MONEY & INVESTING

# Treasury Department Decides To Stop Sale of 30-Year Bonds

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In a surprise move that gave the bond market one of its biggest jolts in years, the Treasury Department said it would no longer sell 30-year bonds, for years the benchmark for the entire $17.7 trillion U.S. bond market.

The decision could be a boost for the U.S. economy by helping drive down long-term borrowing rates for mortgages and other debt. Though mortgage rates are at their lowest level in three years, rates for corporate borrowers haven't moved down as much as expected, despite the Federal Reserve's nine interest-rate cuts this year.

By cutting off new sales of 30-year bonds, which pay a higher interest rate to offset the risk of owning them for the long haul, the government is effectively forcing investors to buy up shorter-term investments such as the 10-year Treasury note, which helps determine mortgage rates, and corporate bonds.

Eliminating sales of 30-year bonds "has the direct effect of cutting long-term interest rates -- something that Greenspan's rate cuts failed to achieve," said Michael Kastner, head of bond investments at Deutsche Bank's private banking unit. "The sharp fall in long rates is likely to stimulate additional mortgage refinancing and provide a powerful stimulus to the economy."

William Gross, chief investment officer at Pacific Investment Management Co., added: "They definitely were trying to bring down the long-term cost of capital -- mortgage refinancing is the great hope to keep the economy going."

Treasury officials dispute that the discontinuance of the 30-year bond is aimed at breaking down interest rates, saying simply that the bond no longer was needed to help pay off the national debt. Instead, the government will rely on shorter-term securities with lower interest rates to raise financing -- saving itself billions of dollars in interest in the process.

The decision underscores the Bush administration's contention that the long-term outlook for the federal budget remains upbeat, despite recent signs that the surplus is giving way to deficit. (The Treasury Wednesday said its books could be in the red not just for the current fiscal year ending next Sept. 30, but also for the fiscal year after that.)

While the 30-year bond has been steadily losing importance in recent years, the timing of Wednesday's move was unexpected, sparking a surge of buying interest for existing 30-year bonds, as well as some criticism on Wall Street over the sudden announcement. With the prospect of no new sales of 30-year bonds, investors who depend on having long-term securities in their portfolios -- such as insurance companies and pension plans -- scrambled to buy up the remaining securities.

In 4 p.m. trading Wednesday, the price on the 30-year bond soared 5 9/32 points, or $52.81 for a bond with $1,000 face value, to 107 21/32, the biggest move for the bond in over a decade, according to Stone & McCarthy Associates, a bond-research firm.

The surge sent the bond's yield, which moves in the opposite direction, to 4.88% from 5.22% on Tuesday, the lowest level in three years. To put the move in perspective, until Wednesday, the biggest one-day move for the bond this year was a jump of 1 24/32 points on Jan. 3.

The sharp jump for the 30-year bond Wednesday came as many Wall Street traders were betting the price of the security would drop, not rise. Some had sold 30-year bonds short, borrowing and selling them, hoping to buy them back at a lower price. They figured Treasury would have to sell more long-term bonds in the next year or so to fund new spending programs resulting from the Sept. 11 terrorist attacks. Others simply expected the Treasury market's recent strength to dissipate.

They were wrong, leading to some criticism that Wall Street wasn't given any signals ahead of Wednesday's move. "There are a lot of people who are very, very frustrated," said Richard Bodkin, head of government trading at Banc One Capital Markets in Chicago. "People were caught off-sides."

Some bond executives had advised the Treasury in recent months not to discontinue sales of the 30-year bond, arguing that it might be hard to restart a market for these bonds if the government needed to issue such bonds again, and as recently as this week, traders who had meetings with Peter Fisher, the Treasury Department's undersecretary of domestic finance who announced the 30-year's demise, say Mr. Fisher made no suggestion that Wednesday's move was coming.

See the Treasury Department's press release.

It didn't help that word of the move leaked out ahead of time when the Treasury Department's Web site posted Mr. Fisher's remarks ahead of the stated 10 a.m. EST embargo time, sending bond prices higher. A spokesman said Treasury would look into what happened and provide explanations as available.

"I was pretty shocked," said Ward McCarthy, a principal at Stone & McCarthy. "Typically the Treasury tips its hand well in advance of something like this, and they did this just as the market is regaining normalcy after Sept. 11, which is hard to figure out."

Other analysts suggested that the rally was just what Treasury wanted, to help push down interest rates across the economy. In recent weeks, Ford Motor Co. and General Motors Acceptance Corp. sold 30-year bonds. They would likely have received lower interest rates had investors had an inkling that 30-year Treasury bonds were set to be discontinued.

For its part, Treasury officials denied they were trying to stimulate the economy with their move. "Management of the Treasury's marketable debt needs to anticipate the possibility of a unified budget deficit for this fiscal year and perhaps the following fiscal year as well," Mr. Fisher said. "However, even if this happens we expect that the federal government will return to surpluses in the coming years."

Despite Wednesday's announcement, there will still be long-term bonds for investors to buy. For one thing, there are about $450 billion of Treasurys outstanding with maturities of longer than 10 years, according to Stone & McCarthy, though $200 billion or so is held by the Federal Reserve or is in "strip" form and can't be purchased as a whole by investors. Companies and quasifederal agencies, such as Fannie Mae, still sell boatloads of 30-year bonds.

Still, Wednesday's announcement shook Wall Street. Since they first were issued regularly in 1977, the 30-year bond has served as the bond market's best barometer. While stock traders had the Dow Jones Industrial Average, and during the past decade or so also embraced the Standard & Poor's 500-stock index and the Nasdaq Composite Index, the acknowledged bellwether of the bond market was always the 30-year Treasury, nicknamed by traders as the "long bond."

But things have been changing during the past few years. The government's budget deficit turned into a surplus and fewer bonds were sold, while Treasury began buying back a variety of bonds. With debt shrinking, the government preferred to sell shorter-term bonds, like five-year notes, rather than 30-year bonds, which usually must carry a higher interest rate to entice investors.

With mortgage rates most influenced by the 10-year Treasury note, and other nations using the 10-year note as their barometer, U.S. bond traders began to embrace the 10-year Treasury note as the new king of the bond market.

The long bond "no longer maintains a position of significance in the financial markets," Mr. Fisher said. "Its role and its liquidity have been significantly impaired by the substantial reduction of issuance that has occurred over the last decade."

-- *Richard A. Bravo contributed to this article.*

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