

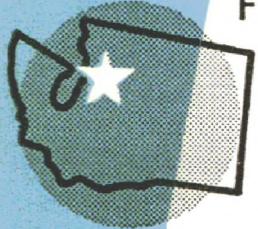
ALASKA



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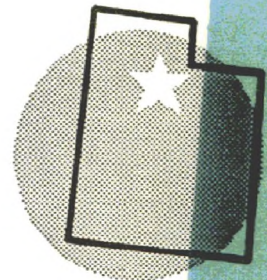
Monthly Review

FEDERAL RESERVE BANK OF SAN FRANCISCO
TWELFTH FEDERAL RESERVE DISTRICT



WASHINGTON

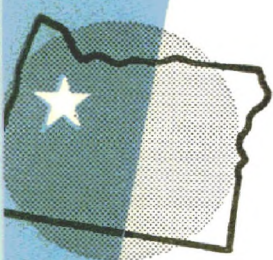
October 1963
In This Issue



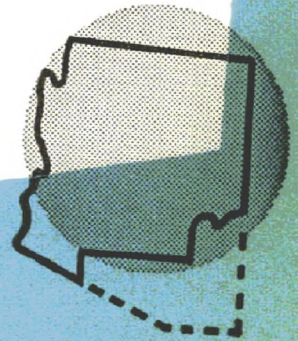
UTAH

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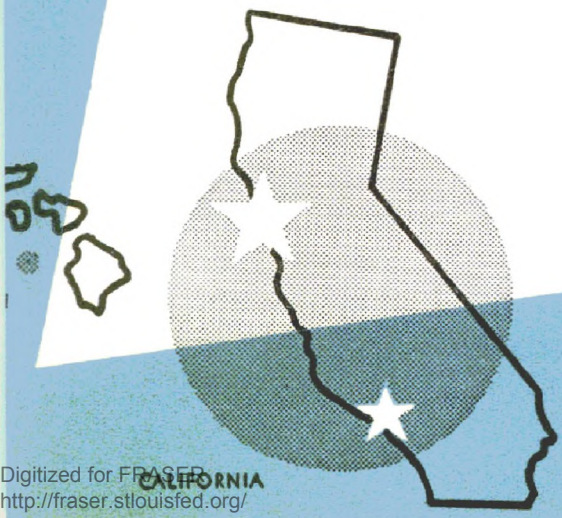
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The Supply page 149**



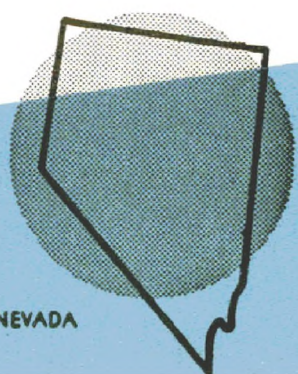
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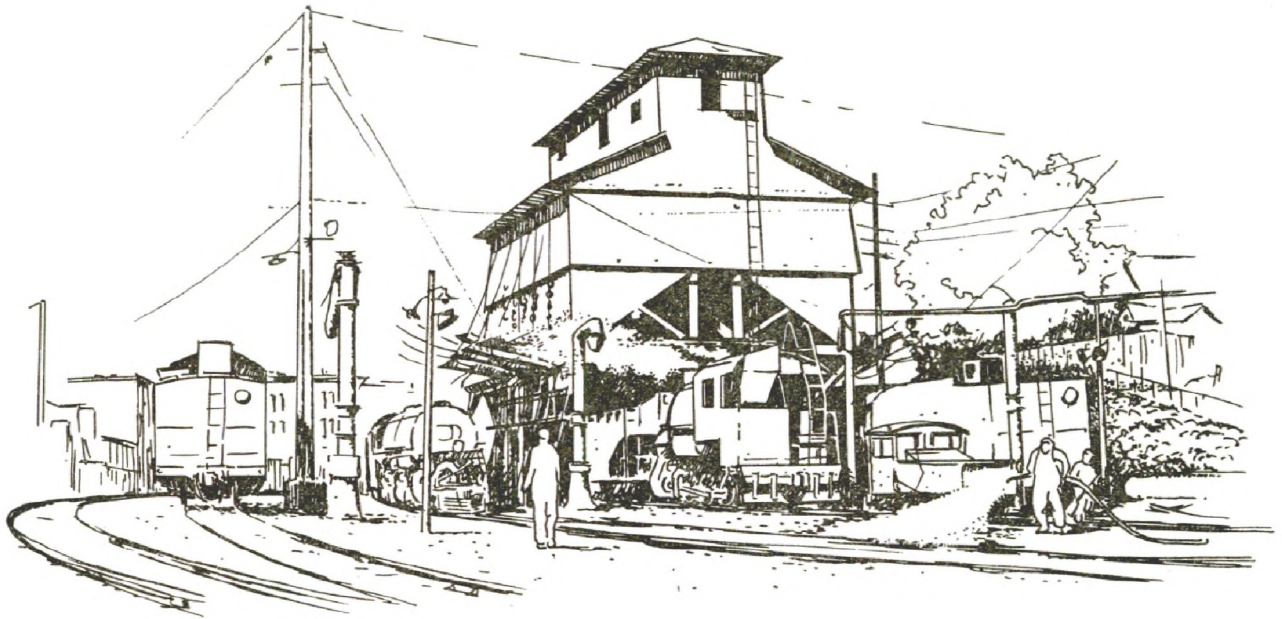
ARIZONA



CALIFORNIA



NEVADA



Jobs and the Jobless

THE expansionists and the structuralists—to use Professor Arthur Burns’ descriptive phrase—have begun what promises to be one of the crucial dialogues of the Sixties. The debate centers around the best solution for the problem of unemployment, which has been labeled in President Kennedy’s *Manpower Report* as “our number one economic problem.”

In their analyses, the extreme expansionists stress the recent failure of business investment to match its earlier postwar performance, the reduced rate of economic growth since 1957, and the higher rate of unemployment since then. As a solution, these critics advocate policies to increase aggregate demand—lower tax rates, higher Federal expenditures, easy credit, or a combination of all three.

The extreme structuralists, however, argue that economic growth is hampered by critical shortages of all types of trained personnel, and that sole reliance on the fiscal remedies pro-

posed by the extreme expansionists would be unsuccessful. The structuralists propose to focus policy on better organization of the labor market—for example, by improving and extending the present system of vocational guidance and retraining, and by assembling detailed information on every unfilled job as well as every unemployed worker. (Many expansionists agree with this approach, of course, but they insist that aggregate demand must be stimulated as long as the total number of jobless exceeds the total number of unfilled jobs.)

What are the facts?

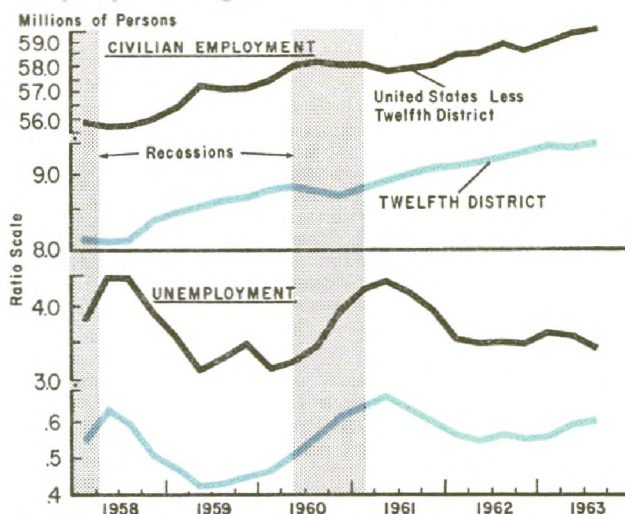
Professor Burns, who became involved in the complexities of this problem while serving as chairman of the Council of Economic Advisers in the mid-Fifties, claims that much of the controversy could be solved on a factual basis if only more facts were available. Speaking at Rice University last spring, he claimed that all sorts of expansionary measures are

undertaken in the name of the Employment Act—yet, after two decades of operation under that Act, “our nation has thus far failed to take the trouble of equipping itself with the facts needed to determine whether, when, or to what degree aggregate demand is deficient.”

Most analysts agree that adequate information is not available to indicate whether the economy at any point of time is meeting what Professor Burns contends is the basic criterion of full employment—equality between the number of men and women seeking jobs and the number of jobs. The usual barometer, the percentage of individuals in the labor force who are unable to find work, provides a rough measure of one element in the equation but fails to indicate the strength of the other element. In fact, the great mass of labor force data developed in recent years, although providing a wealth of information on the number and types of men seeking jobs, has cast relatively little light on the number and types of jobs seeking men.

The need for information of both kinds is increasing, especially because of the rapid shifts occurring in labor-force composition—by age, sex, occupation, industry, and region—throughout the postwar period. In the six years between August 1957 and August 1963, for example, the unemployment rate increased from 4.2 to 5.5 percent (seasonally adjusted), but the increase was caused primarily by joblessness among teenagers and older women rather than by unemployment among married men. (The jobless rate for family breadwinners rose only slightly, to 3.0 percent, between the two points of time.) The large increase in the jobless rate, therefore, is not surprising, in view of the great influx of new types of workers into the labor force in recent years—in view of the fact, for instance, that about one-half of all women in the 45-54 age group are working or looking for work today, as compared with about 46 percent in 1957 and only 33 percent a decade earlier.

Rising unemployment accompanies employment gain in District



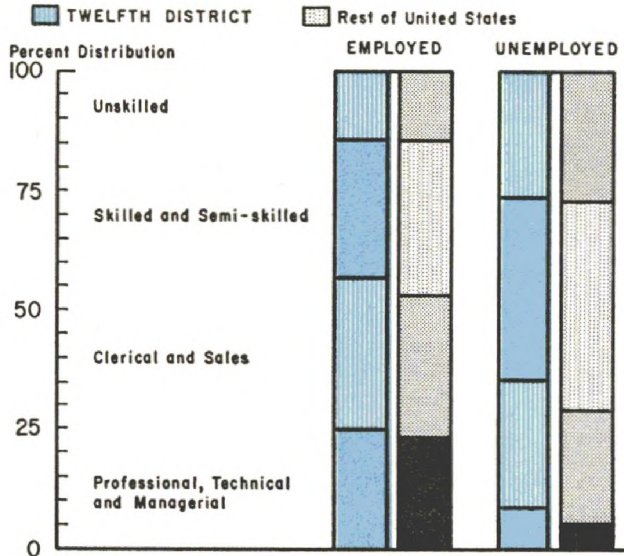
Note: Twelfth District data exclude Alaska and Hawaii. Last plotted figure is for August 1963.
Source: Bureau of Labor Statistics, Federal Reserve Bank of San Francisco.

Jobs and jobless both increase

The need for detailed labor force information is especially great in the Twelfth District—a region whose rapid growth continually generates large numbers of job opportunities, but whose well-known attractions simultaneously attract large numbers of applicants for those jobs. How well, then, does the District meet the full-employment criterion? How well does this region match up the demand for physicists, electronic engineers, grocery clerks, and domestic workers with the supply of workers in each category? In the absence of complete information on job openings, employment, and unemployment, the answer cannot be given adequately, and the dialogue between expansionists and structuralists will remain fuzzy and incomplete.

Even without complete information, however, some understanding of the Twelfth District's success in meeting the full-employment criterion can be obtained by analyzing the size and shape of its employment (and unemployment) growth in recent years. By the standard of employment expansion, it has done quite well. Since the cyclical trough of early 1961, total District employment (excluding

White-collar jobs important in District employment structure



Source: Bureau of the Census (1960 Population Census).

Alaska and Hawaii) has increased about 6 percent to 9.4 million—a rate of gain roughly double the rate of gain recorded by the rest of the nation.

The region's rapid employment growth, nonetheless, has not been rapid enough to induce a substantial reduction in unemployment. In the first year of this cyclical expansion, the unemployment rate in the District (as in the rest of the nation) dropped from about 7 percent to 5.5 percent, but during the later stages of the expansion the District (unlike the rest of the nation) has experienced an upward drift in its jobless rate. In August the rate was 6 percent, on the basis of a 600,000 unemployment count.

The combination of rising employment and rising unemployment emphasizes the crucial role played by population growth and migration in the District's labor market. In the decade of the Fifties, this region contained four of the five fastest-growing states in the nation, and in each of these migration was the dominant if not overriding factor in population growth. California's population, for example, increased almost 50 percent during the decade, but its population grew 30 per-

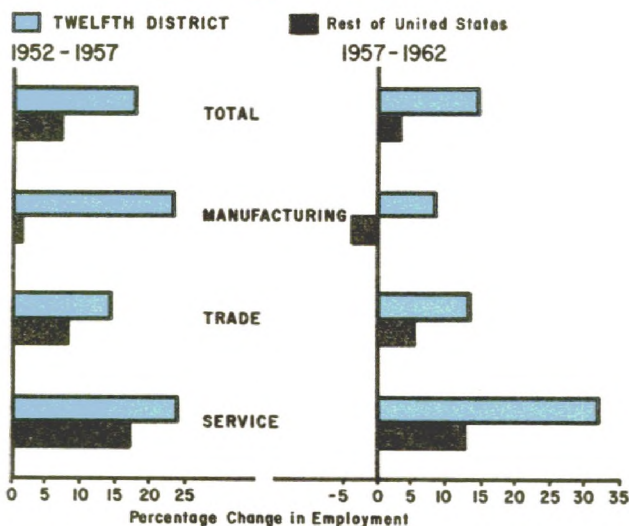
cent on the basis of net immigration alone. More important, recent labor force data suggest that new migrants will continue to add substantially to the employment and unemployment statistics during this decade as well.

District has "better" structure

These aggregates throw little light on the expansionist-structuralist controversy, however; for such an analysis, industrial and occupational data compiled from 1960 Census material must be examined. These data show a "better" employment structure for the District than for the rest of the nation, in the sense that the region's labor force is concentrated in the economy's faster-growing industries and occupations. Thus, occupational data show a greater concentration for the District than for the rest of the nation in professional-technical-managerial categories and in clerical and sales categories, but a smaller concentration in the skilled and unskilled worker categories. In each group, unemployment at the Census date was higher in the District than elsewhere, but the jobless were concentrated in those categories which are of greater importance in the labor force in the rest of nation—that is, the blue-collar categories.

Industrial data show a greater concentration for the District in professional and related services, public administration, and trade, and a much greater concentration for the rest of the nation in the slow-growing manufacturing sector. More important, industry trend data show a better record for the District than for the rest of the country in generating new jobs, even though the rate of growth has slowed down during the second half of the post-Korean decade. Between 1952 and 1957, nonfarm employment increased 18 percent in District states and 7 percent in the rest of the nation; between 1957 and 1962, the comparable increases were 15 percent and 3 percent, respectively.

District outpaces rest of nation in creating all types of jobs



In the West as elsewhere, recent employment gains have centered in trade, services, and government. In fact, those were the only categories in which employment increased outside this region during the 1957-1962 period. In the crucial manufacturing category, Western employment increased far more slowly in the second half than in the first half of the decade—but the West's 8 percent gain was especially noteworthy in the light of the 4 percent loss suffered by the rest of the nation in the last half-decade. Declines in transportation-utilities and in mining have been a nationwide phenomenon in recent years, but construction has been a somewhat different story; between 1957 and 1962, employment in this category increased 10 percent in the West but dropped by a like amount in the rest of the country.

But unemployment rises

Despite the West's noteworthy performance in generating new jobs, however, it has not been so successful as to conquer the jobless problem. Higher unemployment rates, as noted at the outset of this article, emphasize this point, and so too do the available data on recent shifts in employment and unem-

ployment. Since the 1960 Census date, for example, nonfarm employment has risen almost 9 percent in District states, as against 5 percent in the rest of the nation, but insured unemployment has risen about 25 percent in this area while declining 5 percent in the rest of the nation. In all major categories—manufacturing, trade, and services—the West's performance has been stronger in the employment field but weaker in the unemployment field.

These occupational and industrial considerations, of course, are only a few of the many factors involved in a structural analysis of the labor force; age, sex, race, and education all enter into the equation, too. In these as in the industrial and occupational categories, the District's labor force tends to be concentrated in the sectors which suffer the least unemployment. In the nation as a whole, the August jobless rate among females was 6.5 percent as against 4.5 percent for males; similarly, the rate among nonwhites was 10.5 percent as against 4.5 percent for whites. Thus, the District's greater concentration of males and of whites in its labor force might tend (other things being equal) to depress its jobless rate in relation to jobless rates elsewhere.

Since the District's labor resources are not concentrated in the occupational, industrial, and other categories where joblessness is most prevalent, its presently higher unemployment rate probably reflects a higher level of unemployment throughout its labor force—which in turn reflects a continuing heavy inflow of workers of all types and skills. The census-takers in 1960 found, for every occupational category, that jobless rates were higher in the Twelfth District than elsewhere. At the Census date, professionals, farmers, businessmen, clerical and sales workers, skilled and unskilled workers, and domestics all reported higher jobless rates than their counterparts elsewhere, and there is little indication that their situation has changed since.

The dialogue continues

The structuralists could argue that the District's demonstrated ability to create new jobs will permit the absorption of the present pool of unemployed, provided of course that training facilities and information on job opportunities are freely available to those looking for work. The expansionists could argue, on the other hand, that increased spending by consumers, businesses, and governments will be required throughout the national economy in order to generate a sufficient number of jobs in the West and in the other regions as well. But both schools might do well to consider also whether a high level of frictional unemployment, along with a high level of migration, is a necessary factor in rapid regional growth.

Most analysts would probably agree with Professor Burns that the expansionist-structuralist dialogue could be clarified if detailed data on job openings were available along

with the wealth of labor-force information which is already available. According to Labor Department projections, Twelfth District states, during the present decade, will add 4.4 million workers to their labor force—almost one-third of the projected total addition for the entire national economy. Other projections by the same agency indicate that the greatest increases in demand for labor will occur in categories in which the West's occupational structure is concentrated most heavily—professional, managerial, sales and clerical categories, and so on. Taken together, the projections imply that the District will continue to grow rapidly in those occupational categories where it already has shown the most promising growth. A great deal more must be known about the sources of new *industrial* growth, however, before any solid conclusions can be drawn about the District's ability to match its unfilled job vacancies with its supply of available workers.



Federal Agency Securities: The Supply

FIVE Federal agencies finance their credit activities through the \$10-billion Federal Agency market. Agricultural credit systems (Federal Land Banks, Federal Intermediate Credit Banks, and Banks for Cooperatives) and residential mortgage systems (Federal Home Loan Banks and the Federal National Mortgage Association) each account for about one-half of the total amount outstanding in this little-known but expanding market.

This article describes the role played in the securities market by the five systems which issue Federal Agency securities. An earlier article described the principal features of Agency securities — for example, their low degree of risk despite the lack of a Federal Government guarantee — and a forthcoming article will analyze the demand for such securities on the part of commercial banks and other investors.

Farm agencies first in field

The three agencies which provide supplementary long- and short-term credit to agriculture were the first to finance their credit operations by selling marketable securities. These agencies are all supervised by the Farm Credit Administration, an independent agency of the Government. The three systems can borrow from one another, and they can borrow short-term funds from commercial banks, but security sales furnish their main source of funds. The interest rates they pay on their securities determine the rates these agencies charge their member associations, and these rates in turn are reflected in the rates charged by the associations on their loans to farmer borrowers.

The capital stock of the Federal Land Banks is now owned by the member associations, and the other two systems also are moving toward complete private ownership. Their

programs are characterized by slow, steady growth in the volume of credit extended, both absolutely and relative to other sources of farm financing.

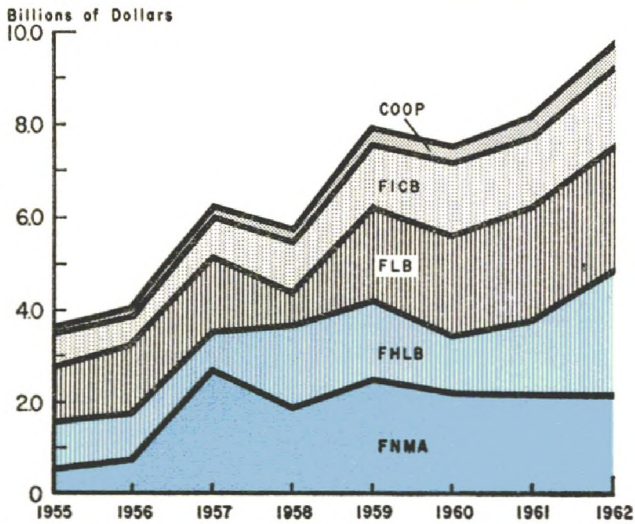
The oldest of these three agricultural credit agencies is the Federal Land Bank System of 12 regional banks. This system, organized in 1916 to act as a source of long-term farm mortgage credit, lends funds to Federal Land Bank Associations which have been set up by law to function as loan retailers. A farmer buys stock in his local Association amounting to 5 percent of his loan, and the Association buys an equivalent amount of stock in the Land Bank in its district. The Federal Land Banks sell bonds, which are the joint and several obligations of the Banks, with maturities of up to 15 years, and they also sell short-term obligations to provide flexibility for their operations. Bonds are sold at intervals throughout the year; as the volume of financing has grown, the Banks have entered the market more frequently, perhaps in 6 months of each year. A short- and a long-term issue are often sold at the same time.

Between December 1955 and December 1962, Federal Land Bank obligations outstanding increased from \$1.2 billion to \$2.6 billion, of which about one-fifth was in maturities of less than one year. System loans have increased by about \$150-\$250 million each year, and the rise in their debt has shown a close correspondence. Throughout the post-war period, the extension of mortgage credit through the Federal Land Banks has risen both absolutely and relative to the total volume of farm mortgages.

Short-term farm needs

The Federal Intermediate Credit Bank system was created in 1923, in order to facilitate the extension of short-term credit for farm

**Five agencies participate
in rapidly growing Agency market**



Note: Data show outstanding obligations for Federal National Mortgage Association, Federal Home Loan Bank, Federal Land Banks, Federal Intermediate Credit Banks, and Banks for Cooperatives.
Source: Department of the Treasury.

production and marketing needs. The 12 Banks are located in the same areas as the Federal Land Banks. They make loans to and discount the paper of Production Credit Associations, which own stock in the Banks. The Government's capital stock is gradually being retired.

The Federal Intermediate Credit Banks deal in short-term credits; their securities also are short-term, normally nine-month debentures. These are the joint and several liability of all 12 Banks, and constitute their major source of funds. The Banks also may rediscount agricultural paper with the Federal Reserve Banks, and may borrow interim funds from commercial banks. Obligations of the Federal Intermediate Credit Banks are unique among Agency securities in that they are eligible as collateral for advances by Federal Reserve Banks to member banks. Sales of debentures occur monthly, in amounts ranging between \$100-\$250 million. The volume of debentures outstanding shows a seasonal pattern, rising in the early part of the year as farmers borrow to finance production expenses, and declining in the later months when loans are repaid out of farm marketing

proceeds. Debentures outstanding more than doubled, to nearly \$2 billion, between the 1955 seasonal peak and the corresponding period in the summer of 1962.

The smallest of the three agencies is the system of 13 Banks for Cooperatives; the system was established with Government capital in 1933. These Banks make loans to farmer-owned cooperatives to meet marketing and operating capital needs. The Central Bank for Cooperatives, in Washington, D. C., also can make loans directly to cooperatives, provided that a district bank is unable to handle them. The farm cooperatives purchase shares of capital stock in the Banks when they take out loans. The Government's capital investment has been declining since 1950 and cooperative-owned stock has been increasing, although the latter still represents less than half the total.

In the early years of operation, this system obtained funds by discounting short-term loans with the Federal Intermediate Credit Banks. This was later supplemented by borrowings from commercial banks. Although the original Act establishing the system provided for the sale of debentures, the first sale did not occur until 1950, and was the sole responsibility of the Central Bank for Cooperatives. Securities were issued by the Central Bank until 1954, when Congress authorized the 13 Banks to issue consolidated debentures; these have been sold since 1955. The volume outstanding rose from about \$100 million in 1955 to an average of \$400-\$500 million in 1962. The Banks now bring out new issues on a regular bi-monthly basis, with six-month maturities, so that only three maturities are outstanding at any one time.

Long-term housing needs

The Federal Home Loan Banks and the Federal National Mortgage Association issue securities to finance the two major Federal credit programs connected with the housing industry. Although their organization and

functions are quite distinct, their common purpose is to strengthen the availability of private funds in the mortgage market. The supply of their securities exhibits marked fluctuations which are associated with mortgage market conditions. By the very nature of their programs, they are likely to borrow heavily when mortgage market conditions are tight, as in 1955 and 1959, and these periods tend to coincide with generally heavy demands on the capital markets from other sectors. Yet even in periods when mortgage investments are relatively attractive compared with alternative investments — as in 1961-62 — these Agencies may raise funds in the market in order to help mortgage lenders meet demands on their resources.

The Federal Home Loan Bank System was established in 1932, and is a system of 11 reserve credit banks, regionally distributed, serving thrift institutions. Member institutions, most of which are savings and loan associations, have owned all the capital stock of the Federal Home Loan Banks since 1951, when the last of the Government stock was retired. The stated function of the System is to supply additional liquidity by making advances to member institutions. This liquidity is for two purposes — to meet unusual or heavy withdrawal demands, and to meet recurring needs for funds for seasonal mortgage lending. Advances also can be made for longer term needs, but the emphasis always has been on problems of liquidity. Advances are financed largely by the sale of notes, which are the joint and several obligations of the Banks. The advances, in effect, give savings and loan associations access to capital markets when their normal flow of savings is not sufficient to enable them to meet demands for mortgage credit which they desire to accommodate. In recent years, about half the increase in advances has been related to a need to import capital into those growing areas where demands for mortgage credit chroni-

cally outstrip the pace at which savings funds are accumulated. Future increases in advances may be moderated, however, by a change in regulations which permits member associations greater freedom to participate in loans made outside their own geographical areas. This will permit associations in surplus areas to make funds available to institutions in deficit areas, thereby reducing the dependence of the latter on advances from the Federal Home Loan Banks.

The supply of Federal Home Loan Bank obligations outstanding in the market at any given time is closely geared to the volume of outstanding advances to member associations, which follow a distinct seasonal pattern. Nearly all of the notes are short-term, most of them falling in the 9-12 month maturity range. The seasonal pattern of advances and notes outstanding shows a peak in December, followed by a heavy flow of repayments in the following quarter. While the seasonal peak in mortgage lending actually occurs in the second or third quarter, year-end advances serve to enhance members' liquidity positions in year-end financial statements. To some extent, year-end borrowings are undertaken in anticipation of withdrawals after year-end dividend credits are made.

Advances and retreats

The cyclical nature of residential construction is the dominant factor in borrowings by the Federal Home Loan Banks. In 1955, private nonfarm residential construction reached a peak for the postwar period to that time. Mortgage credit extended by savings and loan associations rose sharply, and Federal Home Loan Bank advances to member associations rose also. Borrowing by the Banks, through note sales, increased by a corresponding amount, about \$800 million. Then, as residential construction declined through 1956 and the 1957-58 recession, both Home Loan Bank advances and borrowings registered slight

declines. During the recession, mortgages became relatively more attractive investments than they had been before to the variety of investors who normally invest in them. In view of this factor, and in view of the easier mortgage market conditions prevailing during most of 1958, Home Loan Bank advances and borrowings declined from the previous year.

Later, as the business recovery gathered momentum in 1959, mortgage lending institutions were particularly hard pressed to acquire investment funds to meet the demand for new mortgages. In that period, the Home Loan Banks' advances provided supplementary credit to the savings and loan associations, and again the volume of note sales increased. The amount of Federal Home Loan Bank notes outstanding increased from \$714 million in December 1958 to \$1,774 million at the end of 1959. This \$1 billion increase in debt coincided with a period of sharply rising interest rates and intense competition among most sectors of the economy for funds.

During the 1960 recession, the Home Loan Banks were under less pressure to provide funds to savings and loan associations. The volume of advances continued at a high level, but repayments rose, and permitted a reduction of about \$500 million in the volume of notes in calendar 1960. In the subsequent period of rising residential construction activity that began in 1961 and continued into 1962, Home Loan Bank borrowings rose more than in the 1958-59 period, even though home building did not increase as much. Conventional financing played an expanded role in the 1961-62 expansion of private nonfarm residential construction, and refinancing of existing homes also increased. Consequently, savings and loan associations—which tend to concentrate their lending activities in the conventional mortgage field—expanded their mortgage lending substantially, and the Home Loan Bank System increased its outstanding

obligations from \$1.3 billion in December 1960 to \$2.7 billion at the close of 1962.

Federal Home Loan Bank obligations, despite their seasonal and cyclical fluctuations, have tended to increase over time, in line with the rising trend of savings-and-loan associations' lending activity. These associations have increased their share of the mortgage market in every year of the past decade; their loans represented 32 percent of the estimated mortgage debt outstanding on 1-4 family homes in 1953, and reached 41 percent in 1962. Their participation in the mortgage market was stimulated further by revised regulations which the Federal Home Loan Bank Board put into effect during 1961, as a result of provisions in the Housing Act of 1961 that expanded the lending authority of federally chartered savings and loan associations.

Fannie Mae reorganizes

The organization and credit functions of the Federal National Mortgage Association differ substantially from those of the other Agencies. The Association, popularly known as "Fannie Mae," is a United States Government corporation engaged in buying and selling mortgages. It has been in existence since 1938, purchasing residential mortgages insured by the Federal Housing Administration or guaranteed by the Veterans' Administration. Until 1954, these purchases were financed with Treasury funds. The Association was reorganized in November 1954, and thereafter began to finance some of its operations through the sale of debentures.

The reorganized Fannie Mae's purchases and sales of mortgages are carried on under three programs which are organizationally separate. Two of these programs—management and liquidating functions, and special assistance functions—are outside the scope of this article because they still are financed directly with Treasury funds.

The third program—secondary market operations—is financed now in the capital

markets. These operations were originally capitalized with \$90 million of preferred stock purchased by the Secretary of the Treasury. Private investors selling mortgages to FNMA are required to purchase common stock, however, and the ultimate goal is retirement of the preferred stock and transfer of the assets and liabilities, as well as transfer of the management of secondary market operations, to the common stockholders. As of December 31, 1962, preferred stock outstanding was \$158.8 million of the \$208 million statutory maximum, and common stock outstanding amounted to \$89.8 million.

The purpose of Fannie Mae's secondary market operations is:

“. . . to provide supplementary assistance to the general secondary market for home mortgages by providing a degree of liquidity for home mortgage investments. This objective is accomplished by the purchase of acceptable FHA-insured and VA-guaranteed mortgages in areas where, and at times when, investment funds are in short supply and by selling the mortgages in areas where and when investment capital is available.”¹

In general, Fannie Mae purchases mortgages in periods when an expansion of mortgage lending activities is hampered by an insufficient supply of new investment funds. By purchasing FHA-insured or VA-guaranteed mortgages from private mortgage lenders at prices within the prevailing market range, Fannie Mae enables lenders at such times to reinvest their funds in new mortgages. In tight money periods, the Association can avoid excessive purchases which might conflict with national credit policy by adjusting upward both its fees and the percentage of the mortgage value each seller must apply to purchases of common stock in the Association.

Fannie Mae is authorized to have securities outstanding amounting to a maximum of 10 times its outstanding capital and surplus. The amount of preferred stock the Treasury

may buy is limited by statute, but the amount of common stock owned by the public depends largely on the amount of mortgages purchased by the Association. The Association requires each seller to buy stock amounting to between 1 and 2 percent of the unpaid balance of mortgages offered for sale, but it may vary the exact percentage depending on whether it wants to encourage or discourage investors from offering mortgages. (It may also increase the percentage when more capital stock is needed to permit greater borrowings for increased purchases of mortgages.)

Net purchases of mortgages tend to coincide with periods of heavy demands on the capital markets. For example, the Association made large secondary market purchases in the 1956-57 period, and again in 1959 and early 1960. On the other hand, net sales tend to coincide with periods of credit ease, when mortgage loans are easily absorbed in the market, and when investors are actively looking for relatively high yielding investments within a context of declining long-term interest rates. Thus, sales were concentrated in the recession months of early 1958 and early 1961, but also at times in 1962 and early 1963. Fannie Mae's role in the mortgage market during this recent upturn in residential construction was quite different from that of earlier expansions, largely because the mortgage market remained relatively easy. During most of this period, the supply of long-term investment funds competed for the supply of new mortgages being created; consequently, Fannie Mae both purchased mortgages to provide liquidity and sold mortgages to provide investment outlets.

Fannie Mae innovates

Purchases of mortgages in the secondary market began in 1955. Purchases at that time were financed by selling debentures to the Secretary of the Treasury, who held \$66 million under this arrangement by the end of the

¹ *Annual Report of the Housing and Home Finance Agency, 1961.*

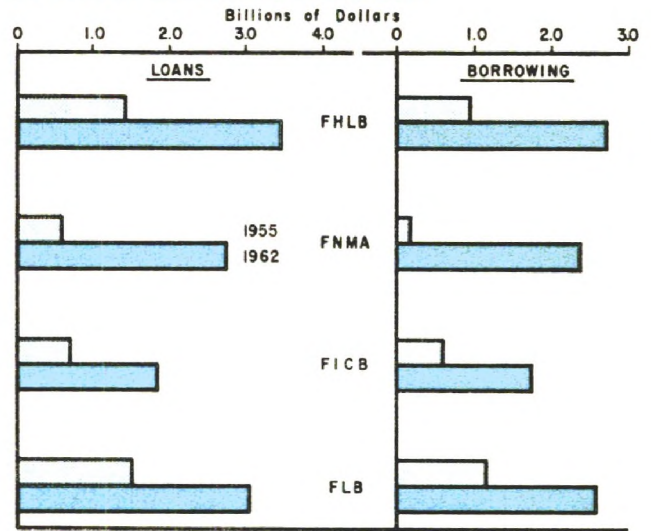
year. Public financing began in 1956, when three \$100 million issues were sold, each carrying 9-month maturities.¹ Since mortgage purchases were heavy in 1956 and 1957, by the end of the latter year the Association had \$1,315 million of (mostly short-term) debentures outstanding. In the easier money market of 1958, however, Fannie Mae began to shift toward longer-term financing. At the end of 1959, when it was again financing heavy purchases of mortgages, only \$750 million of the \$2,190 million outstanding secondary market debentures were short-term issues. The tendency toward longer-term financing has since continued, so that by the end of 1962 the average length of maturity was nearly six years. Early in 1962, in fact, the Agency sold a \$200 million issue with a maturity of 15 years, the longest maturity it has yet sold.

Short-term financing, nonetheless, has remained an indispensable adjunct to secondary market operations. In late 1959, when the Treasury was borrowing heavily to finance the huge deficit resulting from the 1957-58 recession, market rates on short-term issues rose above long-term rates, and Fannie Mae found itself competing in a very tight market. Consequently, in April 1960, the Association began to shift all its short-term borrowing operations to the commercial paper market, until eventually it replaced short-term coupon issues with discount notes.

Fannie Mae's discount notes represent a significant innovation in Agency financing. Their use reduces the need for interim borrowings from the Treasury between debenture

¹ The timing of debenture sales is partly controlled by considerations of practicability. To finance its secondary market operations between debenture sales, Fannie Mae can borrow short-term funds from the Treasury, which are reflected in the budget as expenditures. This is usually done until borrowings are large enough to make a debenture sale feasible. Sales are usually for \$100-\$200 million. All or part of the proceeds are then used to repay the Treasury.

Agencies add to borrowings as credit activities increase



Note: Data show outstanding loans and advances and outstanding bonds, notes and debentures, for selected Federal agencies.

Source: Board of Governors of Federal Reserve System.

sales, because they are frequently sold in small lots. They compete in the market with Treasury bills; unlike bills, however, they can be bought with maturity dates tailored to the individual needs of the investor. The Agency's quasi-governmental status enables it to obtain rates for its discount notes that are below commercial paper rates. Thus, as the market for Fannie Mae discount notes has developed, state and local governments have become an important factor in the market, and yields on discount notes have moved closer to Treasury bill yields.

By lengthening maturities and by adopting new short-term borrowing methods, therefore, Fannie Mae has introduced several significant innovations into its financing procedures. These changes have been more extensive than those of other agencies, possibly because its financial needs are more subject to change over short periods of time, and possibly also because its operations have a more direct impact on the Federal budget.