

Institutions specializing in mortgage finance, by and large, did not possess the financial resources or flexibility to cope with large and sudden shifts in savings flows and still maintain a flow of commitments and funds into the housing industry. The bulk of the liabilities of savings and loan associations and mutual savings banks are payable on short notice, while the bulk of their assets are of fixed yield, and turn over slowly. These institutions have been relatively slow in developing a structure of liabilities which would permit them to offer higher returns in order to immobilize, for fixed periods, the most highly interest-sensitive funds. Moreover, only a limited volume of loanable funds could be obtained from liquidating assets or borrowing from the Federal home loan banks to supplement diminished savings inflows.

Rigidities in our financial system, therefore, helped focus on home-builders and home buyers much of the initial impact of the financial restraint needed to curb inflationary credit flows. But as the year progressed, flows of credit to other borrowing sectors became more limited. State and local government borrowing began to be curtailed as large commercial banks, previously very active buyers of municipal securities, reduced their purchases to husband available funds. Consumer credit lenders, finding funds more expensive to acquire, began screening out some marginal borrowers. Credit extended to foreign borrowers by American lending institutions was sharply curtailed, even below the limits established in the voluntary foreign credit restraint program. Even domestic business firms, which previously had been most successful in increasing their external financing, were experiencing constraints on their borrowing ability, particularly at banks.

In addition to the earlier Board actions aimed at limiting the diversion of funds from the mortgage market, the presidents of Federal Reserve banks addressed a letter on September 1 to member banks urging moderation in business loan expansion in the interest of achieving a more balanced economic and credit expansion. The letter assured System members that banks losing deposits and adjusting their positions through curtailment of loan commitments would be able to obtain accommodation through the discount facilities of the Federal Reserve for longer periods than would be required if adjustments to deposit losses were to be accomplished through disposition of securities. The longer lived availability of Federal Reserve discount credit would thus permit member banks to adjust to deposit losses without adding to the pressures on construction finance or on markets for State and local government securities.

A similar kind of contingency planning had earlier been introduced with respect to nonbank thrift institutions and commercial banks not members of the Federal Reserve System. Some of these institutions have only limited access to public sources of emergency credit. Arrangements were activated, therefore, to permit Federal Reserve banks to provide credit assistance to any such institution that might suffer sudden withdrawals that could not be met by resort to its usual sources of funds. This facility was not expected to be needed, and has never in fact been used; it represented simply an assurance that protection existed against the remote possibility of exceptional drains of funds that could not be accommodated through normal adjustment procedures.