

STATEMENT BY WILLIAM McCHESNEY MARTIN, JR.
BEFORE THE SUBCOMMITTEE ON HOUSING
OF THE SENATE BANKING AND CURRENCY COMMITTEE

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Mr. Chairman:

One of my early responsibilities after I assumed my duties as Chairman of the Federal Reserve Board was to testify on housing and mortgage finance before the Senate Committee on Banking and Currency. That was in May 1951, just about six years ago. We were then concerned over the high cost of housing. Yet because of the pressure to build houses as well as plants, we have witnessed a steady rise in construction costs and the typical home purchaser finds a new house today costs about 15 per cent more than in 1951.

The volume of home mortgage debt now totals about \$100 billion. It is about equal in size to long-term corporate debt, and over three times as large as consumer instalment debt. It is more than one-third the size of our gigantic Federal Government debt.

In the past decade, home mortgage debt has grown by \$76 billion, long-term corporate debt by \$60 billion, and consumer instalment debt by \$27 billion. During the same period, Federal Government debt increased by only \$17 billion.

During 1956 alone, home mortgage debt grew \$11 billion, long-term corporate debt \$9 billion, consumer instalment debt \$2-1/2 billion, while Federal Government debt declined \$4 billion. The growth in home mortgage debt during 1956 was much larger than for any other year except 1955 when it grew by \$12-1/2 billion.

Each spring witnesses before this Committee and others have testified that the nonavailability of mortgage money would shortly bring about the collapse of the housing industry in the United States. Letters and telegrams from all over the United States have come to your desks and to mine confirming this impending crisis. Despite these gloomy predictions, each year housing starts have exceeded a million units, often by a substantial margin.

What concerns me about this is not so much the misleading impression that may have been created in the past--that is water over the dam. Rather, it is that these past alarms make it difficult to discern whether the situation confronting the building industry and the country today is as serious as some observers would have us believe.

It may well be that the mortgage finance situation is more serious than in previous years. Housing starts in February dropped sharply to the lowest rate, seasonally adjusted, since the spring of 1949. The whole of the drop was concentrated in starts financed through federally-sponsored financing instruments. Comparing the first two months of 1957 with the same months of 1955 and 1956, respectively, starts financed by the VA mortgage program were off 60 per cent and 46 per cent and starts financed through the FHA mortgage program were off 53 per cent and 33 per cent. Starts financed with conventional mortgages did not decline at all. Actually they appear to have risen very slightly from the level of the two preceding years. Conventional financing currently accounts for nearly seven out of ten starts whereas two years ago it accounted for less than half.

The slower rate of home building during the past two years may represent, in part, a corrective action to the unusually high rate of starts in early 1955 and, in part, consumer resistance to rising construction costs. However, the fact that the recent decline in starts has been confined to the federally-aided programs indicates that the ceilings on interest rates on FHA and VA mortgages have interfered with the smooth functioning of the housing industry.

A growth in competing demands for the savings that might otherwise be invested in home mortgages is clearly evident. During the past two years, the demand for savings to finance industrial growth, expansion of public utility and commercial facilities, instalment and consumer purchases, roads, schools and other public works have mounted. These demands, together with those for home mortgage financing, have exceeded the supply of current savings, large as it has been. This has caused a rise in interest rates. In the last two years, yields on Government bonds and high-grade State and municipal securities have risen about one percentage point, and on conventional mortgages and high-grade corporate bonds almost as much.

The $4\frac{1}{2}$ per cent ceiling rates that formerly prevailed on both FHA and VA home mortgages gradually became an increasing barrier to the ability of borrowers using these programs to compete with other borrowers for the savings that were available. For a time, contact with the market was maintained through resort to discounts which had the effect of providing a higher gross yield to the lenders than the $4\frac{1}{2}$ per cent rate stated on the face of the mortgage. The workability of this mechanism diminished as the $4\frac{1}{2}$ per cent ceiling got further and further out of line with competitive rates in other lending areas.

The total volume of VA financed home mortgages was over \$7 billion in 1955, and nearly \$6 billion in 1956. So long as the present relationship between demands for and the supply of new savings prevails, there is no possibility that lenders will invest at anything approaching this volume in VA mortgages subject to a 4-1/2 per cent ceiling. There have been several suggestions directed toward relieving this situation through further Government investment in mortgages. The ones which appear to have received most serious consideration are--(1) an increase in direct VA loans, (2) an increase in FNMA operations, or (3) absorption of VA mortgages in the Government trust funds.

None of these proposals operates to encourage new savings, i.e., to increase the total flow of funds from which all demands for long-term investment must be met. All three, furthermore, require that the Federal Government borrow in the market more than it would otherwise borrow. This additional borrowing by the Treasury would not only be inflationary but would tend to raise market rates of interest still further and thus increase the barrier that is already impeding the flow of private investment funds into VA mortgages.

These three programs would, of course, make funds available up to the limits provided in the legislation, and in some cases would help certain individuals to purchase homes. To the extent that already existing VA mortgages were acquired from institutions, however, it might simply provide those institutions with funds to lend in other markets. Hence, tracing the effects of these proposed programs, we find that under them the Federal Government would have assumed large additional responsibilities, without, in the end, restoring the market for VA mortgages. In a time when

strenuous efforts are being made to reduce Government expenditures, it should be kept in mind that outlays of this nature by the Federal Government, even though they may not appear in the budget, place the same strain on money markets and have the same inflationary effect on the economy as an increase in budget expenditures not covered by taxes.

The home construction industry is probably the most important single industry in the country, and home ownership is the most important asset for many American families. Almost 30 million, or 6 in 10, households own their home. About 80 per cent of the home owners have incomes of less than \$7,500 a year. Significantly, the trend in home ownership in recent years is most evident among families that in the past usually included a large proportion of renters, such as wage workers, young people and those in the middle or lower income brackets. This "catching up" in home ownership reflects the rising incomes, increased stability of employment, availability of financing and other economic developments of recent years.

Home mortgage debt is the most important liability and the most common obligation of American families. Over 15 million households are making mortgage payments currently. The existence of mortgage debt is closely associated with the recency of home purchase. Almost 7 in 8 of the families who have bought homes since 1954 have mortgage debt, while only 2 in 5 of the home owners who purchased before 1954 are still making mortgage payments.

The sheer magnitude of these figures, and the need to continue to make home ownership available to large segments of the population indicates the seriousness of the problem before us. The home building industry

must be kept operative, but not on a basis that leads to skyrocketing costs, overcommitments and, ultimately, to market saturation and collapse--which would be damaging not only to builders and suppliers--but to the millions of Americans who have undertaken home purchase as the primary basis for their savings.

Nearly a billion dollars of new funds every month is required to support the level of home construction we have had in recent years. In order to maintain a flow of funds of this magnitude, it is essential that all the major types of financing maintain contact with the market. At the moment this contact has been severed, particularly in the case of VA-guaranteed mortgages, by the prescription of unrealistic ceilings on the rate of interest.

In my judgment the essential thing is to restore contact with the free market. Only in that way can we look forward to a strong, healthy private building industry, which can contribute its full share to the stable growth of our country.