**Fed Wants to Keep Rates Low to Ensure Housing Is Affordable, Dudley Says**

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By Caroline Salas Gage - Oct 24, 2011 11:42 AM ET

Federal Reserve Bank of [New York](http://topics.bloomberg.com/new-york/) President William C. Dudley said the central bank wants to keep mortgage interest rates from rising too much and may do more to hold down borrowing costs.

The Fed’s decision last month to reinvest proceeds from maturing housing debt into mortgage-backed securities was a “signal that we do have concern about the level of mortgage spreads,” Dudley said today. “Clearly we’ve indicated our interest in supporting the housing market” and keeping yields from “getting too elevated.”

Policy makers approved the action as part of an effort to spur the economy with lower borrowing costs by replacing $400 billion of short-term Treasuries in the Fed’s portfolio with longer-term bonds. The decision prompted dissents from three regional Fed presidents: [Richard Fisher](http://topics.bloomberg.com/richard-fisher/) of [Dallas](http://topics.bloomberg.com/dallas/), [Charles Plosser](http://topics.bloomberg.com/charles-plosser/) of Philadelphia and [Narayana Kocherlakota](http://topics.bloomberg.com/narayana-kocherlakota/) of [Minneapolis](http://topics.bloomberg.com/minneapolis/).

“We could move a degree more in that direction,” and policy makers “do care about the level of housing affordability,” Dudley said in response to audience questions after a speech at [Fordham University](http://topics.bloomberg.com/fordham-university/) in the Bronx, New York.

Fisher said today the Fed’s so-called Operation Twist, in which it swaps shorter-term debt with longer-maturity bonds to push down long-term rates, isn’t showing signs of succeeding.

“It’s not clear Operation Twist works,” Fisher said to reporters after a speech in Toronto. “The 10-year note is actually backed up, not gone down.”

Little Changed

The yield on 10-year Treasuries was little changed at 2.23 percent at 11:27 a.m. in New York trading, compared to 1.86 percent on Sept. 21, when the Fed announced Operation Twist.

Separately today, the U.S. government announced that a mortgage relief program will expand to allow homeowners to refinance regardless of how much their houses have dropped in value. The [Federal Housing Finance Agency](http://topics.bloomberg.com/federal-housing-finance-agency/) also said it will eliminate some fees as part of the changes announced today to the Home Affordable Refinance Program, or HARP.

Fed officials are developing options for further monetary easing even as better-than-forecast economic reports have allayed concerns the U.S. may relapse into a recession. Fed Vice Chairman [Janet Yellen](http://topics.bloomberg.com/janet-yellen/) said last week that a third round of large-scale asset purchases “might become appropriate if evolving economic conditions called for significantly greater monetary accommodation.” Governor [Daniel Tarullo](http://topics.bloomberg.com/daniel-tarullo/) said buying mortgage-backed securities “should move back up toward the top of the list of options.”

Offer More Clarity

Dudley said the Fed is also considering ways to offer more clarity in public communication about when it plans to raise interest rates. “This is something that we’re discussing but it’s a fairly complicated question of how we actually represent that in a compact way,” he said. “It’s hard to do that.”

The Fed pledged in August to hold interest rates near zero through at least mid-2013.

That move, along with the decisions last month to shift the Fed portfolio toward longer-term bonds and reinvest proceeds from maturing housing debt into mortgage-backed securities, “will be helpful in supporting growth and jobs,” Dudley said in his speech. “However, I do not think that monetary policy is all-powerful. To get the strongest possible recovery we need reinforcing action in areas such as housing and fiscal policy.”

Key Factor

Bolstering the housing market is “particularly important” because it’s a key factor in household wealth, he said. [Home prices](http://topics.bloomberg.com/home-prices/) in the U.S. were down 31 percent as of June from the peak reached in June 2006, according to figures from S&P/Case- Shiller. A combined 5.23 million new and existing homes were sold in 2010, a 13-year low and 37 percent fewer than the record 8.36 million bought in 2005.

“Continued house price declines could lead to even more defaults, foreclosures and distress sales, undermining wealth, confidence and spending,” Dudley said in his speech. “Breaking this vicious cycle is one of the most pressing issues facing policy makers.”

The average [interest rate](http://topics.bloomberg.com/interest-rate/) on a typical 30-year fixed-rate home loan declined to 4.17 percent on Oct. 21 from 5.06 percent in February and reached a low of 4 percent earlier this month, according to Bankrate.com data.

Still, sales of previously owned homes fell 3 percent last month to a 4.91 million annual rate, matching the median forecast of economists surveyed by Bloomberg News, figures from the National Association of Realtors showed last week. The median price dropped 3.5 percent from a year ago and about one in five real-estate agents polled said contracts had been canceled, the group said.

“If prospective homeowners no longer fear that prices could decline further, they will be more willing to enter the market to take advantage of reduced prices and low financing costs, and existing homeowners will feel more confident about spending,” Dudley said. “A vicious cycle could be replaced by a virtuous circle, in which stabilization in [house prices](http://topics.bloomberg.com/house-prices/) supports spending, growth and jobs.”

To contact the reporter on this story: Caroline Salas Gage in New York at [csalas1@bloomberg.net](mailto:csalas1@bloomberg.net)

To contact the editor responsible for this story: Chris Wellisz at [cwellisz@bloomberg.net](mailto:cwellisz@bloomberg.net)