Stemming the tide of foreclosures: an alternative to quantitative easing

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The mortgage assistance scheme announced February 19, 2009 would help more people and cost the government a lot less, if borrowers could refinance at, say, 2% interest rate instead of close to 5% as at present. This alone would reduce mortgage payments so much that very few people, even if they are in negative equity, would opt to go the route of foreclosure.

The Fed would initiate this by making available, through a special facility, funds at a very low interest rate. Lenders would be able to tap this source only for the purpose of providing refinancing at the 2% rate. All mortgages existing at the time of announcement – irrespective of their extent of negative equity – would be eligible.

The 2% rate would be fixed for 5 years, say. Thereafter it would be raised by, say, not more than 0.5% annually, until convergence with market rates. This would demonstrate the government's long-term commitment. The Administration would have to work with the Fed and run a tight ship so that inflation expectations stay low and convergence can take place before too long.

The above is a Letter to the Editor in the Washington Post on 27/2/2009.