BOARD OF GOVERNORS
OF THE
FEDERAL RESERVE SYSTEM

Office Correspondence

Date April 25, 1950.

To Governor Eccles

Subject:

From Mr. Sherman

In accordance with the understanding at the meeting this morning there is attached a copy of Chairman McCabe's letter to Mr. Foley, Administrator, Housing and Home Finance Agency, dated April 20, 1950.

Attachment.

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April 20, 1950.

Dear Ray:

This is in response to your telephone conversation on Tuesday, April 18, advising that the Federal Housing Administration is seriously contemplating, on its own responsibility, a reduction of the maximum interest rates permitted on F.H.A. mortgages insured under Title II, from 4-1/2 per cent to 4-1/4 percent. I understand that the purpose of your telephone call was both to inform the Board of a proposed action that might affect its policies, and to give us an opportunity to comment before the action received final approval. Since I have had no opportunity to talk this over with the Board, or any member of the Board, I am giving you my personal judgment hastily.

At the outset, I should like to express strong reservations about the timing and market implications of the proposed action and to recommend a further canvassing of the situation before final decision is made. Originally, the idea of reducing the maximum rate on F.H.A. mortgages by a quarter of one per cent was premised on raising the V.A. mortgage financing rate by the same amount, thus eliminating the rate disparity to the lender between these two types of guaranteed mortgages.

From a broad financial point of view, I favor a uniform rate in the market, provided that it is a market rate. By a market rate, I mean a rate which will attract sufficient mortgage funds without requiring substantial support from Government funds to make it effective. Such a market rate would clearly not be established by moving the F.H.A. maximum rate down to the V.A. rate which already imposes heavy burdens on the Treasury. It was earlier felt that an administrative rate uniform at 4-1/4 per cent might approximate a market rate in this sense and succeed in attracting mortgage funds sufficient to float the whole mortgage program largely free of Government aid. In these terms, action on the F.H.A. maximum rate merited consideration, even though it entailed some risk that a 4-1/4 per cent rate might be a bit too low.

Unless other mortgage terms were tightened simultaneously, the present proposal to drop the F.H.A. maximum without achieving a uniform rate, would involve the serious risk of encouraging some further credit demand and repelling some credit supply. If the proposed action has any effect on the demand for housing, it will be to stimulate demand this spring when housing starts are at a very high level and prices are firming. Use of this stimulus now will make it unavailable later when construction activity may need special support. Also, rather than attracting market funds in volume sufficient to help reduce the load now falling on the Treasury through F.N.M.A. and contributing to the deficit, the proposed change might have just the opposite effect.

A further factor to be taken into account is the possibility that the current volume of private mortgage funds may not be as ample at present rates in the future as they now appear. Much will depend on the nature and success of the large volume of Treasury deficit financing that will soon begin to come on the markets. It would be unfortunate, in my judgment, if a reversal of the proposed action should become necessary at an early date.

These are first reactions on your problem. You can understand that it is difficult to give a full assessment on short notice of an action having such far reaching ramifications and implications.

Despite the short time, I deeply appreciate your thoughtful consideration in advising me of this impending move before it may become final.

With warmest regards,

Sincerely,

Thomas B. McCabe.

Honorable Raymond M. Foley,
Administrator,
Housing and Home Finance Agency,
1626 K Street, N. W.,
Washington, D. C.