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U.S. Will End Regular Sale Of Long Bond

By JONATHAN FUERBRINGER NOV. 1, 2001

The United States retired the old faithful of the bond market yesterday, ending the regular sale of 30-year bonds after a quarter of a century.

The Treasury Department said that despite the prospect of federal budget deficits this year and next, it expects surpluses to return soon. With that in mind, borrowing for 30 years is too costly and imprudent, it said, because shorter-term debt can be issued to cover its needs at lower rates.

The announcement, which inadvertently appeared on the Treasury Web site 10 minutes before the planned release at 10 a.m., caught bond traders and analysts flat-footed. With the economy slowing and the government spending more in the war on terrorism, they had anticipated the return of deficits and generally concluded that the 30-year bond would survive a while longer even though it had been slated for extinction when budget surpluses were growing.

Many traders and dealers were angry about the lack of warning from the Treasury. Others suggested that the Treasury might be trying to push down long-term interest rates, which plunged yesterday, in an effort to encourage mortgage refinancing and aid an economic recovery.

Though fewer bonds had been issued the last few years, the elimination of 30-year bonds will require changes by bond professionals, institutions and individual investors. Investment alternatives include government agency and corporate bonds. Corporate bonds served investors quite well before regular sales of the 30-year bond began in February 1977.

In explaining the Treasury's decision, Peter Fisher, the undersecretary for domestic finance, said, ''We do not need the 30-year bond to meet the government's current financing needs, nor those that we expect to face in coming years.''

''The 30-year bond,'' he said, ''no longer maintains a position of significance in the financial markets.''

Mr. Fisher added that ''today's decision is in no way an attempt to manage long-term interest rates.''

Reflecting the fact that 30-year bonds will now be scarce, the price jumped 58/32 points, about seven times more than a normal daily move. The yield, which moves in the opposite direction, plunged from 5.20 percent Tuesday to 4.87 percent, the lowest since the bonds were regularly issued.

The demise of 30-year bonds, including those indexed for inflation, will increase demand for the 10-year note. Its price rose sharply yesterday, while the yield fell to 4.23 percent, near its record low in 1998.

The sharp moves in the bond market were exacerbated by investors and dealers who scrambled to reverse trades that suddenly became losers after the announcement.

''I think injecting this change into the market, particularly in a time of crisis, is not smart,'' said Charles Parkhurst, managing director of government bond trading at Salomon Smith Barney. ''If the Treasury said that the February bond would have been the last and the market would get to to bid on it, the decision would have been more acceptable.''

The outside committee of bond market professionals that advises the Treasury on policy had recommended the retirement of the 30-year bond. Those advisers met with Treasury officials on Tuesday about other decisions that the Treasury announced this morning at its regularly scheduled quarterly announcement. But the committee was not consulted on the 30-year decision.

When asked why the Treasury did not instead decide to cancel the 30-year bond after the next scheduled sale in February, the chairman of the committee, James R. Capra, said ''that's a good question.''

Micah Green, the president of the Bond Market Association, supported the Treasury's decision, although the association opposed the elimination of the 30-year bond in a statement in January.

''The Treasury Department's decision today to suspend issuance of the 30-year bond is reasonable and understandable based on its conclusion that the cost of continuing issuance of these bonds in the current market is not justifiable,'' he said.

Since 1977, $564.4 billion of regular 30-year bonds have been sold to the public. About $40 billion of inflation-protected 30-year bonds have been sold since 1998. The 30-year yield quickly became the benchmark interest rate for the U.S. bond market and for other countries' markets.

But as government budget deficits shrank and then gave way to surprisingly large surpluses, the Treasury scaled back the amount of securities it sold and wondered if the cost of 30-year bonds was just to high.

Though the 30-year bond is cherished by many bond dealers at the core of the Treasury market, the advisory committee recommended its retirement in January and repeated the recommendation in July. The issuance had already been cut to $15 billion a year, from almost $47 billion in 1991.

With the diminishing role of the 30-year bond, the 10-year note has become the benchmark for the Treasury market. Longer-term debt of government agencies, like Fannie Mae, is vying for the role previously served by the 30-year bond. Dealers were already adjusting how they traded and how they hedged against risk, some using bond futures instead of Treasury bonds. Investors will probably substitute agency debt or corporate debt for 30-year Treasuries, though there is additional risk in such securities. Long-term corporate debt, like that of AT&T, filled that role in the past.

The issue of savings for the taxpayer, one reason for the elimination of the 30-year bond, is simple. The yield on the 30-year bond, before yesterday's announcement, was 5.20 percent. The comparable yields were 4.41 percent on the 10-year note, 3.58 on the five-year note and 2.44 percent on the two-year note.

Louis Crandall, chief economist at Wrightson Associates, has advocated the demise of the 30-year bond for some time. His analysis of borrowing in the early 1990's showed that the government made significant savings in interest costs by choosing to sell more short-term debt, even with 30-year bond yields near historic lows.

The Treasury's decision seems to be an implicit bet that the budget will move back into surplus soon. Mr. Fisher said that if deficits persist, it would be easy for the government to return to selling 30-year bonds. In the interim, he added, ''it is still likely that our decision to suspend 30-year borrowing at this time will have saved the taxpayers money.''

Robert J. Barbera, chief economist at Hoenig & Company, has criticized the Bush administration's surplus projections as being too optimistic but still supports the decision to shift to shorter-term debt. ''I can understand the logic of doing this even if I disagree with the administration's 10-year budget projections,'' he said.

The Treasury also announced yesterday that it would curtail, but not discontinue, its program of buying back higher-interest rate debt with 20 or more years to maturity. Since March 2000, the Treasury has bought back $57.5 billion in old debt. It will proceed with the scheduled buybacks of $6.5 billion of debt in November and December but do none in January. Beginning with February, it will announce each quarter whether it will do buybacks, depending on its cash flow and borrowing needs. Mr. Fisher said this meant there would be buybacks in some quarters and not in others.

The Treasury also said it would sell next week $16 billion of new five-year notes and $7 billion of the existing 10-year note, which matures in August 2011.

Results of Tuesday's Treasury auction of 4-week bills:

(000 omitted in dollar figures

Price: 99.834

High Rate: 2.140

Coupon Yield: 2.168

Low Rate: 2.100

Median Rate: 2.130

Total applied for: $29,441,820

Accepted: $12,996,320

Noncompetitive: $16,909

The 4-week bills mature Nov. 29, 2001.