago period
Member Bank Reserve Position			
Excess Reserves (+)/Deficiency (−)	− 6	20	28
Borrowings	198	263	19
Net free reserves (+)/Net borrowed(−)	− 206	− 243	9
Federal Funds**			

* Excludes trading account securities.
\# Includes items not shown separately.
** The revised series on Federal Funds and Repurchase Agreement Borrowings (FR 2415) is available on request from the Statistical and Data Services Department of the Federal Reserve Bank of San Francisco.

Editorial comments may be addressed to the editor (William Burke) or to the author.... Free copies of this and other Federal Reserve publications can be obtained by calling or writing the Public Information Section, Federal Reserve Bank of San Francisco, P.O. Box 7702, San Francisco 94120. Phone (415) 544-2184.