Treasuries tumble amid concern government to boost borrowing

by Dakin Campbell and Susanne Walker

February 3, 2009

Treasuries dropped for the first time in three days on speculation the U.S. government will increase borrowing as President Barack Obama pushes his stimulus package through Congress.

The U.S. may sell $69.25 billion in notes and bonds next week and reintroduce the seven-year note, according to the average forecast of six firms surveyed by Bloomberg News before the Treasury announces the amounts tomorrow. The U.S. Senate is debating the administration's stimulus plan. Rates on three- month Treasury bills rose the highest since November.

"It's just fear of supply and more talk of the stimulus as it gets closer," said Andrew Brenner, co-head of structured products and emerging markets in New York at MF Global Inc. "Anything that puts the economy back on an even keel will pressure the bond market."

The yield on the benchmark 10-year note climbed 16 basis points, or 0.16 percentage point, to 2.88 percent at 4:46 p.m. in New York, according to BGCantor Market Data. The price of the 3.75 percent security due in November 2018 tumbled 1 3/8, or $13.75 per $1,000 face amount, to 107 3/8. Thirty-year bond yields surged 17 basis points to 3.66 percent.

The index of pending U.S. home resales rose 6.3 percent in December, the first increase since August, the National Association of Realtors said in Washington.

Stimulus Plan

The Federal Reserve extended its emergency-lending programs and foreign-currency swap lines by six months through Oct. 30, citing "continuing substantial strains in many financial markets." The central bank's decision applies to five emergency-lending programs that provide funds or Treasury securities to securities brokers, money-market funds and companies that issue commercial paper, the Fed said.

The U.S. is increasing its debt sales to finance a growing budget deficit and programs to spur the economy. Senate Majority Leader Harry Reid said lawmakers would take up a plan to add $25 billion in infrastructure funds to the administration's stimulus package, which may cost almost $900 billion.

"Supply is a big issue, and there is some fear about the lack of buyers," said Andrew Richman, who oversees $10 billion in fixed-income assets as a strategist in West Palm Beach, Florida, at SunTrust Bank's personal-asset management division.

Next Week's Sales

The Treasury Department probably will say tomorrow it plans to sell $69 billion in notes and bonds, according to Wrightson ICAP LLC. The estimate was just below the forecast in the Bloomberg survey.

The U.S. will likely sell $32 billion in three-year notes, $22 billion in 10-year debt and $15 billion in 30-year bonds next week, said Wrightson, a Jersey City, New Jersey-based firm that specializes in government finance. The company also said yesterday the Treasury may sell a seven-year note four times a year, starting as early as March.

"People have their arms around the good chance that they will reintroduce the seven-year," said Thomas Tucci, head of U.S. government bond trading at RBC Capital Markets in New York, the investment-banking arm of Canada's biggest lender. "That makes sense to me."

The Treasury said yesterday it will borrow $493 billion this quarter, 34 percent more than it initially projected.

"Easily in fiscal year 2009 it's not out of the realm of possibility to have a $2 trillion deficit," said Mary Ann Hurley, vice president of fixed-income trading in Seattle at D.A. Davidson & Co. "That's a huge number, and it has to be financed by debt issuance and the taxpayer."

Corporate Bonds

Treasuries dropped 3.1 percent in January, the biggest monthly decline in almost five years, according to Merrill Lynch & Co.'s U.S. Treasury Master index. Corporate bonds returned 1.2 percent, another Merrill index showed.

U.S. and worldwide corporations are also issuing debt. Procter & Gamble Co., the world's biggest consumer-products company, was expected to sell more than $3 billion of notes as soon as today, a person familiar with the transaction said. Mortgage-finance company Fannie Mae said it sold $7 billion of five-year notes. Altria Group Inc., the biggest U.S. cigarette maker, planned to raise $4.2 billion, according to people familiar with the sale.

"Demand continues to be good for corporate debt," said Michael Knebel, a portfolio manager at Ferguson Wellman Capital Management Inc., in Portland, Oregon, which oversees $2.5 billion. "Companies may be selling Treasuries to participate in those new issues."

Rates on three-month Treasury bills touched 0.34 percent, the highest since Nov. 12, when Congress was debating an automaker bailout amid fears the industry would collapse.

Consumer Lending Rates

The TED spread, which measures the difference between what banks and the U.S. government pay for three-month loans, narrowed to 92 basis points, the lowest since July. It was 464 basis points in October, after the collapse of Lehman Brothers Holdings Inc. during the previous month.

The Fed's attempts to reduce consumer lending rates have so far fallen short, with the difference between 30-year mortgage rates and 10-year Treasury yields at about 2.26 percentage points, up from 1.55 percentage points five years ago.

The central bank may buy Treasuries when 10-year yields approach a range of 3 percent to 3.25 percent and when 30-year bond yields are near 3.75 percent to 4 percent, according to David Ader, head of U.S. interest-rate strategy at Greenwich, Connecticut-based RBS Greenwich Capital Markets, one of 17 primary dealers that trade with the Fed.

To contact the reporters on this story:
Dakin Campbell in New York at +1-212-617-6311 or dcampbell27@bloomberg.net;
Susanne Walker in New York at +1-212-318-2000 or swalker33@bloomberg.net.