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THE WHITE HOUSE

PRESS CONFERENCE

OF

WILLIAM E. SIMON
SECRETARY OF THE TREASURY

AND

STEPHEN S. GARDNER
DEPUTY SECRETARY OF THE TREASURY

THE BRIEFING ROOM

9:55 A.M. EDT

MR. HUSHEN: The President is transmitting to Congress today legislation which expands competition, provides approved customer service and strengthens the ability of financial institutions to adjust to changing economic conditions.

We have here today Secretary of the Treasury William Simon, and Deputy Secretary Steve Gardner, who will explain the legislation and answer your questions.

You should have in your hands a copy of the message, a fact sheet, and charts. We have additional information which will be available after the briefing.

Secretary Simon.

SECRETARY SIMON: Ladies and gentlemen, as you know, in announcing a number of his initiatives last fall, the President proposed a careful review of all government regulations that restrict competition and results in higher cost to consumers.

One of the initiatives the President referred to was the Financial Institution Act of 1973. As all of you know, that act has a long history. It was the outgrowth of extensive studies of the Hunt Commission that began really over five years ago. Almost two years ago, George Shultz and I met with you to introduce that act, and this, I certainly think, is a great indication of how difficult it is to end government regulation that is costing our consumers in this country tens of billions of dollars.

Today, after a period of careful review that concludes the extensive hearings that were held in the Senate in 1973 and 1974, the President is resubmitting the basic legislation and transmitting it to Congress as the Financial Institution Act of 1975.

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There are some changes in the bill -- which my associate are here to talk to you about today -- but the new bill really calls for essentially the same reforms we needed then and the same reforms we need now which will help in strengthening our economy. This is more than just the regulatory reform.

It is fundamentally a consumer measure which will result in increased competition, increased services and returns to small savers and broader competition among institutions, which are now limited by the existing regulations.

It is also very timely economic reform because it provides the flexibility that many institutions need.

In addition, it is going to provide new incentives to many financial institutions to invest in home mortgages: those institutions that are not doing it today to the extent we all know they can.

Therefore, it is going to aid homebuyers as well as the housing industry.

I think the events of the past two years in particular, and the events of the past decade in general, serve far better than any speeches or any testimony can to emphasize the critical need for this type of reform.

When the Financial Institutions Act was debated and discussed last year, we had a crisis in the money markets. Small savers were prevented from getting market returns on their savings. Institutions that served savers were losing deposits and the mortgages they traditionally provide were virtually unobtainable.

Now that interest rates are declining and funds are again flowing back to the thrift institutions, it is high time we carefully consider the merits of the proposal that is aimed to preventing a recurrence of these conditions.

As George Shultz did with me almost two years ago, I would like to introduce now my Deputy Secretary of the Treasury, Steve Gardner, who will provide you with a full opportunity to discuss this proposal with you.

MR. GARDNER: Thank you, Bill.

The last time I was here, I came with the group that discussed the Pension Act, ERSI, and that was a heavy, complex, difficult act that had contained innumerable features.

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I think the Financial Institutions Act is also a heavy, complex act because of the traditional nature of regulation of financial institutions. I hope here this morning to just quickly run over the basic concept. The act is not a new one, although we changed it. To give you some flavor of why we changed it and what we are doing in the act, and to try to answer broadly your questions are my associates. I have a number here from the Treasury, which I may call on, in addition to our press corps from the Treasury.

So, with that opening statement, let me begin by saying that basically in this country, we have placed a limit on the amount of interest that a small saver can earn on his savings account, beginning back in 1966, I think. That was an abortive effort in order to prevent the thrift and banking institutions that provide the small saver, with all of his various financial needs, from receiving a market rate.

It did not really matter too much until we had very high interest rates. Time and again, there have been several periods when we had very tough high interest rates, and then a word crept into our vocabulary called "disintermediation." I will not attempt to define disintermediation. Technically, it simply meant the traditional funds that flowed to these institutions, financial intermediaries that served the small saver, were disrupted. People sought market rates as market rates reached extraordinary heights.

The result was very clear. The main institutions that finance home mortgages in this country suddenly were without a flow of funds that was normal. You all know that last year it was very difficult to obtain a mortgage. One of the reasons -- and one of the very important reasons -- was that funds were not flowing into those institutions that traditionally grant mortgages.

So, I think it is high time that we reintroduce the act. We have held extensive hearings. There are many other features to the act, and generally speaking, they broaden the opportunity for competition because they provide checking account services in savings institutions in addition to the checking account services that already exist in commercial banks.

They provide, in addition, the opportunity for thrift institutions, or savings institutions, to invest their assets a little more broadly, not totally, in market rate instruments like consumer loans. This helps the thrift institution serve the whole family financial needs of our citizens.

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In addition, they broaden and liberalize some of the powers of credit unions, which, as you know, are non-profit associations and selected membership. Credit unions will be able to make larger loans. They will be able to compete for funds by having a variety of depository instruments to offer. They will be able to make mortgage loans, if they are Federally chartered, to their own members, which they are now really prohibited from doing.

Going to the commercial banking industry, the act provides for all investors in mortgages the mortgage interest tax credit. That mortgage interest tax credit we think is a fine incentive to increase investments in home mortgages.

There are many other features of the act deeply technical. Let me tell you what we have done to it since 1973, when you were perhaps all familiar with it. Because we are removing deposit ceilings 5-1/2 years from now, we have agreed to conduct an administrative review of the economic conditions that exist at that time.

That was not in the old act, and in conducting that review, I think it is just good, common sense to look at the whole situation when Regulation Q, and other restraints on the amount of interest that can be paid to small savers, are finally ended.

Those restraints will be ended, but nevertheless, we will have an administrative review. If the world is in chaos, perhaps we will change our minds, but the act calls for the ending of deposit ceilings.

In addition to that, we used to have in the act something called the phase-out of the differential. We have these lovely words in financial institution legislation. That simply means that the regulators have, since the inception of the interest rate ceilings, given a higher rate of return permissible to the thrift institutions than was permissible by the offering of the commercial banks.

That differential originally approached .5 percent. You could get a little more for your savings in a savings bank or a thrift institution than you could in a commercial bank. The differential is now about one-quarter of one percent, and the original act called for a phase-out of the differential. That differential is within the administrative capability of the regulators, and the phase-out of the differential language in the old act provided for a phase-out over a period of years one-quarter at a time.

This just did not make any sense, so we dropped all reference to the phase-out of the differential in the act.

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In the case of the mortgage interest tax credit, it was originally conceived to be a substitute for the way thrift institutions compute their bad debt loss reserve. By that highly technical process, they have an incentive for investing in mortgages because they are allowed to charge off bad debts in their accounting process.

Under our revised act, we are going to permit them to retain their present system for a period of three or four years, when they must then change to the mortgage interest tax credit system.

The commercial banks, for the first time, will have the availability of the mortgage interest tax credit incentive for investing in residential mortgages.

This act is complex, and I think one of the quick ways that I can describe the situation most effectively is to allude to this chart.

If you look at the number of institutions -- and I hope you all have the chart -- that exist in the country that are depository in nature, you will see that we have a very large number.

We have 14,000 commercial banks. We have 23,000 credit unions. We have 5,000 savings and loan associations. We have a small number of mutual savings banks, principally in the East, that is an old form of financial organization that grew up early in the country and did not expand across the country as widely as have savings and loan associations and commercial banks.

We are talking about a country that has a very unique financial structure. We have a very large number of institutions. Those institutions, by definition, are mostly small; both the commercial banks and the credit unions and the savings and loan associations. They are your neighborhood financial institution.

You can see the breakdown of deposits between those institutions and, of course, commercial banks being the only institution that at the present time can have demand deposit accounts of major corporations or all businesses certainly have a very large proportion of the assets.

That is not a fair distribution in terms of family financial business. I think the picture would look a little different if we had excluded commercial, but I am just pointing out to you the size and complexity of the United States financial institution structure.

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Traditionally, it is much more diversified than it is in other countries.

Residential mortgage holdings are the third high chart, and that simply shows where the bulk of mortgages are held in the United States and the kinds of institutions that fund or provide these mortgage funds.

The last one is the most significant in the sense that we dramatized what happens to a consumer with a passbook savings account when interest rates rise and fall. I guess you can see clearly that the short-term Treasury three-month bill, which we used for a special reason, has floated way above passbook ceiling rates time and again, and significantly above.

It is true that you can get certificates of deposits at various financial institutions that pay higher rates than passbook savings, but they are, as you know, maturity instruments that go on for a longer period of time than 30 days, so we put in the passbook ceiling rate.

I have just touched the high spots here of what the act is about, alluded to its history and talked about the changes that we have made which they think are responsive. I want to say that we think we are dealing with an act that has been rather thoroughly explored already.

It was introduced in the Congress. As Bill Simon said, in 1973 hearings were held in the Senate. Industry associations of all types and groups from all persuasions have met with and talked to the Treasury. The regulators in government, with the Treasury taking the lead, have considered all phases of the act.

So, we are sending a new act to the Congress for the specific purposes, as the Secretary has indicated, of getting on with the business of trying to make our government regulations more consistent with changing economic conditions, hopefully, and directly to improve the vitality of our system, to provide better services to our people.

I should say, incidentally, that some of the other features that I have not touched on are routine but very important.

The Truth in Savings Act is a kind of regulation that will parallel the Truth in Lending Act, and while our fact sheet says it will apply to banks, I want to make it very clear that was a euphemism. The Truth in Savings will apply to all depository institutions, the savings institutions, the credit unions and the like.

(Correction: The Truth in Savings provision does not apply to credit unions.)

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Q Mr. Gardner, assuming your act was passed into law, how would that affect Chart 2? How would the pie that indicates deposits size be sliced?

MR. GARDNER: I think it would affect it modestly, but not significantly because I would have to give you a breakdown of individual savings and individual checking accounts vis-a-vis these various institutions, and I mean family checking accounts.

The commercial banks are the traditional financiers of business, so the deposit chart is heavily weighted by the size of their business deposit accounts. It will, however, provide more competition because the mutual savings banks and the savings and loan associations will be able to offer checking accounts.

If you deal only with a savings and loan association -- and now you have got to buy a check if you want to pay a bill -- you will be able to get a checking account from that association. Family financial competition will increase.

Q Mr. Gardner, the last Congress did not pass this. What makes you think this Congress will handle it any differently?

MR. GARDNER: I think that the last Congress delayed -- it certainly did not pass this -- but we got hearings in the Senate. We hope to get hearings in both the House and the Senate.

We have seen the pronouncements of the various new chairmen of the various committees who are very interested in reform, financial reform. This is clearly good financial reform, and I am confident that this will be given serious attention in Congress. I predict it will eventually pass in Congress.

Q Mr. Gardner, the banks are going to have to pay out more to customers. Do you think this will lead them to make riskier investments? What protection is there against their not making riskier investments to cover the increased cost?

MR. GARDNER: There are all the traditional protections. Banks, savings and loans, mutual savings banks and others are examined and regulated as to the kinds of investments they make and so forth. I do not know whether they are going to make riskier investments. I doubt that any responsible financial institution will.

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What I am trying to say is that in the periods of very tight money, very large amounts of funds were pushed into the very short-term money market, commercial paper, treasury bills, CDs of 100,000 or over.

In our economic malaise of this last year or 12 months, we have had huge amounts of short-term credit seeking very high money market rates. The small savers had great difficulty reacting and getting into that marketplace.

Through the release or the demise of Q, they will have more opportunity and the institutions that are their financial intermediaries will have more opportunity to pay a fairer rate because we are indeed making changes in what these institutions are allowed to invest in and they will be able to invest in more sensitive money market instruments, which should permit them to pay a higher rate.

Q Mr. Gardner, aren't you saying to small savers that they are just going to have to wait a while? They are going to have to wait five years, and then if economic conditions are bad enough, they are even going to have to wait longer?

MR. GARDNER: I hope not. They have now a ceiling on their deposits, on the amount of interest that can be paid on those deposits.

That ceiling is the administrative responsibility of the various parallel regulators in government -- the FDIC, the Federal Reserve Bank, the Federal Home Loan Bank Board, and the like.

What we are saying is that there will be no ceiling five and one-half years from now, and that period is believed a responsible and necessary period to permit the institutions that are affected to adjust the assets side of their ledgers so that they are able to meet competition among themselves and the money market world.

Q I thought this bill, however, would give you the option of perhaps changing that deadline from five and one-half years to maybe six or seven at the end of five years.

MR. GARDNER: No, the bill calls for five and one-half years. That is the original language. The review is just what you would normally expect anybody to do when a protracted period of change finally takes place.

I think we cannot predict the economic conditions five and one-half years from now, and we thought it was responsible to include in the legislation a full administrative review of the economy.

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Q That review would give you the opportunity to recommend perhaps that the ceiling be retained after five and one-half years.

MR. GARDNER: Only on the basis that Congress would have to pass new legislation.

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Q Mr. Gardner, there is a mention here of a coordinating committee of financial regulators. Is that a formally constituted body or is this just people that are normally involved in financial institutions?

MR. GARDNER: The act provides that the Treasury join that body which in fact does meet and coordinate. It includes the FDIC, the Federal Home Loan Bank Board, the Federal Reserve, and the Comptroller of the Currency. Andy, how formal is the coordinating committee?

MR. ANDY CAROTHERS (Legislative Counsel): It was established by President Johnson.

MR. GARDNER: I get a better answer from my associates than I can give you myself.

Q Mr. Gardner, this bill would take the interest rate ceiling off of VA and FHA mortgages. How high do you think that interest rate is going to go?

MR. GARDNER: I don't think it is going to go any higher than the market rate. The point of the removal of the ceilings is, clearly, as you remember, when mortgage rates went above the legislated ceilings then the business of charging points on the principal came into play.

As a normal course of events, and in order to get an FHA or VA mortgage, you had to pay more for the house because your interest rate was artificially held down. I do not want to make any prediction as to how high or how low VA and FHA ceilings, or rather interest rates, will go, but they will be more responsive to the market rate and the business of charging points, which occurred not only on FHA and VA, but in those states where there are usury ceilings on mortgage interest.

Q What is the inflationary impact of this bill in terms of driving up the price corporations must charge to pay off high interest loans dictated by higher interest deposits?

MR. GARDNER: The inflationary impact in that area we have not felt existed for the simple reason that we are taking off restrictions and permitting a market rate and a market flow of funds.

The idea that that would drive up the rates that corporations would have to pay would only be a minor part of any existing economic condition at any particular time.

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Q Mr. Gardner, if you take the ceilings off the savings rates, won't the institutions have to charge significantly more for their mortgage monies? How much higher do you anticipate the consumers would have to pay for mortgages after the ceilings are eliminated?

MR. GARDNER: We are going to allow those institutions or we propose that those institutions that invest heavily in mortgage be allowed to diversify their investment to some extent so we do not think there will be a direct cause and effect here of removal of ceilings vis-a-vis much higher mortgage interest rates.

We are permitting S&L's, mutual savings banks, and others, to invest more broadly in interest sensitive instruments, consumer loans, for example, where the rates are traditionally higher.

I, like the rest of you, hope we never see 12 percent prime rate again in this country. It is symptomatic of a very difficult economic condition. As you know, all of our economic programs in government and the interest of our regulators and our administration is maintaining a more even economic flow.

Q Mr. Gardner, as you said, this is a kind of complicated act for a lot of regular people to understand. Could you give me kind of a short shopping list of what things in 5-1/2 years the American consumers could find at their finger tips? Where would it make a difference in checking accounts and savings accounts?

MR. GARDNER: The American consumers will find at their finger tips right away that their local savings institutions will be able to offer them checking accounts; that their commercial bank will be able to offer them NOW accounts -- negotiable order of withdrawal accounts.

I did not touch on that, and I should, because that is a system that exists in Massachusetts and New Hampshire, and nowhere else in the country, and that will permit an institution -- be it a commercial bank or a savings institution -- to provide a service to a client which says, "You can put your money in a savings account. We have the right to withhold payment of that for 30 days but traditionally, or typically, we won't use that right and if you order us to send checks here, there and everywhere, you can substitute that kind of activity for a checking account."

That already exists in Massachusetts and New Hampshire, and nowhere else in the country. This would make it available to commercial banks and the other savings institutions throughout the U.S.

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Q In effect, that is interest on a checking account?

MR. GARDNER: Interest on an account that is similar to a checking account--not a checking account specifically, but similar to a checking account. So, right away, your local thrift institution could offer a checking account. It could offer a NOW account. Your commercial bank could offer a NOW account and your credit union could make a larger loan than it is presently allowed to make. Your credit union could grant you a mortgage for your home which they cannot now do.

Hopefully, your commercial bank will decide to increase its investment in home mortgages.

Q Mr. Gardner, will there be any changes in the bank examining structures if this act is to be passed?

MR. GARDNER: Not specifically as a result of this act. The Hunt Commission covered both regulation and powers granted institutions and the regulatory side is still in abeyance.

Q Mr. Gardner, why did you feel it worthwhile at this time to create another tax credit, tax incentive, for the home building industry? Do you have any estimates of what the tax expenditure costs under tax credit relief?

MR. GARDNER: Yes, I have estimates of what it costs. Number one, the form in which it is being developed is in substitution for an existing accounting procedure that is available to savings institutions, so it is in substitution of that.

The tax credit is also extended to other people who may invest in mortgages -- individuals or corporations. Of course, that would include significantly the commercial banking industry. We think that there has been a clear and present path in this country to support home building.

This proposal was in our original act in the hope that we would broaden the market for mortgages beginning several years ago. If we had had this proposal in the act, hopefully we would have persuaded more people to invest in mortgages. This comes in the financial intermediate stage where a builder and a buyer must meet in order to have a mortgage created, or in order to have a sale take place a mortgage must be created.

I don't think I have to explain why America, with its unique incidence of personal home ownership is involved in providing incentives. Good Lord, we provided enormous incentives in government, in another way, when the housing industry dipped severely.

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I think this is a much more responsible way. I do not tout it as the answer to all the housing industry's problems by any stretch of the imagination, but I think it is a carefully thought out, appropriate kind of a credit which will increase the interest of financial institutions broadly in making home mortgage loans.

Now, the inflation impact on this -- we are only able to estimate that. I think our figure today, after we set off what thrift institutions can now do and replace it with the mortgage tax credit, is around \$440 million.

MR. KENT COLTON (Special Assistant to the Secretary): \$448 million in the first year is our estimate, 1976.

Q That is a plus. Under the accounting change, it would cost an additional \$448 million in revenue loss?

MR. COLTON: That is correct.

Q Does it go up or down?

Q What are the out-year projections of that number?

MR. GARDNER: We are having some difficulty. We are using a base, and we have the latest figures.

Dale, do you remember what base we are using now for that estimate?

MR. DALE COLLINSON (Deputy Tax Legislative Counsel): We are using the base from 1972, projecting it forward.

MR. GARDNER: But this is a constantly changing estimate, isn't it, as we get additional figures available?

MR. COLTON: The number rises, but the rise is primarily because we are estimating the number of mortgages in the country is going to go up, so it is increasing, but not because the formula changes. The effect is because of the increase in mortgages.

MR. GARDNER: What do we have for an out-year projection at present?

MR. COLLINSON: \$725 million for 1980.

MR. GARDNER: \$725 million for 1980 is an estimate and one that I do not have much confidence in, all other conditions remaining exactly the same, which they won't.

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Q Is that more or less?

MR. GARDNER: It goes from \$448 million to \$725 million in 1980, which is loss of revenue.

Q But you did not have too much confidence in the \$725 million figure? In which sense? Is it too low or too high?

MR. GARDNER: I think it is too high, but that is my own personal opinion, unsupported by my statisticians.

Q Why aren't you recommending that the Regulation Q ceiling be eliminated immediately?

MR. GARDNER: Because we think this very large number of savings and loan institutions, mutual savings banks and the like, need a responsible period to adjust their asset structure. Number one, they will get inflows of demand deposits. Number two, they will be able to invest in some consumer loans and some other types of paper which are market sensitive, and it should take them a while to turn around.

They now have a preference under the differential of the interest rate ceilings.

Q If the Federal regulatory agency decided to eliminate the differential during that 5-1/2 year period, would you oppose that?

MR. GARDNER: I would not oppose it, but I would hope they did it responsibly. They have the power to do it. If market conditions change, it may well be an item of their consideration. If you get this act passed, we will be on the coordinating committee.

Q Let me get this straight. There has been no assessment made of the inflationary impact of this bill, and you expect none?

MR. GARDNER: No, that is not what I said.

Q There has been no assessment?

MR. GARDNER: I said that we will lose \$448 million of revenue. That is an inflationary impact in a sense, and that could rise to \$750 million, but I doubt that.

Q That is just on the tax measure?

MR. GARDNER: That is correct.

Q Take a look at this chart. If a bank is paying its depositors, say, 8 percent, they are up in the top. That is backed by the U.S. government. It has to charge a corporation a lot more than that, like last summer when they had to charge somewhere in excess of 12. If a corporation builds a new plant with 12 percent money, it has to charge more than that to recoup the investment?

MR. GARDNER: What you are saying is that that portion of bank assets that now largely invested in savings is the major part of the money stream. I do not agree with that. I don't see how you can define the inflationary impact of the total money flows in the economy because all we are doing is suggesting that market rates will be more closely observed by the various kinds of institutions that pay interest to small savers.

I think we might enlarge the amount of funds that people were paying such high prices for in the past. Therefore, we might, in total, lower interest rates. So, I do not believe that that inflationary impact that you perceive exists.

Q You are seeing a fluctuation in the passbook savings rate, then?

MR. GARDNER: Do I see a fluctuation in the passbook savings rate? I do not have the whole other family of rates that mutuals and thrifts can pay on this chart because they are longer maturity instruments. I was comparing the shorter maturity instruments.

Q Would you see variable interest rates on loans, then?

MR. GARDNER: We already have variable interest rates on loans.

Q Not in a large fraction of them.

MR. GARDNER: It depends on the kinds of loans you are talking about. Banks make many loans tied to various indexes, called the prime rate, and prime rate plus one, two, three, and so forth, that already exist in a large part of the lending in this country.

Consumer loans being of short maturity, usually, are not usually indexed, but then they turn over and the next consumer loan is made at a higher rate.

Q Mr. Gardner, you said in your opening remarks that the phase-out of the rate differential did not make any sense. Why does it not make any sense and why, if it did, did the Administration --

MR. GARDNER: There was a technical reason.

Q Why did the Administration initially recommend that?

MR. GARDNER: When we initially suggested it, I guess I was not here. I came in August. When we initially suggested it, the differential was one-half, and whoever wrote this act -- not me -- said we would split that into four pieces.

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Now, the differential is one-quarter, and being a former banker, I wondered how I would have advertised if I remained in my business that I had gone down one-quarter of one-quarter or gone up one-quarter of one-quarter. It just did not make any sense. You do not phase-out one-quarter of one-quarter percent differential.

Q Mr. Gardner, you may have touched on this, but I want to be clear about this: Are you saying the era of low interest loans is over, but the fact that VA and FHA loans are now floating in the market, or will be floating in the market, just like any other loan?

MR. GARDNER: No, I am not saying they are over. I am saying the process by which a final sale is made with a VA or FHA mortgage usually included points which disguised the interest rate.

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Q But they were one-shot deals, were they not? You paid those points at the time of closing?

MR. GARDNER: Yes, but if you ground the points into the formula, you would get then the true rate. They were big enough so that they did impact and compensate for the fact that there was a ceiling on the rate itself.

Q The important thing was that they were a one-shot deal, was it not?

MR. GARDNER: Sure.

Q When you raise the interest rates or take the ceiling off of FHA or VA loans, that is through the whole life of the loan.

MR. GARDNER: One thing I have to convince you of, either during the conference or after, is the fact that points, per se, represented a way to circumvent a ceiling on rates. By definition, the size of the loan being larger because points were paid at the outset and amortized over its 30 years carried implicitly a higher disguised rate than the actual rate in the mortgage.

All I have to do is get one of my experts to show you how points precisely work to see that when somebody thought they might have been paying 7.5 percent they were, in fact, paying 8-3/4, or something like that, and I think I could do it.

Q Why wasn't that described to the man who got the loan at the time, then? Hasn't the government kind of been fooling the mortgage buyer this whole time, that VA and FHA loans are not really cheap?

MR. GARDNER: I think points are well known to those who have gotten involved in any home purchase.

Q I disagree with you.

MR. GARDNER: It is honest disagreement.

Q Is that legal or illegal, the runaround on the ceiling on VA and FHA loans?

MR. GARDNER: I don't think it was illegal, or we would have had a terrible situation in this country.

Q Mr. Gardner, would you sketch the economic situation or circumstances that might lead the Administration, five years from now, to ask Congress to keep the ceilings on?

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MR. GARDNER: I can hardly conceive of such circumstances. I want to get rid of them.

Q Mr. Gardner, when will the differential end, when will this be eliminated and when will the loan provisions come into effect?

MR. GARDNER: The loan provisions will come into effect when Congress passes the act. The differential will be eliminated if the administrators, in their judgment, do not do anything to the differential. I am talking about the regulatory group. The differential would have to expire at the same time that the Regulation Q expired.

Q Mr. Gardner, if we did not have interest rate ceilings last year, what would the passbook savings rate at a savings and loan or bank have had to be to meet the market demands to let the small saver --

MR. GARDNER: You are asking a question I cannot basically answer. I can guess, but remember, a passbook saving rate -- and they do vary throughout the country -- is available on instant withdrawal as opposed to a certificate of deposit, in which you make an agreement with the bank that you will wait until maturity to get your funds.

Not all banks and not all savings institutions have paid the maximum permitted by the regulators. If we had this free marketplace that I am talking about, I would guess you would have added a 1 percent on your 4.5 percent rate or something on the passbook savings, and maybe much higher rates on the certificates of deposit.

Q A 6 percent passbook?

MR. GARDNER: It is possible. There are some now where 90-day provisions apply to withdrawal. That is just a horseback guess, but it would certainly have improved the rate of return.

In the certificates of deposit, banks and savings institutions might well have offered -- as indeed they did in August of 1973 -- something called the "wild card." Do you remember that? There were indexed rates, and you saw what happened then. They were paying 8 percent or higher on some of those instruments. That was an example of an aborted effort in the free marketplace.

Q But the mortgage rate went way up, also, as a result.

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MR. GARDNER: We cannot take a month for a month's activity on the deposit side. The mortgage rate went up for all kinds of reasons, too.

Q Does this act allow any flexibility in the rate paid on U.S. savings bonds?

MR. GARDNER: No.

Q Should it be? Why isn't it?

MR. GARDNER: That is a separate thing. That is part of the government debt. Anytime you look at savings bonds, you are talking about our statutory authority involving the whole government debt picture.

Q Why shouldn't savings bond rates be flexible?

MR. GARDNER: We hope they would be flexible. This is aimed at financial institutions. The Treasury is not yet in that category.

Q Mr. Gardner, will the 3.5 tax credit go up and down, and under what conditions?

MR. GARDNER: I can perceive that the law could be changed, but the 3.5 max is established in current law, in the proposed law. That makes it simply tax legislation. Incidentally, that portion of the bill would have to go through Ways and Means as opposed to the other portion of the bill going through House Banking and Currency and so forth.

I would guess, as the economic climate moves on, there would be constant or various reviews, both in the offices of the financial managers in the government and in the Congress, if that rate became seriously defective.

You know how frequently we have concerns about taxes around the government. However, it would be part of our tax law, and it would have to be changed by that method.

Q On this chart, you indicate about \$370 billion in outstanding residential mortgage holdings. According to the latest numbers I have heard, Treasury or the U.S. government is going to be going into the market with something between a quarter and a third of that total amount to cover the deficit over the next two years.

What is that going to do to the availability of interest rates on mortgage loans?

MORE

MR. GARDNER: I am glad you asked that. We have been talking about our concern with what is going to happen in the budgetary process this year or fiscal 1976. We are going to be borrowing an enormous amount of money, but we are not only going to impact mortgages, we are going to impact all the corporate debt securities.

You raised a very good point. The validity of the act is aside. We are going to have great trouble in the U.S. by the size of the Federal borrowings in the money market. Clearly, we will impact all kinds of long-term capital, of which indeed mortgage capital is one.

We mentioned that. We have been concerned about it. We think we are on the thin edge of usurping the private credit markets. We have to get a recovery going in this economy without serious inflation, and so forth, in order to come out of that.

Q What is going to happen if things continue as they are now, for instance? Say the GNP stays flat? Now it is going down, but assume it comes back to staying flat.

MR. GARDNER: I think it will come back, but go ahead.

Q What will happen to the availability and rate on mortgage loans then, or corporate borrowing?

MR. GARDNER: All I can do is allude to our past expressions and testimony on this issue. We were on some kind of uncharted waters with the size of the Federal borrowing today, and the marketplace so far, with a heavy corporate calendar, has seemed to agree with us that we can maybe just get by on our original estimates because for a little while we had some strength in the bond markets.

Further, you may have noted that with flows of funds now coming back into thrift institutions, there is mortgage money available and that is a precondition for any recovery in housing.

But, as the year moves on, if we get our best hopes, in terms of recovery for housing and improvements in the economy and, at the same time, are faced with an increasing borrowing requirement, we are going to be in a very delicate position.

THE PRESS: Thank you, gentlemen.

END (AT 10:55 A.M. EDT)