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How Fare the S&L's?

Last year, savings-and loan associations garnered $32 billion in net savings inflows and made $59 billion in new mortgage loans—both new records, by a long margin—but conditions may be somewhat different for them in 1973. To begin with, personal saving declined in the first quarter, as a surge in consumer spending outpaced the rise in consumer after-tax income. Even then, the saving decline might have been even more pronounced had consumers not been willing to finance much of their spending increase with new borrowings.

At the same time, a constant rise in short-term market rates progressively altered the yield structure to the disadvantage of thrift-institution saving flows. For example, the bellwether 90-day Treasury-bill rate rose from 5.06 percent in December to 6.69 percent in late May, while the rate payable on S&L passbook savings remained at 5.00 percent throughout this period.

Inflows (−) and outflows (+)

Net savings inflows through April ($9½ billion) consequently fell 20 percent below the record figure of the comparable year-ago period. New savings increased by 12 percent over a year ago, but withdrawals were up by 30 percent. In April alone, the net inflow was less than half that of a year ago, and S&L's in some sections of the country actually experienced net outflows.

In the face of this slowdown, the S&L's maintained a brisk pace of mortgage lending; new loans totalled $17 billion for the first four months of the year, and outstanding commitments at the end of April reached a record $15 billion—almost one-third above the year-ago level. To finance these commitments, the associations reduced their holdings of cash and investments by $1 billion in April alone, and meanwhile turned to the Federal Home Loan Banks for another $1 billion, raising their outstanding advances and other borrowings to almost $11 billion.

These developments were accompanied by increased pressure on both mortgage lending rates and non-price terms of lending (including down-payment requirements). By early May, rates on new conventional loans in some areas exceeded 8 percent—45 basis points above year-ago levels—and at that stage the Committee on Interest and Dividends "urgently" requested all mortgage-lending institutions to "exercise restraint" in their rate-setting. Towards the same end, the Federal Home Loan Bank Board permitted S&L's to reduce their liquidity from 7 to 6½ percent of their savings funds (including short-term borrowings), thus freeing roughly an additional $1 billion in loanable funds.

Factors in '73

Carl Kamp, Acting Bank Board Chairman, estimated early this year that both savings inflows and mortgage loans could fall about one-

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third below last year's levels, and the S&L performance to date suggests that he may well be right. However, much will depend upon the state of consumer expectations regarding incomes and prices. For example, if prices should continue to rise at a rapid rate, consumers could decide to spend more and perhaps even dissave. Should they do so, the flows of funds to the S&L's could be sharply affected.

Another factor could be the state of the long-term capital markets, which have been relatively stable in recent months because of the lack of heavy financing demands. Corporations, being heavy with liquidity, have been relatively minor participants in the market for some months, but they could begin borrowing again to fulfill their very heavy capital-investment programs, and in that case could put upward pressures on long-term rates. That development, in addition to its impact on mortgage-lending rates, could also affect S&L savings inflows by providing some savers an attractive alternative for their funds.

Still another factor could be the strength of housing demand. In early 1973, housing starts and home sales both remained at very high levels. However, declining activity in March and April, along with rising vacancy rates and rising inventories of unsold homes, suggested that the long-awaited adjustment had finally arrived. This would be no surprise, in view of the record pace of activity of the 1971-72 period, but industry spokesmen feared that the magnitude of the adjustment could be exacerbated by tightening of mortgage-credit conditions. According to the National Association of Homebuilders, a one-percentage-point increase in mortgage rates could lead to a decline of some 150,000 housing starts and of some 400,000 sales of existing homes—a large part of which is financed by S&L's.

Agency intervention

These considerations suggest that the various housing agencies may intervene increasingly to help stabilize mortgage-lending rates and prevent an excessive downturn in housing activity. (Already, as noted above, S&L's have increased their borrowings at Home Loan Banks by $1 billion.) Intervention could take the form not only of Federal Home Loan Bank advances, but also of secondary-market purchases of mortgages by FNMA (Federal National Mortgage Association), GNMA (Government National Mortgage Association) and the recently created FHLMC (Federal Home Loan Mortgage Corporation).

Very few believe that the housing agencies will again account for over two-fifths of net residential mort-

gage financing, as they did in the 1969 tight-money period. Still, in the context of a surging economy and the counter-measures required to curb the boom, increasing agency intervention is likely to ease the impact on housing activity and the S&L's. The other side of the coin, however, is increased borrowing by the agencies themselves to support their increased activity in the mortgage market. Through early May, agency borrowings exceeded $1.7 billion—only about one-fifth less than their total borrowings for all of 1972—and these activities of course created further pressures on the credit markets.

Longer-term issues

S&L's are concerned about a number of other issues besides the state of the 1973 housing market. These longer-term issues involve the curbing of the much-publicized NOW accounts (negotiable orders of withdrawal) currently being offered by mutual savings banks in several New England states; the question of permanent interest-rate controls on savings accounts, including the possible elimination of preferential rates for the S&L's; the Hunt Commission recommendations to expand S&L lending and investment powers while more nearly equalizing regulatory treatment vis-a-vis commercial banks; and lastly, the question of the possible participation by S&L's in an electronic-payments system. The last-named issue is probably the most crucial in the long run.

A priori, S&L participation would seem to fit in well with the Federal Reserve's goal of achieving an integrated nationwide system for the transfer of funds. S&L participation would help reduce the heavy volume of checks and paper-related transfers, and by increasing the volume of paperless transactions, would help realize the economies of scale which are essential to the ultimate success of an electronic-payments system. Related to this is the question of just what services might have to be offered to justify the costs of participation in such a system. The range is relatively broad, and could include consumer lending, overdraft privileges, and various services tied to a credit or cash card. In addition, there are legal questions with antitrust implications—for example, joint operation of financial facilities, and also freedom of access to such facilities as cash-dispensing machines, automated "satellite" offices and automatic clearinghouse arrangements. But all of this gets back to the larger issue regarding how much diversification the S&L's should be permitted if their main function is to finance housing—a role which now guarantees them preferential tax treatment and interest-rate differentials on savings accounts.

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