Under those conditions, entrance of the Federal Reserve on the buy side of the market for FNMA and FHLB issues could be expected to have only a minor effect on the costs of borrowing by these agencies. Since the overall posture of monetary policy must be dictated by economic conditions, purchases of these agency issues would have to be compensated for by equivalent sales of direct Treasury debt from the System's portfolio. Consequently, interest rates on average would be affected little. There might be some tendency for rates on agency issues to decline relative to other market rates, but rates would tend to rise on the Treasury securities that were sold in order to effect open-market purchases in these agency issues. The reduced costs of borrowing by these agencies would thus tend to be offset by higher borrowing costs on other Federal obligations.

Moreoever, the relative decline in rates on these agency issues would likely be small, inasmuch as there is an abundant supply of other Federal securities of comparable maturity to attract investment funds, and investors substitute freely between types of short-term debt as yield spreads change. The differential in yield between agency issues and comparable issues of direct Treasury debt reflects principally the market's evaluation of certain technical factors relating to the size, maturity, ease of marketability, and extent of Federal backing of agency issues. Such differentials can be narrowed by development of a broad private market acceptance, which could be forestalled by more active System intervention in what is, as yet, a relatively small market. A viable and broad private market for these issues would be more likely to develop over the longer-run if demand and supply forces were allowed to work with minimal direct System support.

The proposal to lengthen the maturity of the System's portfolio, the other part of Mr. Reuss' suggestion for dealing with potential problems of housing finance, seems unlikely to be of material benefit to homebuilding during a period of monetary restraint. Indeed, such maturity switches might even result in an additional constriction of mortgage fund availability. Maturity lengthening in the System's portfolio would, to some degree, reduce rates on long-term market securities relative to those on short-term instruments. This would encourage some institutional investors to acquire fewer long-term market securities and more mortgages. But at the same time, the increase in short-term rates would probably reduce the inflow of deposits and shares at nonbank thrift institutions, and this would tend to restrict funds to the mortgage market. This channel of influence stemming from lengthening of maturities in the System's portfolio might well be the more significant channel affecting mortgage fund availability.

There is still reason to be concerned that policies of monetary restraint may fall more heavily on housing than on other activities, so long as artificial rigidities and imperfections in the structure of housing finance are maintained. Measures designed to remove the impediments to a more stable flow of funds to residential construction would help to spread the burden of restraint more uniformly, and offer the greatest promise of avoiding unnecessarily sharp contractions in homebuilding.